BANK AL-MAGHRIB

MONETARY POLICY REPORT

N° 31/ 2014

Document prepared for
the Bank Board
June 17, 2014

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LIST OF ABBREVIATIONS

ANCFCC	:	National Land Registry Office
APC	:	Association professionnelle des cimentiers (Cement manufacturers professional association)
BAM	:	Bank Al-Maghrib
CFG	:	Casablanca Finance Group
CNSS	:	Caisse nationale de sécurité sociale (National Social Security Fund)
CPI	:	Consumer Price Index
CPIX	:	Core inflation indicator
CPIXNT	:	Consumer price index of nontradables
CPIXT	:	Consumer price index of tradables
CUR	:	Capacity utilization rate
DH	:	Dirham
ECB	:	European Central Bank
FDI	:	Foreign direct investments
FISIM	:	Financial intermediation services indirectly measured
GDP	:	Gross domestic product
HCP	:	High Commission for Planning
IMF	:	International Monetary Fund
IPI	:	Import price index
MASI	:	Moroccan All Shares Index
MPR	:	Monetary Policy Report
OCP	:	Office chérifien des phosphates (Moroccan Phosphates Office)
OECD	:	Organization for Economic Cooperation and Development
ONE	:	Office national d'électricité (National Electricity Office)
PER	:	Price Earning Ratio
REPI	:	Real estate price index
YoY	:	Year-on-year
VA	:	Value added

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PRESS RELEASE

BANK AL-MAGHRIB BOARD MEETING

Rabat, June 17, 2014

1. The Board of Bank Al-Maghrib held its quarterly meeting on Tuesday, June 17, 2014.
2. At this meeting, the Board reviewed and approved the Annual Report 2013 on the domestic economic, monetary and financial situation as well as on the Bank's activities.
3. The Board also examined recent economic, monetary and financial developments and inflation forecasts up to the third quarter of 2015.
4. At the international level, the Board noted that, with the exception of the United States which posted a deceleration caused by harsher-than-normal winter conditions, recovery continued in the major advanced economies, particularly in the euro area where growth increased from 0.5 to 0.9 percent in the first quarter. In contrast, in the major emerging countries activity slowed again in China and Brazil and stabilized in India. In terms of outlook, the latest IMF projections show continued improvement in the developed countries and a slowdown in emerging economies. In labor markets, unemployment rate further trended downward in the United States, reaching 6.3 percent in May, its lowest level since October 2008, while it remained broadly elevated in the euro area, at 11.7 percent in April. Commodity prices remained somewhat high in May, mostly with a rise in the prices for energy products and base metals and a relative decline for agricultural goods. In this context, inflation increased in the United States from 1.5 percent in March to 2 percent in April, and fell in the euro area from 0.7 percent in April to 0.5 percent in May. Altogether, these developments do not suggest the emergence of external inflationary pressures in the coming quarters.
5. Domestically, the national economy expanded by 4.4 percent in 2013, driven by a 19 percent growth in agricultural value added, while its nonagricultural component slowed down to 2.3 percent from 4.4 percent in 2012. In 2014, GDP should range between 2.5 and 3 percent, dragged down by lower agricultural value added, while the growth rate in nonagricultural activities would improve to about 4 percent. Labor market situation worsened in the first quarter, as the unemployment rate increased by 0.8 percentage point to 10.2 percent. Under these conditions, nonagricultural output gap would remain negative in the coming quarters, according to Bank Al-Maghrib estimates, suggesting the absence of demand-led inflationary pressures.
6. External account data show that the trade deficit in goods totaled 84.9 billion dirhams at the end of May 2014, up from 83.2 billion in the same period of 2013. Despite the 13.3 percent decline in sales of phosphates and derivatives, exports were up 5.2 percent, marked by strong growth in car industry shipments. Imports expanded by 3.6 percent, in connection with higher food purchases, mainly wheat. At the same time, travel receipts improved by 3.2 percent, whereas transfers of Moroccan expatriates fell by 1.6 percent and net FDI inflows shrank by 18 percent in connection with a base effect. Considering the other elements of the capital account, in particular the OCP international bond sale amounting to $1.55 billion, the stock of net international reserves at the end of May stood at 164.2 billion dirhams, or the equivalent of 4 months and 19 days of goods and services' imports, and should remain close to this level until the end of 2014.

7. On the fiscal side, budget deficit stood at 30.7 billion at end-April, as against 20.3 billion in the same period of 2013. This reflects a 10.3 percent increase in overall spending, following an expansion by 50.1 percent in investment expenditure, while subsidy costs declined by 5.5 percent. Meanwhile, current revenues decreased by 0.1 percent due to a 23.7 percent drop in non-tax receipts. Tax revenue was up 2 percent, driven mainly by an 11.2 percent increase in corporate tax income. For the full year 2014, the Finance Act expects fiscal deficit to narrow to 4.9 percent of GDP, from 5.5 percent in 2013.

8. The analysis of monetary indicators shows accelerated growth in M3 from 3.2 percent in the first quarter of 2014 to 4.2 percent in April. However, money gap remained negative, suggesting the absence of monetary inflationary pressures. At the same time, bank credit grew at a higher rate, from 3.8 to 4.4 percent, and is expected at 4.5 percent for the full year 2014. With regard to monetary conditions, the weighted average rate on the interbank market averaged 3.03 percent in April and May, slightly down from the average of the first three months of the year. Lending rates, according to Bank Al-Maghrib survey among banks for the first quarter, were down 56 basis points to 5.96 percent. The effective exchange rate of the dirham appreciated at a quarterly rate of 0.57 percent in nominal terms and 0.34 percent in real terms. Moreover, property prices in the first quarter 2014 increased by a mere 0.1 percent year on year.

9. Under these conditions, year-on-year inflation averaged 0.4 percent in the first four months of 2014. Core inflation, which reflects the underlying trend of prices, fell from 1.3 percent in the first quarter to 1.1 percent in April, in conjunction with less rapid growth in prices of nontradables from 0.9 to 0.6 percent, while inflation of tradables stabilized at 1.5 percent. The downward trend in industrial producer prices, which began in February 2013, eased from 3.2 percent on average in the first quarter to 1.2 percent in April.

10. Considering the above elements, and taking into account the recent Government decisions relating to the unit subsidy of some oil prices and the rise of minimum wage in the private and public sectors, inflation is expected at 0.9 percent in 2014, 1.3 percent on average over the forecast horizon and 1.5 percent at the end of this horizon (third quarter 2015). Core inflation should remain below 2 percent.

11. In this context where the central inflation forecast is consistent with medium-term price stability objective against a background marked by persistent internal and external uncertainties, despite an emerging recovery in nonagricultural activities, the Board decided to keep the key rate at 3 percent while continuing to monitor all these developments.

OVERVIEW

International economic environment was characterized in the first quarter of 2014 by a continued recovery in the major advanced economies, albeit with a deceleration from 2.6 percent to 2.1 percent in the United States, due to unusually harsher winter conditions. Indeed, GDP growth accelerated from 0.5 percent to 0.9 percent in the euro area, from 2.7 percent to 3.1 percent in the United Kingdom and from 2.5 percent to 2.7 percent in Japan. In emerging countries, growth continued to slow down from 7.7 percent to 7.4 percent in China and from 2.2 percent to 1.9 percent in Brazil, and stabilized at 4.6 percent in India. Regarding the outlook, IMF projections in April indicate that growth should improve in the euro area and the United States and would continue to decelerate in emerging countries, mainly in China and Brazil. However, growth is set to go on an upward trend in India.

In the labor market, the unemployment rate in the United States stabilized at 6.3 percent in May, its lowest level since October 2008, while it remained high in the euro area at 11.7 percent in April.

In financial markets, some easing conditions were observed in both developed and emerging countries, with lower sovereign yields, albeit slightly up in peripheral eurozone countries in the week preceding the European elections. In stock markets of advanced economies, the major indexes were up, with a decrease in their volatility. The annual growth of loans to the private sector moved up in the United States to 3.7 percent in May from 2.9 percent in April, while in the euro area, its contraction eased from 2.2 percent to 1.8 percent in April. With regard to monetary policy decisions, the ECB decided at its meeting of June 5 to lower its key rate by 10 basis points to 0.15 percent. The Fed announced, on April 30, a further reduction of $10 billion in its bond buyback program, bringing it to $45 billion a month. It also reiterated its commitment to keep its key rate low for a longer period.

On commodity markets, prices remained relatively high in May, mainly covering an increase in energy and base metal prices and a slight decrease in agricultural commodities. In particular, the Brent price rose 1.2 percent, month on month, averaging $109.3 per barrel, due to geopolitical tensions, particularly in Ukraine, and uncertainties about future exports from Russia to the European Union. Against this backdrop, inflation was up in the United States from 1.5 percent to 2 percent between March and April and is expected to fall to 0.5 percent in the euro area in May from 0.7 percent a month earlier.

Overall, these developments do not suggest external inflationary pressures in the coming quarters.

Nationally, growth stood at 4.4 percent in 2013, particularly driven by a 19 percent increase in the agricultural value added, while nonagricultural growth slowed down to 2.3 percent. At the end of the first quarter of 2014, it would stand at 2.7 percent, covering a 4 percent increase in nonagricultural GDP and a 4.1 percent decline in the agricultural value added. Throughout 2014, it should stand between 2.5 percent and 3 percent, with a marked improvement of around 4 percent in nonagricultural GDP. On the labor market, despite a creation of 89,000 jobs, the unemployment rate rose by 0.8 percentage point to 10.2 percent in the first quarter, with an increase from 13.7 percent to 14.6 percent in urban areas and from 4.4 percent to

5.1 percent in rural areas. Under these conditions and based on estimates from Bank Al-Maghrib, nonagricultural output gap should continue to be negative in the coming quarters, indicating an absence of inflationary pressures from the real economy.

External account data at end-May 2014 show a trade deficit of 84.9 billion dirhams, up 2.1 percent compared to the same period of 2013. Exports were up by 5.2 percent to 82.2 billion dirhams, covering an increase of 37.2 percent in the automotive sector and a decline of 13.3 percent in sales of phosphates and derivatives. Excluding these two components, they improved by 3.2 percent. Imports rose by 3.6 percent to 167.1 billion dirhams, mainly due to higher food purchases, particularly wheat supplies. Travel receipts moved up 3.2 percent, while remittances from Moroccans living abroad declined by 1.6 percent compared to the same period of 2013. Based on these developments, the current account deficit should improve further to around 7 percent of GDP at the end of 2014, from 7.6 percent in 2013. Net flows of foreign direct investment fell by 18 percent to 9.5 billion dirhams. Given the other elements of the capital account, particularly an OCP bond issue on the international market, amounting to $1.55 billion, the outstanding net international reserves stood at 164.2 billion dirhams at the end of May 2014, equaling 4 months and 19 days of goods and services' imports. They should remain at this level by the end of 2014.

Regarding public finance, the first four months of the 2014 fiscal year show that the deficit worsened to 30.7 billion from 20.3 at the end of April 2013. This change reflects a 10.3 percent increase in overall expenditure, due to a growth of 50.1 percent in investment spending, while subsidy costs declined by 5.5 percent. Current revenues fell by 0.1 percent, due to a 23.7 percent decrease in nontax receipts, while tax revenues rose by 2 percent, owing to an 11.2 percent increase in corporate tax. At end-December 2014, Finance Act projections indicate that budget deficit would stand at 4.9 percent from 5.5 percent in 2013.

On the monetary side, despite a faster growth of money supply from 3.2 percent in the first quarter of 2014 to 4.2 percent in April, the monetary gap remained negative, suggesting the absence of monetary inflationary pressures. Bank credit growth improved over the same period from 3.8 percent to 4.4 percent at end-April, and should stand around 4.5 percent at end-2014. Regarding monetary conditions, the interbank market weighted average rate stood at 3.03 percent on average in April and May, slightly down compared to the average of the first three months of the year. Moreover, BAM's lending rates survey for the first quarter of 2014 indicates a quarterly decline of 56 basis points in the weighted average rate to 5.96 percent, mainly reflecting lower rates on cash advances. In parallel, the weighted average rate of 6- and 12-month deposits stood at 3.69 percent in April, almost stable compared to the average of the first quarter. The dirham's effective exchange rate rose in the first quarter of 2014 by 0.57 percent in nominal terms and by 0.34 percent in real terms.

In the real estate market, after a decline of 0.5 percent in the fourth quarter of 2013, the real estate price index rose slightly by 0.1 percent, year on year, in the first quarter of 2014, reflecting higher urban land and commercial property prices and lower residential property prices.

Under these conditions, inflation, measured by the year-on-year change in the consumer price index, remained relatively low at 0.4 percent in April and on average in the first quarter. Core inflation fell from 1.3 percent to 1.1 percent over the same period, in conjunction with a virtually stable inflation of tradables at 1.5 percent and a decline in nontradables from

0.9 percent to 0.6 percent. In addition, the drop in industrial producer prices that started in February 2013 eased in April, thus showing a drop to 1.2 percent from 3.2 percent in the first quarter.

Based on all of these developments and given the recent decisions by the Government concerning unit subsidies for some oil products and the increase in wages, inflation should remain moderate with a balance risks at equilibrium. It would stand at 0.9 percent in 2014, 1.3 percent on average over the next six quarters and 1.5 percent at the end of the forecast horizon (third quarter of 2015). Core inflation should remain below 2 percent.

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1. AGGREGATE SUPPLY AND DEMAND

Throughout the year 2013, national growth stood at 4.4 percent, driven mainly by a 19 percent increase in the agricultural value added, while the nonagricultural GDP growth slowed down year on year from 4.4 percent to 2.3 percent. In the first quarter of 2014, growth would have stood at 2.7 percent, reflecting an increase of 4 percent in nonagricultural GDP and a decline of 4.1 percent in the agricultural value added. The decrease in the agricultural component would be attributable to a much lower cereal production compared to the previous crop year, while nonagricultural growth should be supported by a recovery in secondary activities and further momentum of services. Regarding demand, household final consumption should remain at a growth pace similar to that of the last two years, while investment would rebound slightly. Throughout 2014, growth should be between 2.5 percent and 3 percent, with a marked improvement around 4 percent in nonagricultural growth, albeit dependent on the continued recovery in our major partner countries.

1.1 Output

Growth stood at 4.5 percent in the fourth quarter of 2013, reflecting increases of 18.5 percent in the agricultural value added and 2.4 percent in nonagricultural activities. For the full year 2013, the provisional national accounts, published by the HCP, show a GDP growth of 4.4 percent, covering respective increases of 19 percent and 2.3 percent in the agricultural value added and nonagricultural GDP.

Based on the latest available data, Bank Al-Maghrib forecasts a slowdown of growth to 2.6 percent in the first half, reflecting a 4.7 percent decrease in the agricultural value added and a 4.1 percent increase in nonagricultural GDP.

According to the Ministry of Agriculture and Fisheries, cereal production in the 2013-2014 crop year is estimated at 67.3 million quintals, of which 37.2 million quintals of soft wheat. Regarding the activities of inshore and small-scale fishing, landings rose 2.8 percent in volume in the first four months of the year. This trend reflects mainly a 7.3 percent increase in landings of pelagic fish whose share amounted to 89.1 percent of the total. In contrast, landings of white fish and cephalopods were down 6.8 percent and 50.1 percent, respectively.

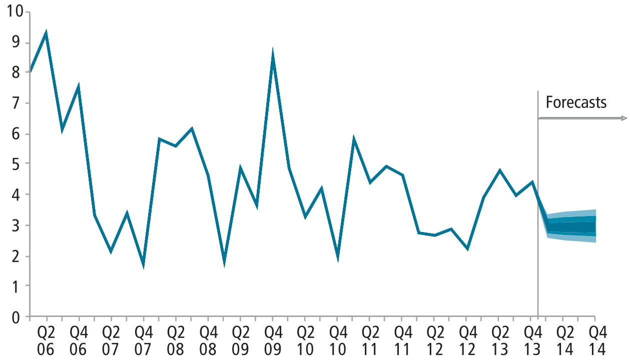
Table 1.1: YoY growth of quarterly GDP at chained prices per major sectors (%)

Activity sectors	2012			2013				2014	
	QII	QIII	QIV	QI	QII	QIII	QIV	QI_F	QII_F
Agriculture	-9.5	-8.5	-9.1	17.8	20.1	18.2	18.5	-4.1	-5.3
Nonagricultural VA	**4.5**	**4.7**	**4.0**	**2.1**	**2.7**	**1.8**	**2.4**	**4.1**	**4.1**
Extractive industry	-5.0	4.7	-3.7	-3.6	0.1	-3.2	-1.9	2.0	1.9
Processing industry	1.4	1.4	0.1	0.5	0.8	-0.1	2.7	2.1	2.2
Electricity and water	9.0	9.9	-1.9	-4.2	-0.9	1.9	5.7	3.5	4.5
Construction	3.5	-0.5	0.7	-5.9	-4.6	-0.2	3.2	1.5	1.5
Trade	2.7	2.0	1.4	2.3	3.7	3.1	4.1	3.4	3.2
Hotels and restaurants	3.9	2.7	8.8	3.7	5.1	4.4	4.1	5.9	4.7
Transportation	4.2	2.5	5.3	0.2	2.7	2.9	2.6	3.1	3.2
Post and telecommunication	22.4	27.1	28.6	14.7	11.5	8.9	8.8	8.6	8.5
General government and social security	6.9	6.3	6.1	6.3	6.3	2.0	0.3	6.0	5.8
Other services*	5.5	5.4	5.8	3.0	3.3	2.4	2.7	3.3	3.3
Taxes on products net of subsidies	5.7	4.6	4.8	1.0	2.4	2.8	1.6	3.5	3.8
Nonagricultural GDP	**4.6**	**4.7**	**4.1**	**2.0**	**2.6**	**1.9**	**2.4**	**4.0**	**4.1**
Gross Domestic Product	**2.7**	**2.9**	**2.3**	**4.0**	**4.8**	**4.0**	**4.5**	**2.7**	**2.5**

(*) Including financial activities and insurance, services to corporations and personal services, education, health, and social action, and the FISIM.

Sources: HCP, and BAM forecasts.

Chart 1.1: GDP projected growth Q1-2014 - Q4-2014*



(*) Fans depending on the standard deviation.

Sources: HCP, and BAM forecasts.

Concerning secondary activities, the latest available data show overall signs of improvement. Indeed, the value added of the extractive industry would have increased by 2 percent in the first quarter of 2014 and should maintain the same growth pace in the next quarter. This improvement would be largely attributed to a rise of 4.3 percent in the volume of marketable production of crude phosphate at end-April 2014, as against a virtual stagnation over the same period of the previous year.

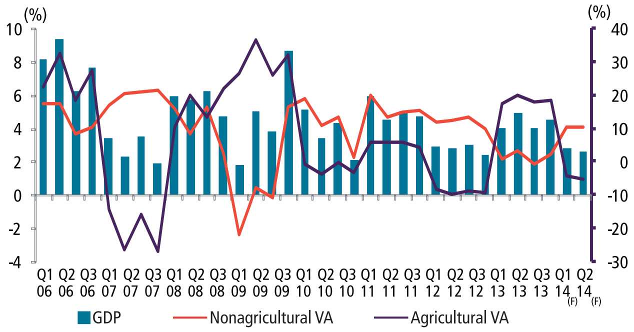
The value added of the processing industries would have grown 2.1 percent in the first quarter of 2014. Medium and high voltage electricity sales recovered by 1.5 percent in the first quarter of 2014 after a decline of 2.7 percent a year earlier

Meanwhile, the industrial activity in 2014 should continue to be supported by the momentum of Morocco's global businesses. Indeed, the latest foreign trade data indicate an increase in exports of 48.3 percent for cars, 23.2 percent for electronics and 14.2 percent for aeronautics. Moreover, after a positive appreciation in March, the findings of BAM's business survey for April 2014 show that economic activities and sales stagnated, and the capacity utilization rate stabilized at 72 percent. However, during the same month, orders received were up.

After a decline of 4.2 percent in the first quarter of 2013, the value added of "electricity and water" should grow by 3.5 percent in the first quarter of this year. This trend is attributed to respective recoveries of 3.8 percent and 2.6 percent in local net production of the National Electricity and Water Office and in its overall sales, after declines of 3.7 percent and 0.9 percent. In the second quarter of 2014, this sector should register a growth of around 4.5 percent.

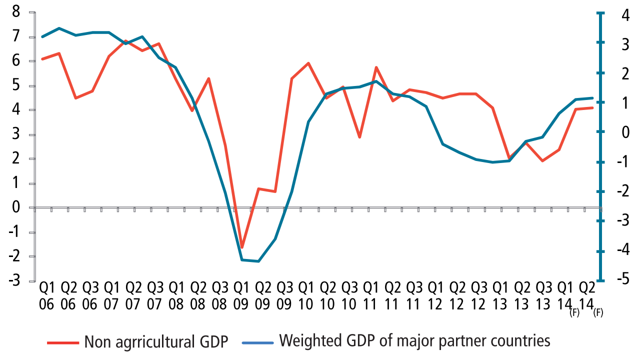
After an increase of 1.4 percent in 2013, the construction sector's value added would have increased by 1.5 percent in the first quarter of 2014. At the end of March, the decrease in cement sales eased moving down in one year from 20.8 percent to 3.2 percent.

Chart 1.2: YoY change in the GDP and its components (chained prices 1998)



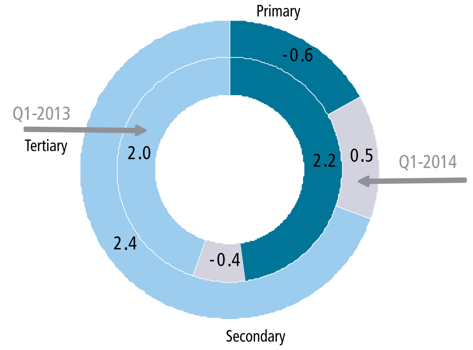
Sources: HCP, and BAM calculations and forecasts.

Chart 1.3: YoY change in domestic nonagricultural GDP and in partner countries' GDP



Sources: HCP, IMF and BAM forecasts.

Chart 1.4: Contribution of the primary, secondary and tertiary sectors to overall growth, in percentage points



Sources: HCP, and BAM calculations and forecasts.

Regarding the tertiary sector, the value added of posts and telecommunications should continue its slowdown that began in early 2013, reaching 8.6 percent in the first quarter of 2014. This trend should continue in the second quarter of the year, thus showing a growth of the same magnitude. Indeed, data of the first quarter of 2014 reveal an increase of 9.8 percent in the number of mobile phone subscribers and 57.3 percent in that of Internet subscribers. In addition, the consumer price index of the communication branch dropped by 9 percent in April.

The trade and transport value added, largely dependent on the performance of other sectors, should grow, respectively, by 3.4 percent and 3.1 percent in the first quarter of 2014 and by 3.2 percent for both branches in the second quarter.

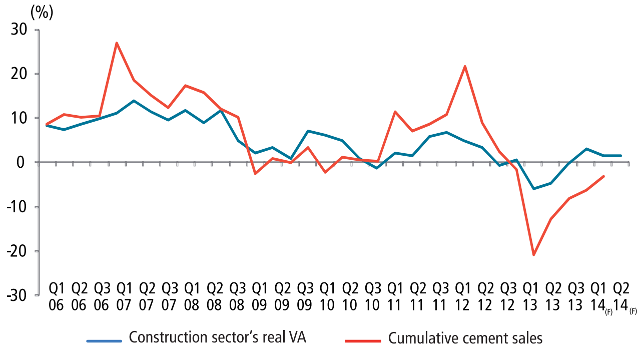
The value added of hotels and restaurants would have grown by 5.9 percent, exceeding the average rate of 2013. This trend is supported by foreign trade data at end-April, which show an increase of 5.2 percent in travel receipts after a decline of 0.5 percent a year earlier. In addition, data from the Ministry of Tourism for the first quarter indicate an 8.4 percent increase in arrivals at border posts and a slight improvement in the occupancy rate of hotels to 41 percent. Assuming that this positive trend would continue, the growth of the value added of this branch should stand at 4.7 percent in the second quarter of 2014.

For the full year 2014, national growth should be between 2.5 percent and 3 percent with a decrease in the agricultural value added and a recovery of nonagricultural growth of around 4 percent.

1.2 Consumption

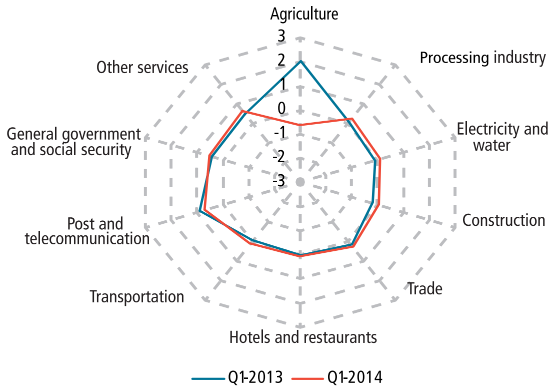
In the first quarter of 2014, the HCP economic survey shows that the household confidence index fell to its lowest level since the beginning

Chart 1.5: YoY change in the construction sector's value added and cement cumulative sales



Sources: APC, HCP and BAM forecasts.

Chart 1.6: Sectoral contribution to overall growth



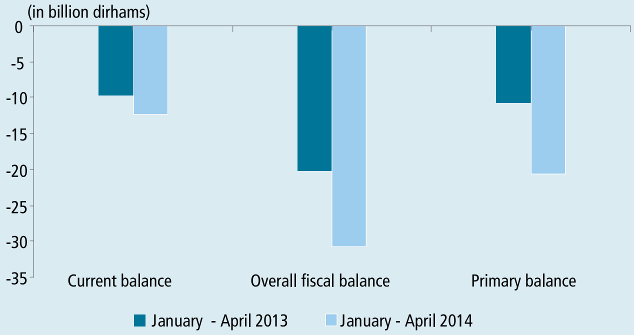
Sources: HCP, and BAM forecasts and calculations.

Box 1.1: Budget execution at end-April 2014

The first four months of the 2014 fiscal year resulted in a deficit (excluding privatization) of 30.7 billion dirhams as against 20.3 billion at end-April 2013. This worsening is attributable to a 10.3 percent increase in overall expenditure, mainly in conjunction with investment and other goods and services, while current revenues were down 0.1 percent, albeit with an increase in tax receipts. The current balance was negative at 12.3 billion, up 2.7 billion from end-April 2013.

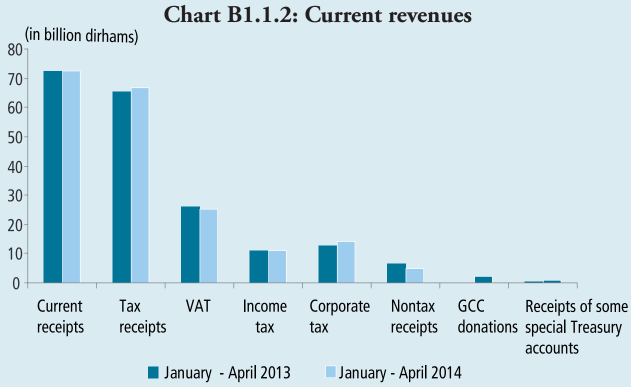
The Treasury's current revenues fell by 0.1 percent to 72.6 billion, covering a 2 percent increase in tax revenue to 66.9 billion and a 23.7 percent decrease in nontax receipts to 4.9 billion. The improvement in tax revenue is mainly attributable to higher direct taxes, while indirect ones were almost stable. Indeed, direct tax receipts moved up by 4.8 percent to 25.9 billion, mainly reflecting an increase of 11.2 percent in corporate tax revenues to 14.2 billion, while income tax receipts rose only by 0.4 percent. Indirect tax revenues improved slightly by 0.4 percent to 33.2 billion dirhams. The VAT revenue fell by 3.7 percent to 25 billion, covering a decrease of 12.1 percent to 9.4 billion in domestic VAT and an increase of 2.2 percent to 15.6 billion in import VAT. Domestic consumption taxes (DCT) generated 8.3 billion, up 15.3 percent, primarily due to revenues from energy DCT, which rose by 21.7 percent to 5 billion. Customs duties generated 2.5 billion, up 0.4 percent, while registration and stamp fees dropped slightly by 0.4 percent to 5.3 billion.

Chart B1.1.1: Budget balances



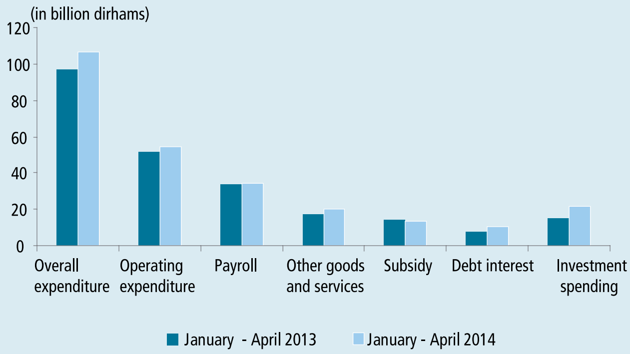
Source: Ministry of Economy and Finance

Chart B1.1.2: Current revenues



Source: Ministry of Economy and Finance

Chart B1.1.3: Overall expenditure



Overall expenditure amounted to 106.9 billion dirhams, up 10.3 percent, reflecting an increase of 50.1 percent in investment spending to 22 billion and a rise of 3.2 percent in current expenditure to 84.9 billion. Indeed, operating expenses heightened by 6.1 percent to 54.2 billion, mainly due to an increase of 15 percent to 19.8 billion in spending on other goods and services, while staff costs moved up 1.6 percent to 34.5 billion. Debt interest charges rose by 5.8 percent to 10.1 billion. Subsidy costs fell by 5.5 percent to 13.1 billion.

Given a backlog of outstanding payments, amounting to 1 billion, bringing the stock to 11.6 billion, the Treasury borrowing requirement stood at 29.7 billion from 27.8 billion at end-April 2013. In addition to privatization receipts of nearly 2 billion from the sale of State shares in the capital of Banque Centrale Populaire, and due to a negative external net flow of 3 billion, the Treasury used the domestic market for an amount of 30.7 billion.

of the survey, thus showing a decrease of 1.7 point compared to the same period last year. In the same vein, the unemployment rate jumped from 9.4 percent to 10.2 percent in the first quarter, a rate never registered since the fourth quarter of 2006, which is likely to have a negative impact on the household purchasing behavior.

End-April monetary data indicate a sharp slowdown in consumer loans, moving down in one year from 6.7 percent to 2.1 percent, while foreign trade indicators show a 1.2 percent decline in remittances from Moroccans living abroad.

The infra-annual profile of household consumption indicates a faster growth to 4.9 percent in the fourth quarter of 2013, from 3.1 percent on average in the first three quarters. In 2014, the latter should take advantage over the next few quarters from the expected improvement of nonagricultural income and current transfers.

Regarding government consumption, data on Treasury expenses and revenues at end-April reveal a slowdown from 15.5 percent to 6.1 percent in operating expenses. This change reflects a deceleration in personnel costs and spending on other goods and services, moving down in one year from 4.7 percent to 1.6 percent and from 45.1 percent to 15 percent, respectively.

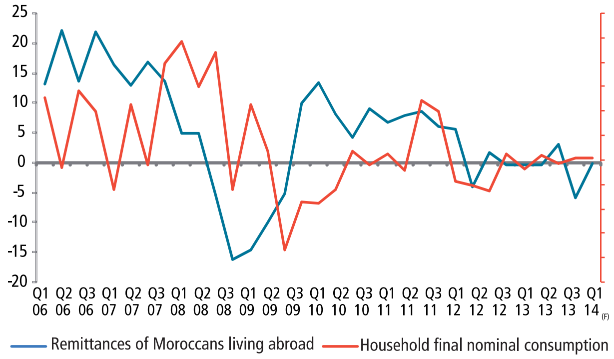
Overall, domestic final consumption should grow 4.7 percent, a rate almost similar to that recorded in 2013.

1.3 Investment

In the fourth quarter of 2013, investment dropped by 2.9 percent at current prices and 1.5 percent at constant prices.

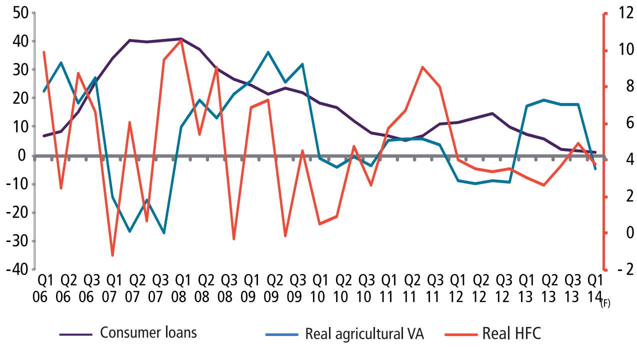
In late April 2014, the monetary data show a 2.7 percent increase in equipment loans

Chart 1.7: YoY change in household final consumption and remittances of Moroccans living abroad (%)



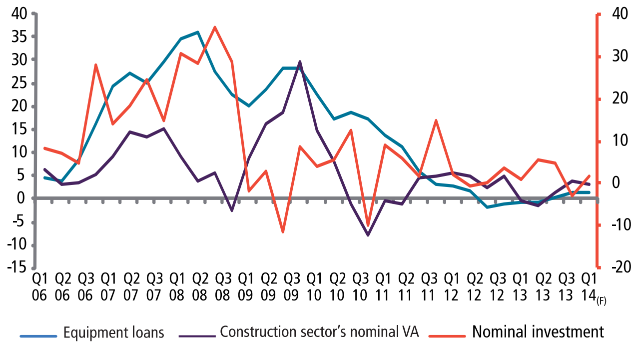
Sources: HCP, Foreign Exchange Office, and BAM calculations and forecasts.

Chart 1.8: YoY change in household final consumption, agricultural VA and consumer loans, in %



Sources: HCP, BAM, and BAM calculations and forecasts.

Chart 1.9: YoY change in total investment, construction sector's value added and equipment loans



Sources: HCP, BAM, and BAM calculation and forecasts.

after a decrease of 0.9 percent in the same month a year earlier. This change reflects stabilization in equipment loans granted to private nonfinancial corporations, an increase in those accorded to public nonfinancial corporations, and a decrease in those granted to local governments.

Moreover, foreign trade data at end-April show respective declines of 7.1 percent and 19.9 percent in capital goods imports and FDI flows.

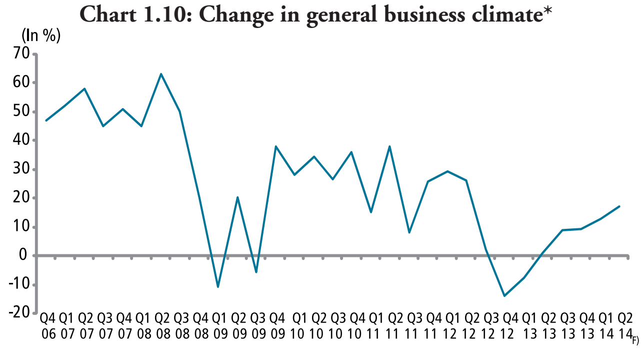
Real estate loans decelerated from 7.3 percent to 2.4 percent, reflecting a slowdown in both loans to private nonfinancial corporations and credit to households. In addition, loans to real estate developers dropped by 10.2 percent after an increase of 3.7 percent. Albeit under deceleration, cement sales at end-March remain down at 3.2 percent from 20.8 percent a year earlier. However, property prices stagnated in the first quarter of 2014, quarter on quarter. This change reflects a decrease of 0.4 percent in residential property prices and increases of 0.4 percent in land prices and 3.8 percent in commercial property ones.

Data available at end-April on Treasury expenses and revenues show a 50.1 percent increase in Treasury investment as against 39.4 percent in the previous year. Compared to budget planning, the implantation rate stood in the first four months at 50.2 percent.

1.4 External accounts

In late May, the trade deficit rose by 2.1 percent to 84.9 billion dirhams compared to the same period of 2013. This trend is attributed to an increase of 5.2 percent in exports to 82.2 billion dirhams, faster than 3.6 percent in imports, which moved up to 167.1 billion dirhams. The import coverage rate rose from 48.4 percent to 49.2 percent.

Chart 1.10: Change in general business climate*



** Balance of opinion representing the difference between the percentage of "good" and "poor" answers.*
Source: BAM monthly business survey.

Table 1.2 : Change in the trade balance at end-May 2014

(In millions of dirhams)	jan.-may 2013	jan.-may 2014*	Change Amount	Change %
Exports	**78 077**	**82 169**	**4 092**	**5.2**
Phosphates and derivatives	16 581	14 375	-2 206	-13.3
Exports excluding phosphates and derivatives'	**61 496**	**67 794**	**6 298**	**10.2**
Automotive	12 725	17 455	4 730	37.2
Electronics	2 849	3 566	717	25.2
Aeronautics	3 382	3 859	477	14.1
Textile and leather	13 822	14 398	576	4.2
Agriculture and food industry	15 816	15 869	53	0.3
Imports	**161 245**	**167 109**	**5 864**	**3.6**
Energy imports	39 192	41 082	1 890	4.8
Imports excluding energy	**122 053**	**126 027**	**3 974**	**3.3**
Consumer goods	26 629	28 922	2 293	8.6
Food products	17 647	21 087	3 440	19.5
Semi-finished goods	34 456	34 316	-140	-0.4
Capital goods	35 505	33 915	-1 590	-4.5
Raw products	7 796	7 657	-139	-1.8
Trade deficit	83 168	84 940	1 772	2.1

** Provisional data.*
Source: Foreign Exchange Office.

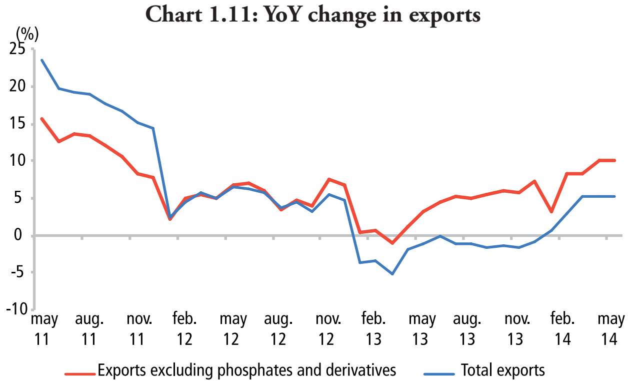
Despite a 13.3 percent decline in sales of phosphates and derivatives, export growth results mainly from the uptrend of the automotive sector, whose shipments accounted for a share of 21.2 percent in May 2014 from 16.3 percent a year earlier. Sales in this sector were up 37.2 percent to 17.5 billion dirhams, in conjunction with car manufacturing exports, which almost doubled to 8.6 billion dirhams.

Meanwhile, supplies of electronics and aeronautics industries grew by 25.2 percent and 14.1 percent, respectively. Meanwhile, after a downward trend since April 2013, textile and leather exports amounted to 14.4 billion dirhams, up 4.2 percent. This change covers respective increases of 5.4 percent and 7.1 percent in sales of ready-made garments and footwear, and a decline of 1.8 percent in sales of hosiery items. Shipments of the agricultural and agri-food sector increased slightly by 0.3 percent to 15.9 billion dirhams, following a 10.6 percent increase in citrus and vegetables sales to 4.6 billion dirhams, offset by a 4.7 percent decline in the food industry to 8.4 billion.

Import growth resulted mainly from a 35.7 percent increase in purchases of wheat to 8.9 billion dirhams. Meanwhile, consumer goods imports moved up by 8.6 percent to 28.9 billion dirhams, mainly owing to a 17.4 percent increase in purchases of passenger cars. Similarly, energy purchases rose by 4.8 percent to 41.1 billion dirhams, especially oil and gas-oil imports, which were up by 21.2 percent and 14.2 percent to 13.7 billion and 9.2 billion dirhams, respectively. In contrast, imports of capital goods dropped by 4.5 percent to 33.9 billion dirhams, due to a decline in purchases of sorting machines and industrial vehicles.

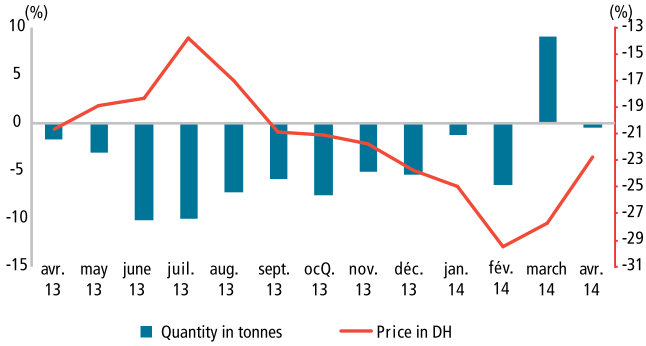
Travel receipts showed an increase of 3.2 percent to 21.7 billion compared to the same period of 2013, while transfers from

Chart 1.11: YoY change in exports



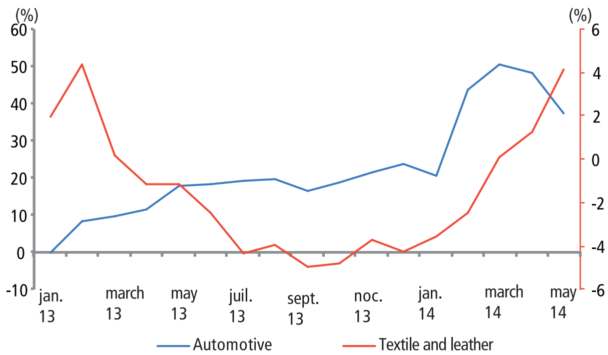
Source: Foreign Exchange Office.

Chart 1.12: YoY change in phosphate exports



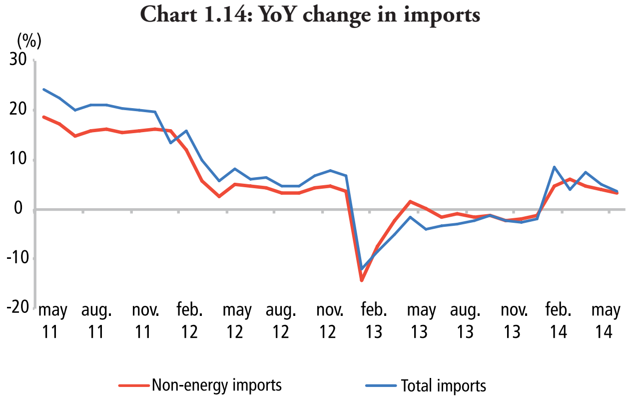
Source: Foreign Exchange Office.

Chart 1.13: YoY change in sales of automotive and textile industries



Source: Foreign Exchange Office.

Chart 1.14: YoY change in imports



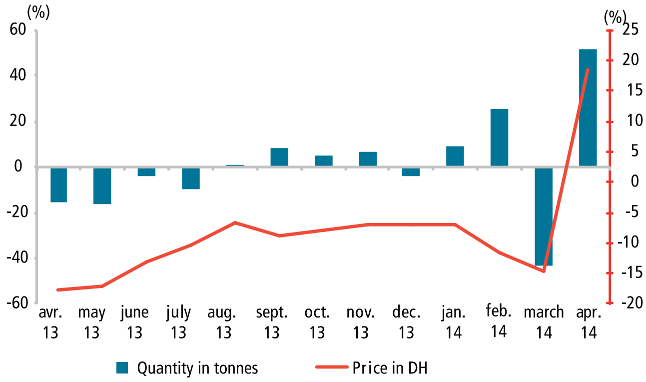
Source: Foreign Exchange Office.

Moroccans living abroad dropped by 1.6 percent to 22.7 billion dirhams.

Based on these developments, the current account deficit in 2014 should be around 7 percent as a percentage of GDP, representing a slight improvement compared to 2013.

Receipts from foreign direct investment were down 42.5 percent to 11.6 billion dirhams and expenditure of the same type fell sharply by 76.1 percent to 2 billion, which is a net inflow of 9.5 billion dirhams. Given the other elements of the capital account, the outstanding net international reserves stood at 164.2 billion dirhams at end-May 2014, equaling 4 months and 19 days of goods and services' imports.

Chart 1.15 : YoY change in crude oil imports



Source: Foreign Exchange Office.

2. PRESSURES ON OUTPUT CAPACITY AND LABOR MARKET

In the second quarter of 2014, nonagricultural output gap should remain below zero, according to Bank Al-Maghrib estimates, while capacity utilization rate (CUR) in the industrial sector stabilized in April at 72 percent. On the labor market, the unemployment rate rose significantly from 9.4 percent to 10.2 percent between the first quarter of 2013 and the same period of 2014, despite the creation of 89,000 jobs. Concerning costs, the private sector's average wage index showed a year-on-year growth of 3.5 percent in nominal terms and 3 percent in real terms.

Overall, although the data do highlight some tensions in production costs, the deterioration of labor market conditions and the persistence of spare capacity in the economy do not suggest price pressures in the coming quarters.

2.1 Pressures on output capacity

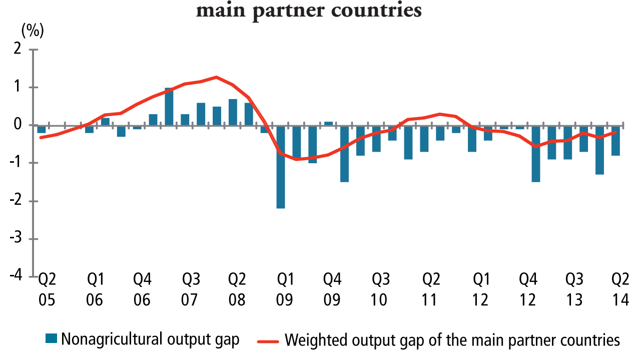
The latest estimates of Bank Al-Maghrib indicate that nonagricultural output gap would continue to be negative in the second quarter of 2014, suggesting the absence of significant price pressures (Chart 2.1).

At the same time, the findings of BAM's monthly business survey in industry show that the CUR stabilized in April at 72 percent, a rate close to its historical average (Chart 2.2). This trend affected all sectors, with the exception of textile and leather industries and electrical and electronic ones, in which the CUR rose from 67 percent to 70 percent and from 77 percent to 80 percent, respectively.

The same survey shows that the unit production cost would have stagnated overall in the first quarter of 2014, according to 61 percent of manufacturers and increased according to 27 percent (Chart 2.3). By component, stagnation affected financial costs and wage levels for 75 percent of companies, and non-energy commodity costs for 51 percent, while energy costs would have increased according to 60 percent of them.

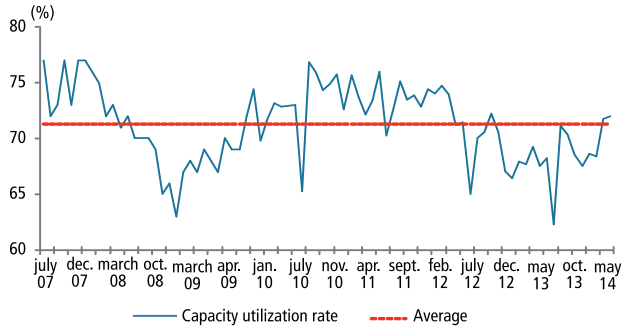
The industrial producer price index showed a further decline of 0.7 percent over the same period as against 0.3 percent a quarter earlier.

Chart 2.1: Output gap of nonagricultural sectors and in the main partner countries



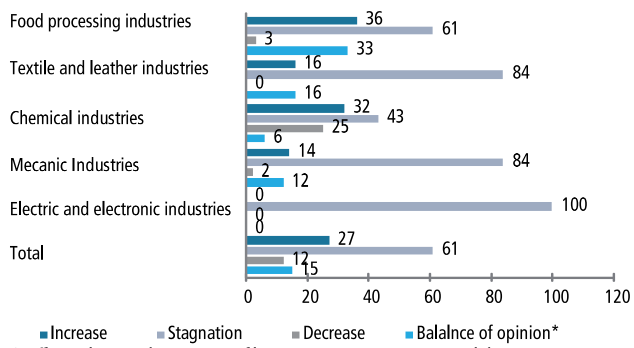
Sources: HCP, Eurostat and BAM estimates.

Chart 2.2: Industrial capacity utilization rate



Source: BAM monthly business survey.

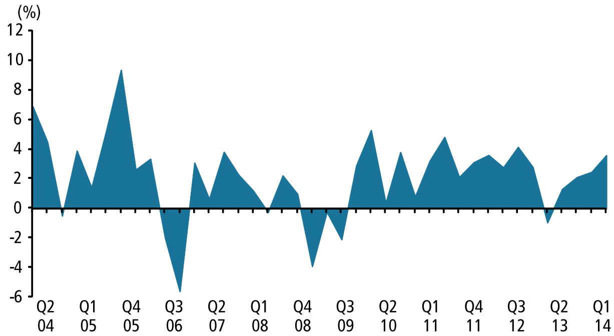
Chart 2.3: Change in sectoral production unit cost



**Difference between the percentage of businesses reporting an increase and those reporting a decrease.*
Source: BAM monthly business survey.

Apparent labor productivity in nonagricultural activities rose by 3.6 percent in the first quarter after a decline of 0.9 percent a year earlier, reflecting an acceleration from 2.1 percent to 4.1 percent in nonagricultural growth and a slowdown from 3.1 percent to 0.5 percent in nonagricultural employment (Chart 2.4).

Chart 2.4: YoY change in apparent labor productivity (Nonagricultural VA/nonagricultural employment)



Sources : HCP, and BAM estimates.

2.2 Pressures on the labor market

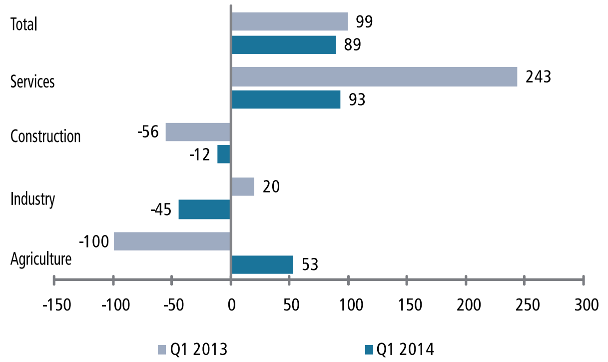
During the first quarter, the labor force aged 15 and over increased by 1.8 percent to almost 11.7 million people, with an increase of 2 percent in urban areas and 1.6 percent in rural areas. Taking into account demographic changes, the participation rate moved up slightly by 0.1 percentage point to 47.7 percent. It remained unchanged at 42.2 percent in urban areas, while in rural areas it rose from 55.9 percent to 56.3 percent.

Meanwhile, 89,000 jobs were created, occupied almost entirely by female labor force. This trend covers the creation of 46,000 jobs in urban areas and 43,000 jobs in rural areas.

At the sectoral level, services and agriculture remain the only job-providing sectors, with 93,000 and 53,000 jobs, respectively. However, the industrial, including handicrafts, and construction sectors showed respective losses of 45,000 and 12,000 jobs (Chart 2.5).

In total, employed labor force grew by 0.9 percent to nearly 10.5 million people and the employment rate declined from 43.2 percent to 42.9 percent overall, with stagnation at 53.5 percent in rural areas and a decline of 0.4 percentage point to 36 percent in urban areas (Table 2.1).

Chart 2.5: Change in job creations per sector (in thousands)



Source: HCP.

Table 2.1: Quarterly indicators of activity, employment, and unemployment

In thousands / in %	Q1- 2013			Q1- 2014		
	Urban	Rural	Total	Urban	Rural	Total
Labor force and employment	6145	5329	11474	6265	5412	11677
Labor force [(1)]	42.2	55.9	47.6	42.2	56.3	47.7
Labor force participation rate (%) [(2)]	5303	5094	10397	5349	5137	10486
Employed labor force	36.4	53.5	43.2	36.0	53.5	42.9
Employment rate (%) [(3)]						
Unemployed labor force	842	235	1077	916	275	1191
Unemployment rate (in %) [(4)]	13.7	4.4	9.4	14.6	5.1	10.2
By age						
.15 - 24 years	35.6	9.2	19.5	36.7	9.9	20.2
.25 - 34 years	19.6	5.2	13.5	20.4	5.1	14.0
.35 - 44 years	7.3	2.7	5.5	8.3	3.8	6.5
By degree						
. Non-graduates	7.8	2.8	4.7	7.6	3.7	5.2
. Graduates	18.2	10.9	16.5	19.9	10.3	17.5

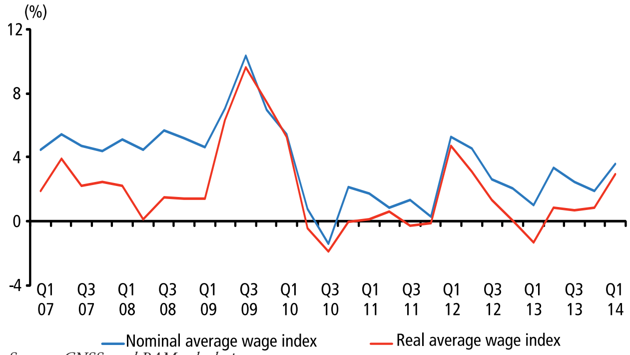
(1) Population aged 15 years and above (in thousand of persons).
(2) Labor force aged 15 years and above /total population aged 15 years and above.
(3) Employed labor force aged 15 years and above /total population aged 15 years and above.
(4) Unemployed labor force aged 15 years and above /labor force aged 15 years and above.
Source : HCP.

Against this backdrop, the unemployment rate increased by 0.8 percentage point to 10.2 percent, with an increase from 13.7 percent to 14.6 percent in urban areas and from 4.4 percent to 5.1 percent in rural areas. This change particularly affected urban young people aged 15 to 24 years, as the rate rose from 35.6 percent to 36.7 percent (Table 2.1).

Regarding labor costs, the private sector's wage average index, based on CNSS data, posted in the first quarter a year-on-year increase of 3.5 percent in nominal terms and 3 percent in real terms (Chart 2.6).

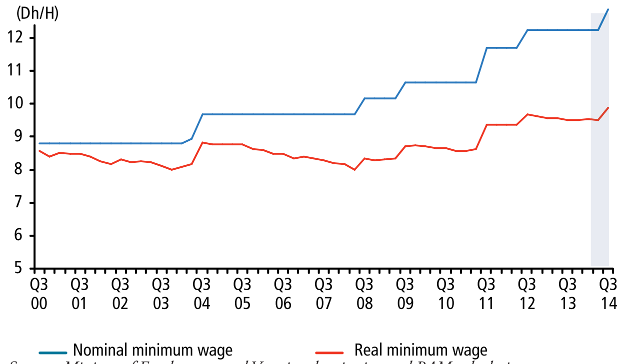
The hourly minimum wage stagnated in the first quarter in nominal terms, while it fell by 0.5 percent in real terms. However, it should rise 5 percent in nominal terms, in the beginning of July 2014, to 12.85 dirhams/ hour (Chart 2.7).

Chart 2.6: YoY change in the private sector's average wage index in nominal and real terms



Sources: CNSS, and BAM calculations.

Chart 2.7: Minimum wage in real and nominal terms



Sources: Ministry of Employment and Vocational trainning and BAM calculations.

3. INTERNATIONAL ENVIRONMENT AND IMPORT PRICES

The results of national accounts for the first quarter of 2014 show a further recovery in major developed countries, except the United States, and an economic slowdown in emerging economies, mainly in China. The positive economic trends in advanced countries are also confirmed by the findings of business surveys. However, unemployment remains high overall in the euro area, while in the United States, it stabilized at its lowest level since October 2008. Financial markets were characterized by a downward trend of bond yields and an increase in major stock indexes. Commodity prices were overall tilted to the upside. This price rise helped reverse the disinflationary trend, as inflation moved up in most developed countries, mainly the United States. In total, the slower recovery in Morocco's partner countries and the persistently low inflation rates suggest a moderation of external inflationary pressures over the coming quarters.

3.1 Global financial conditions and economic activity

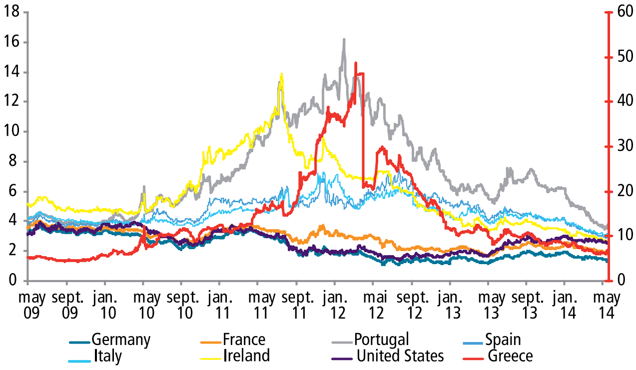
3.1.1 Financial conditions

In bond markets, sovereign yields in May dropped overall in peripheral eurozone countries, but trended upward during the week before the European elections, reflecting investors' fears about an advance of anti-European parties. Between April and May, 10-year yields fell from 3.8 percent to 3.6 percent in Portugal, from 3.1 percent to 2.9 percent in Spain and from 3.2 percent to 3.1 percent in Italy. However, Greek yields were up from 6.2 percent to 6.4 percent. In other countries of the euro area, these yields moved down from 2 percent to 1.9 percent in France and decreased slightly in Germany from 1.5 percent to 1.4 percent. Yields on U.S. Treasury bills fell slightly to 2.6 percent in May from 2.7 percent a month earlier.

In emerging markets, 10-year yields dropped overall between April and May from 12.5 percent to 12.2 percent in Brazil, from 4.5 percent to 4.3 percent in China, from 8.9 percent to 8.8 percent in India and from 9.9 percent to 9.2 percent in Turkey.

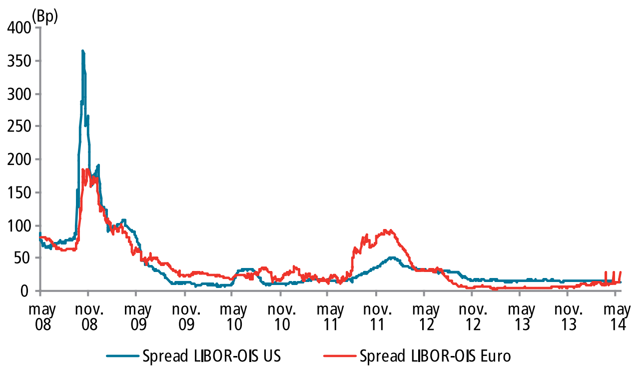
In money markets, the 3-month Euribor and Libor virtually stagnated in May at 0.33 percent and 0.22 percent, respectively.

Chart 3.1: Change in the yield of ten-year euro area and U.S. government bonds



Source: Datastream .

Chart 3.2: Change in the OIS-LIBOR spread*



** The Libor-OIS spread reflects an interest rate risk. and corresponds to the difference between the 3-month interbank rate (Libor Eurodollar) and the 3-month overnight indexed swap rate (OIS).*
Source: Datastream .

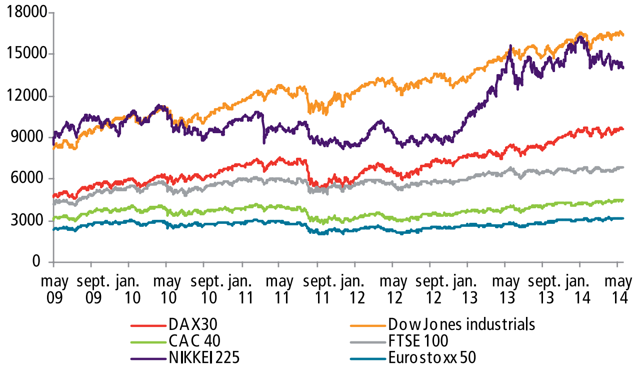
Meanwhile, spreads followed divergent trends, between April and May, showing an increase from 11.9 basis points to 16.3 points for the euro Libor-OIS spreads, while the dollar Libor-OIS ones fell from 14 to 13.3 basis points. The annual credit growth accelerated in the United States to 3.7 percent in May from 2.9 percent a month earlier, while in the euro area, its contraction eased from 2.2 percent to 1.8 percent in April.

In stock markets, most major indexes of advanced economies were tilted to the upside, with a decrease of their volatility. Indeed, from April to May, the EUROSTOXX50 showed an increase of 0.4 percent, Dow Jones Industrials and CAC 40 rose by 0.8 percent each, and the FTSE100 and DAX30 were up 2.7 percent and 1.4 percent, respectively. In contrast, the Nikkei225 fell by 1.4 percent. In terms of volatility, VSTOXX were down from 17.4 basis points to 16.8 points, while VIX declined from 14.2 basis points to 12.9 points. In emerging economies, the MSCI EM rose slightly by 1 percent, covering respective increases of 5.3 percent and 2.9 percent in MSCI Turkey and India, and a decrease of 2.3 percent in MSCI China.

In foreign exchange markets, the euro remained stable against other major currencies, trading at 1.38 dollar and 0.82 pound sterling between April and May. However, it depreciated slightly by 0.81 percent vis-à-vis the Japanese yen. Most currencies of key emerging economies stagnated against the dollar. Indeed, a dollar traded at 2.2 Brazilian real, 2.1 Turkish lira and 6.2 Chinese yuan, while it depreciated by 1.2 percent against the Indian rupee, standing at 59.6 rupees.

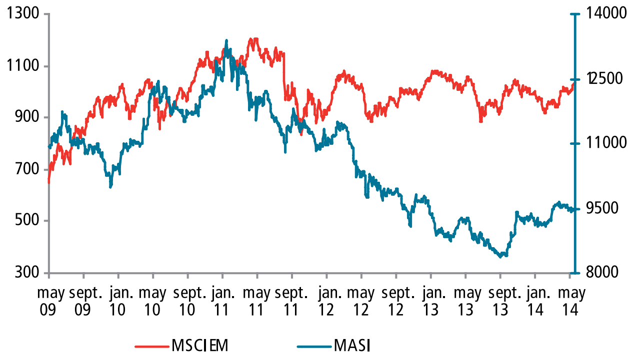
With regard to monetary policy decisions, the Bank of England kept its key rate unchanged at 0.5 percent. Meanwhile, the ECB lowered its key rate from 0.25 percent

Chart 3.3: Change in the major stock market indexes of advanced economies



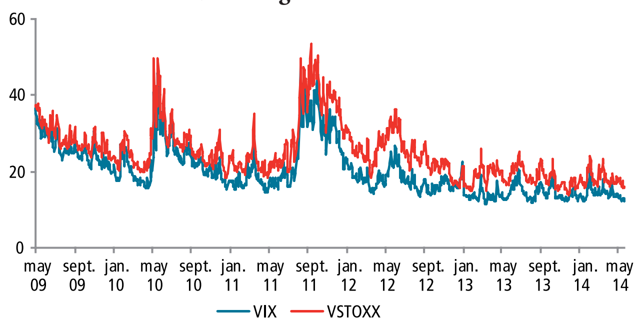
Source: Datastream.

Chart 3.4: Change in the MSCI EM and MASI



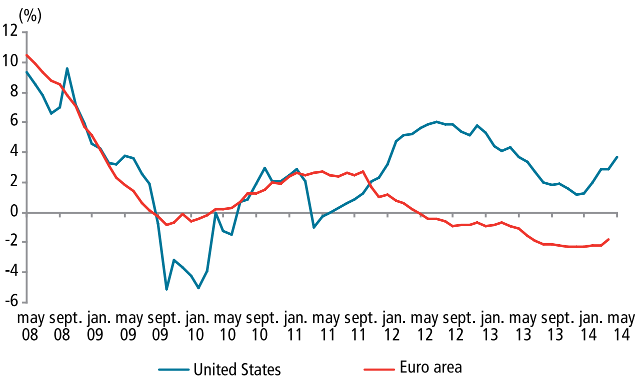
Source: Datastream.

Chart 3.5: Change in VIX and VSTOXX



Source: Datastream.

Chart 3.6: YoY change in credit in the United States and in the Euro area



Source: Datastream.

to 0.15 percent and reduced its deposit rate to -0.1 percent, which are historically low levels. It also announced new measures to provide liquidity to banks in an attempt to sustain growth and fight against the disinflationary trend in the euro area. The Fed announced a further $10 billion reduction in its bond buyback program, bringing it to $45 billion a month. It also reiterated its commitment to maintain its key rate low for a longer period.

Table 3.1: YoY change in quarterly growth

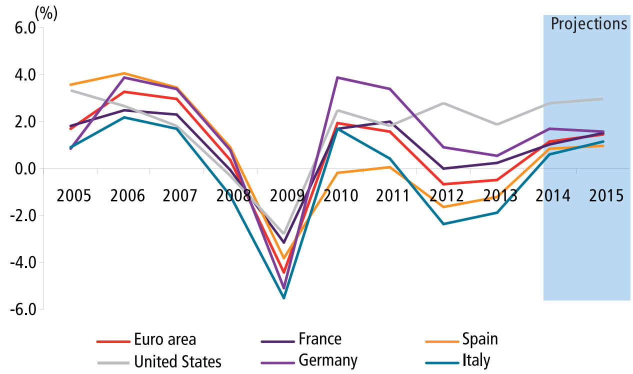
	2012		2013				2014
	Q3	Q4	Q1	Q2	Q3	Q4	Q1
United States	3.1	2.0	1.3	1.6	2.0	2.6	2.1
Euro area	-0.7	-1.0	-1.2	-0.6	-0.3	0.5	0.9
France	0.5	0.0	-0.2	0.7	0.3	0.8	0.8
Germany	0.9	0.3	-0.3	0.5	0.6	1.4	2.3
Italy	-2.6	-2.8	-2.4	-2.1	-1.9	-1.0	-0.5
Spain	-1.7	-2.1	-1.9	-1.6	-1.1	-0.2	0.5
United Kingdom	0.3	0.2	0.5	1.7	1.8	2.7	3.1
Japan	-0.1	-0.3	-0.1	1.4	2.5	2.5	2.7
China	7.4	7.9	7.7	7.5	7.8	7.7	7.4
India	4.6	4.4	4.4	4.7	5.2	4.6	4.6
Brazil	0.9	1.8	1.9	3.5	2.4	2.2	1.9

Source : Datastream.

3.1.2 Global economic activity

With the exception of the United States, the national accounts figures of advanced countries for the first quarter 2014 show an improved growth. However, they indicate a further slowdown in emerging economies, mainly in China, which should weigh more on the medium-term outlook.

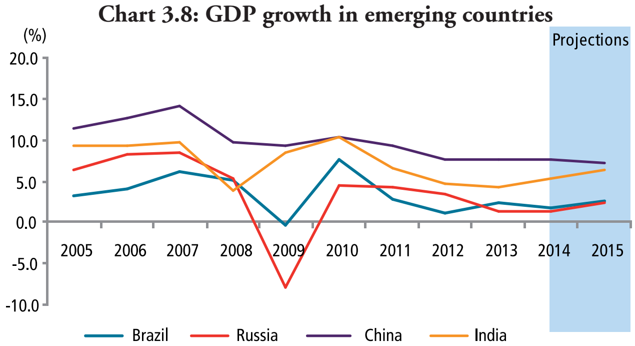
Chart 3.7: GDP growth in advanced countries



Source: IMF projections, April 2014.

Indeed, growth in the United States decelerated from 2.6 percent to 2.1 percent, impacted by a slower increase in exports and inventory rebuilding. However, it accelerated from 2.7 percent to 3.1 percent in the United Kingdom, supported by services and industrial production. Similarly, growth in Japan improved from 2.5 percent to 2.7 percent, driven by consumption expenditure of households anticipating higher VAT as of April.

Chart 3.8: GDP growth in emerging countries



Source: IMF projections, April 2014.

In the euro area, GDP grew by 0.9 percent year on year from 0.5 percent in the previous quarter, particularly reflecting acceleration from 1.4 percent to 2.3 percent in the growth of Germany, due to improved domestic demand. In France, growth stagnated at 0.8 percent, while GDP of Italy showed an easing in contraction from 1 percent to 0.5 percent. In Spain, it grew 0.5 percent, after nine successive quarters of declines.

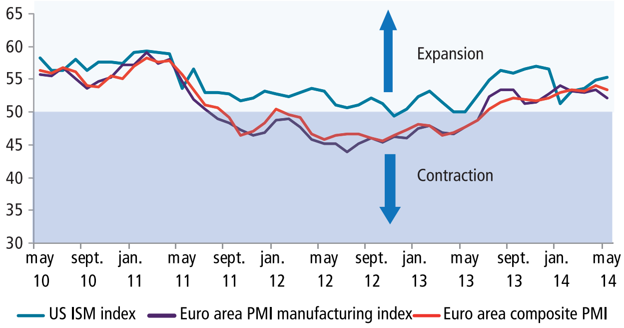
Concerning major emerging economies, economic growth slowed down in China from 7.7 percent to 7.4 percent, the lowest level in five quarters. Similarly, growth decelerated from 2.2 percent to 1.9 percent in Brazil, while it stabilized at 4.6 percent in India

High-frequency indicators confirm the continued recovery in the euro area. Indeed, even if it dropped in May to 53.5 points from 54 points in April, the composite PMI exceeded the expansion threshold of 7 percent. This change reflects mainly a decline in the manufacturing PMI from 53.4 to 52.2 points. In the United States, the ISM manufacturing index improved, month on month, from 54.9 to 55.4 points in May, exceeding the expansion threshold of 10.8 percent.

In terms of outlook, the IMF, in April 2014, kept growth prospects unchanged for advanced economies and revised down forecasts for emerging and developing countries. By country, growth in the United States should stand at 2.8 percent in 2014 and 3 percent in 2015, supported by accommodative monetary and fiscal policies. In the euro area, it should be 1.2 percent in 2014 and 1.5 percent in 2015, while in Japan, GDP would grow by 1.4 percent and 1 percent respectively. Concerning major emerging economies, growth should decline slightly in China to 7.5 percent in 2014 and 7.3 percent in 2015, while it should reach 1.8 percent and 2.7 percent in Brazil, 5.4 percent and 6.4 percent in India and 1.3 percent and 2.3 percent in Russia, respectively for the two years.

In the same vein, recent forecasts of May from the OECD and the European Commission show a slight downward revision of global growth to around 3.4 percent in 2014 and 3.9 percent in 2015, mainly due to moderate economic activity in key emerging countries.

Chart 3.9: Change in high-frequency indicators in the USA and the Euro area



Source: Datastream .

Table 3.2: Global growth outlook

	Forecasts (%)					
	European commission		IMF		OECD	
	2014	2015	2014	2015	2014	2015
Global GDP	3.5	3.8	3.6	3.9	3.4	3.9
United States	2.8	3.2	2.8	3.0	2.6	3.5
Euro area	1.2	1.7	1.2	1.5	1.2	1.7
Germany	1.8	2.0	1.7	1.6	1.9	2.1
France	1.0	1.5	1.0	1.5	0.9	1.5
Italy	0.6	1.2	0.6	1.1	0.5	1.1
Spain	1.1	2.1	0.9	1.0	1.0	1.5
United Kingdom	2.7	2.5	2.9	2.5	3.2	2.7
Japan	1.5	1.3	1.4	1.0	1.2	1.2
China	7.2	7.0	7.5	7.3	7.4	7.3
India	4.7	5.4	5.4	6.4	4.9	5.9
Brazil	2.6	2.9	1.8	2.7	1.8	2.2
Russia	1.0	2.0	1.3	2.3	0.5	1.8

Sources: OECD. European commission (May 2014). IMF (Apr. 2014).

3.1.3 Labor market

In the United States, the unemployment rate stagnated at 6.3 percent in May 2014, its lowest level since October 2008. In the euro area, it fell slightly to 11.7 percent in April from 11.8 percent in March. In partner countries, this rate remained stable in the same month at 5.2 percent in Germany, 10.4 percent in France, 12.6 percent in Italy, while it decreased to 25.1 percent in Spain from 25.2 percent a month earlier. In the United Kingdom, February 2014 data show that the unemployment rate dropped to 6.6 percent.

Regarding labor market prospects, the IMF, in its update of April 2014, revised down its overall projections for 2014 and 2015 in most developed countries. The IMF predicts respective unemployment rates of 6.4 percent and 6.2 percent in 2014 and 2015 in the United States and 11.9 percent and 11.6 percent in the euro area. In partner countries, this rate should stand in France at 11 percent in 2014 before declining to 10.7 percent in 2015, while in Germany it would remain stable at 5.2 percent. In Italy and Spain, the unemployment rate would stand at 12.4 percent and 25.5 percent in 2014 respectively, before declining to 11.9 percent and 24.9 percent in 2015. In the United Kingdom, it should be 6.9 percent in 2014 and then decrease to 6.6 percent in 2015.

May projections of the European Commission and OECD remain broadly in line with those of the IMF, showing downward revisions of unemployment rates in most developed countries in 2014 and 2015.

3.2 Commodity prices and inflation

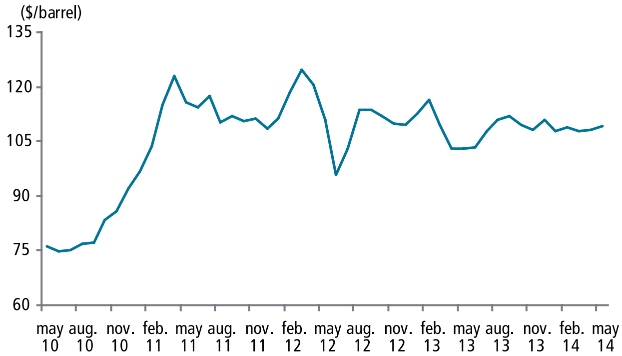
With the exception of agricultural commodities, which declined slightly, commodity prices trended overall

Table 3.3: Change in unemployment rate

	2012	2013	March 2014	April 2014	May 2014
United States	8.1	7.4	6.7	6.3	6.3
Euro area	11.3	12.0	11.8	11.7	N.D
France	9.8	10.3	10.4	10.4	N.D
Italy	10.7	12.2	12.6	12.6	N.D
Germany	5.5	5.3	5.2	5.2	N.D
Spain	24.8	26.1	25.2	25.1	N.D
United Kingdom	7.9	7.5	N.D	N.D	N.D

Source : Eurostat.

Chart 3.10: World price of brent oil in dollars



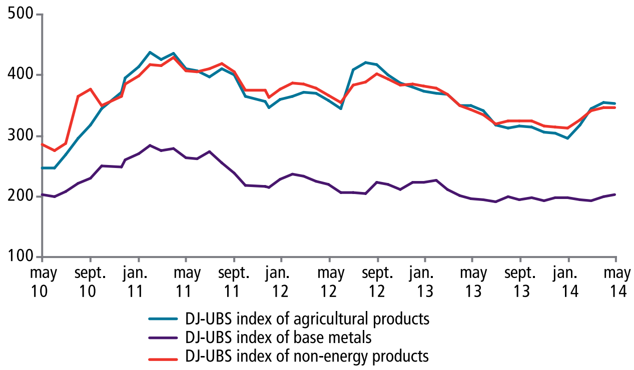
Source: Datastream.

Table 3.4: Oil futures price (Brent in U.S. $)

	Q2:14	Q3:14	Q4:14	Q1: 15	2014	2015	2016
Oil	109.13	108.52	106.86	105.41	108.09	103.54	99.13

Source : Bloomberg.

Chart 3.11: Change in the DJ-UBS non-energy commodity indexes (100=2006)



Source: Datastream.

upwards in May, thus remaining relatively high. Under these conditions, inflation recorded in April an increase in most developed countries, particularly the United States.

3.2.1 Energy commodity prices

In May, the Brent price rose again, averaging $109.3 per barrel from $108 in April. This 1.2 percent increase is mainly due to geopolitical tensions, particularly in Ukraine, and uncertainties about Russia's exports to the European Union. Year on year, the Brent price increased by 6.1 percent.

Regarding the outlook for oil prices1, the World Bank revised down its April projections, now assuming a price of $102.8 per barrel in 2014 from 103.5 in January, which is a revision of -0.7 percent. In contrast, the IMF expects a price of $104.17 per barrel in its WEO of April 2014 from $103.84 provided in its January update. The European Commission revised up its forecasts for the Brent price, to $107.6 per barrel in 2014 from 105.8 in its winter projection.

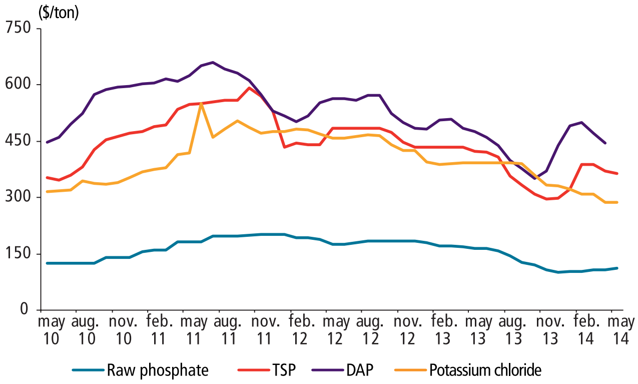
3.2.2 Non energy commodity prices

In May 2014, non-energy prices decreased slightly, year on year, as evidenced by a 0.3 percent decline in the relevant Dow Jones-UBS index. This change covers a 1.8 percent increase in the index of base metal prices and a slight decrease of 0.8 percent in agricultural commodities prices.

In the world market of phosphate, the price of crude phosphate moved up by 3.7 percent from $108 per tonne in April to $112 in May. In addition, after three months of consecutive decreases, the urea

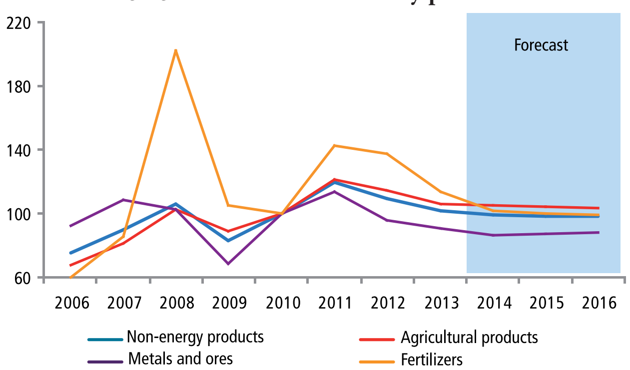
1 The World Bank and the IMF make their forecasts based on the average price of the three oil categories (Brent, WTI and Dubai). The European Commission projects only the Brent price.

Chart 3.12: Change in the world prices of phosphate and derivatives



Source: World Bank.

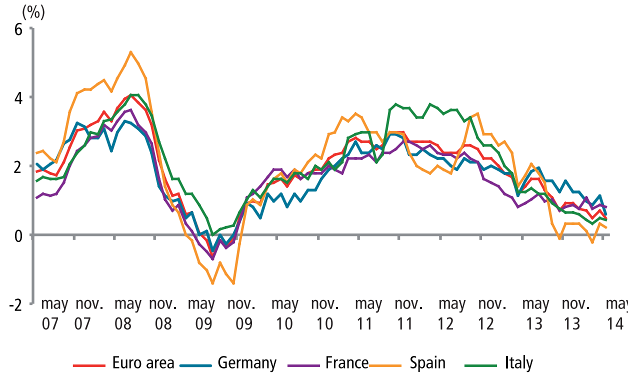
Chart 3.13: Outlook for commodity prices indexes



Source: World Bank.

price rose 2.7 percent, month on month, while Potassium Chloride prices remained unchanged in May. TSP and DAP prices in May continued to decline since last month to 1.7 percent and 5.5 percent, respectively. Year on year, prices fell 32.1 percent for crude phosphate, 27 percent for Potassium Chloride, 13.7 percent for TSP, 13.2 percent for urea and 8.3 percent for DAP.

Chart 3.14: Inflation trend in the main partner countries



Source: Eurostat and Datastream.

3.2.3 Inflation in the world

In the United States, inflation rose markedly in April, from 1.5 percent to 2 percent. Similarly, having stood at 1.6 percent in March, inflation rose sharply in Japan to 3.4 percent in April. Moreover, according to an initial Eurostat estimate for May, inflation would drop from 0.7 percent to 0.5 percent in the euro area, with declines from 1.1 percent to 0.6 percent in Germany, from 0.5 percent to 0.4 percent in Italy and from 0.3 percent to 0.2 percent in Spain. Moreover, inflation remained unchanged in France at 0.8 percent in May. In the United Kingdom, the latest available data remain those of April and show a slight increase in inflation from 1.6 percent to 1.8 percent. In emerging countries, inflation rose in May from 1.8 percent to 2.5 percent in China and from 6.3 percent to 6.4 percent in Brazil.

Regarding the outlook, the IMF forecasts in April 2014 WEO that inflation would be limited to 1.5 percent in 2014 and 1.6 percent in 2015 in developed countries, while in emerging and developing countries, it should stand at 5.5 percent in 2014 and would decline to 5.2 percent in 2015. Moreover, according to the latest forecast by the European Commission, inflation should drop in the euro area to 0.8 percent in 2014 before increasing to 1.2 percent in 2015, and would stand in the United States at 1.7 percent and 1.9 percent in 2014 and 2015, respectively. In the euro area, the OECD expects an inflation of 0.7 percent in 2014 and 1.1 percent in 2015

Table 3.5 : World inflation outlook, YoY

	OECD		European commission		IMF	
	2014	2015	2014	2015	2014	2015
United States	1.5	1.7	1.7	1.9	1.4	1.6
Euro area	0.7	1.1	0.8	1.2	0.9	1.2
Germany	1.1	1.8	1.1	1.4	1.4	1.4
France	0.9	1.1	1.0	1.1	1.0	1.2
Spain	0.1	0.5	0.1	0.8	0.3	0.8
Italy	0.5	0.9	0.7	1.2	0.7	1.0
United Kingdom	2.0	2.1	1.9	2.0	1.9	1.9
Japan	2.6	2.0	2.5	1.6	2.8	1.7

Sources: OECD. European commission and IMF .

3.3 Morocco's import unit price index

Month on month, the growth of non-energy import prices (IPI) decelerated from 3.6 percent to 0.9 percent at end-March 2014, mainly due to slower mining import prices. Indeed, the mining IPI was up 1.5 percent as against 7.8 percent a month earlier, reflecting changes in import prices of sulfur, which slowed down from 16.6 percent to 2 percent.

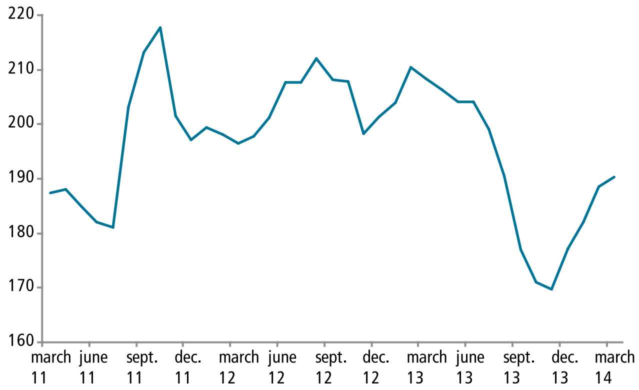
The food IPI rose 0.6 percent in March, after a 1 percent decline in the previous month, mainly due to respective increases of 0.6 percent and 2.2 percent in import prices of wheat and corn, while they showed respective decreases of 4 percent and 5.4 percent a month earlier.

Similarly, the index of semi-finished goods was up 1.2 percent, after a decrease of 6.4 percent. This trend reflects an increase of 1.3 percent in the IPI of rolled products, after a decline of 10.8 percent in February, and a rise of 2.5 percent in that of plastics, as against a decline of 1 percent in the previous month.

Year on year, the non-energy IPI continued to decline to 8.7 percent from 10.4 percent in February. Indeed, the food IPI fell by 18.5 percent as against 20.5 percent in the previous month, in conjunction with a 13.6 percent decline in the average import price of wheat after dropping by 16.8 percent in February. Similarly, the decline in the corn IPI eased slightly, month on month, from 28.8 percent to 26.4 percent.

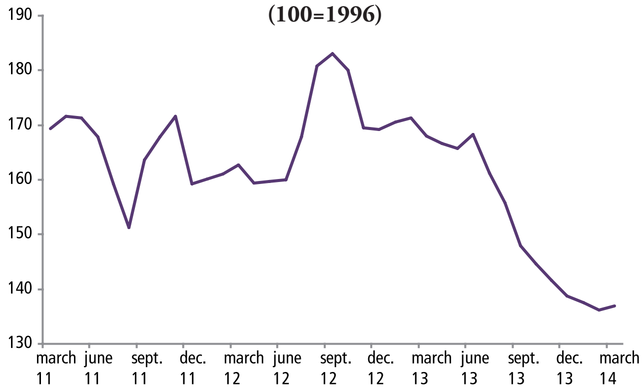
The IPI of semi-finished goods showed a drop of 16 percent after that of 16.7 percent in February. This trend is attributable to a decline in import prices of fertilizers from 11.6 percent to 11.1 percent. In parallel, the paper and cardboard IPI fell by 6.4

Chart 3.15: Non-energy import price index (100=1996)



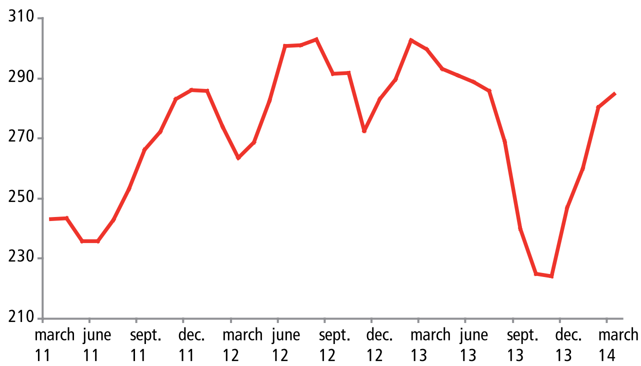
Sources: Foreign Exchange Office, and BAM calculations.

Chart 3.16: Food import price index (100=1996)



Sources: Foreign Exchange Office, and BAM calculations.

Chart 3.17: Mineral import price index (100=1996)

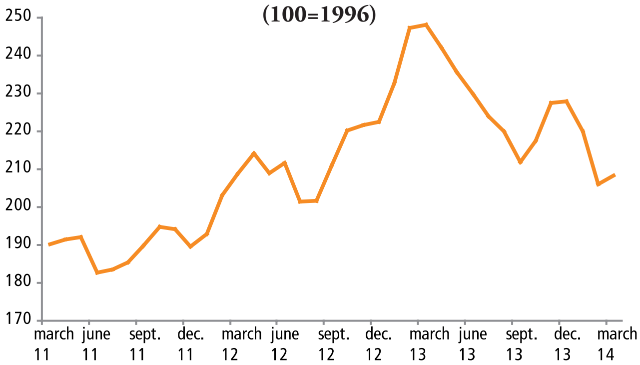


Sources: Foreign Exchange Office, and BAM calculations.

percent in March, as against 6.8 percent in the previous month.

The mining IPI declined by 5 percent, as against 7.3 percent a month earlier. This change is mainly due to an easing in the decrease of import prices of sulfur from 9.5 percent in February to 4.1 percent in March.

Chart 3.18: Import price index of semifinished goods (100=1996)



Sources: Foreign Exchange Office, and BAM calculations

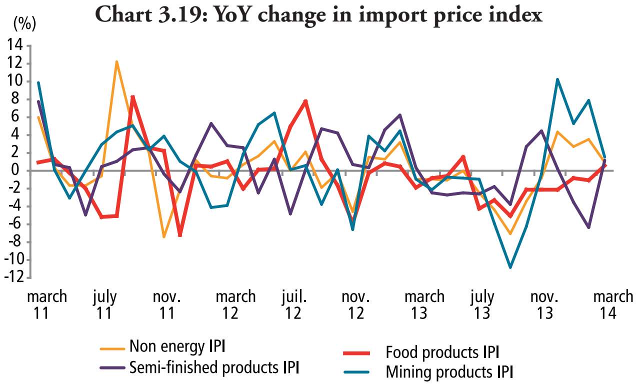
Table 3. 6 : Change in import price index (IPI)

	Monthly change in %			Annual change in %		
	Jan. 2014	Feb. 2014	March 2014	Jan. 2014	Feb. 2014	March 2014
Non energy IPI	2.8	3.6	0.9	-10.8	-10.4	-8.7
Food IPI	-0.8	-1.0	0.6	-19.3	-20.5	-18.5
Mining IPI	5.3	7.8	1.5	-10.2	-7.3	-5.0
Semi-finished products IPI	-3.5	-6.4	1.2	-5.5	-16.7	-16.0

N.B: Indexes calculated on the basis of unit prices in Dirhams

Sources: Foreign Exchange Office, and BAM calculations

Chart 3.19: YoY change in import price index



Sources: Foreign Exchange Office. and BAM calculations

4. MONETARY CONDITIONS AND ASSET PRICES

Recent money market developments indicate a decrease of 2 basis points in the interbank rate to 3.03 percent on average between April and May 2014, thus remaining aligned with the key rate, which was kept unchanged at 3 percent at the last meeting of the Bank Board on March 25, 2014. Lending rates showed a quarterly decline of 56 basis points in the first quarter of 2014 to 5.96 percent, mainly reflecting lower rates on cash advances and to a lesser extent on real estate loans. As to deposit rates, the weighted average rate of 6- and 12-month deposits fell by 2 basis points between the first quarter and April 2014, to 3.69 percent. Meanwhile, although the M3 growth accelerated from 3.2 percent in the first quarter to 4.2 in April, the monetary gap remained negative. Bank credit growth accelerated over the same period to 4.4 percent from 3.8 percent. This change reflects an improved growth of all credit components, with the exception of real estate loans. In 2014, bank lending should register an annual growth of around 4.5 percent. Meanwhile, the dirham's effective exchange rate appreciated from one quarter to another by 0.57 percent in nominal terms compared to the fourth quarter of 2013 and by 0.34 percent in real terms. In the assets market, real estate prices almost stagnated in the first quarter of 2014 from one quarter to the next, covering a 0.4 percent decline in residential property prices and respective increases of 0.4 percent and 3.8 percent in land prices and commercial property ones. Overall, these developments suggest the absence of monetary and real estate inflationary pressures in the medium term.

4.1 Monetary conditions

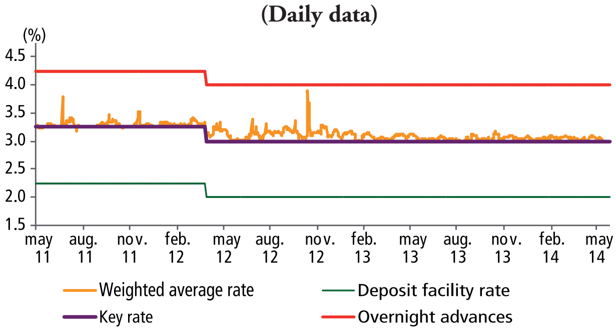
4.1.1 Interest rates

At its meeting of March 25, 2014, the Bank Board decided to maintain the key rate unchanged at 3 percent. Under these conditions, the interbank market weighted average rate stood at 3.03 percent on average from April to May 2014, slightly down compared to the first quarter of 2014.

As to lending rates, BAM's survey for the first quarter of 2014 shows a decrease of 56 basis points to 5.96 percent in the weighted average rate of bank loans. This trend mainly reflects a drop of 75 basis points in rates on cash advances. In contrast, rates on equipment loans and consumer ones were up 59 basis points and 7 points, respectively. Rates on real estate loans remained virtually unchanged from its level of the fourth quarter.

Regarding deposit rates, the weighted average rate of 6- and 12-month deposits fell slightly by 2 basis points between the first quarter and April 2014, standing at 3.69 percent. Indeed, 6-month deposit rate

Chart 4.1: Change in the interbank rate* (Daily data)



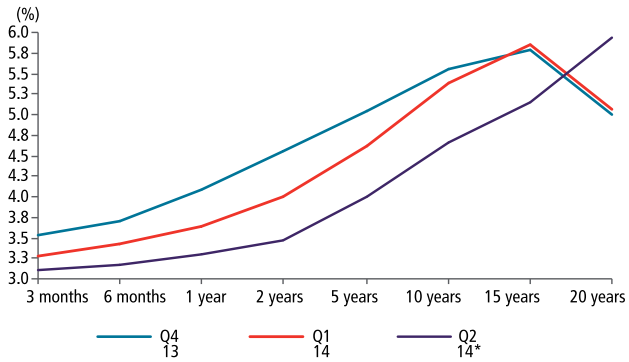
**Data at May 26th, 2014.*
Source : BAM.

Table 4.1: Deposits rates

	2012		2013				2014	
	Q3	Q4	Q1	Q2	Q3	Q4	Q1	April
6 -month deposits	3.49	3.55	3.52	3.56	3.55	3.59	3.51	3.48
12- month deposits	3.83	3.84	4.02	3.89	3.83	3.92	3.86	3.83
Weighted average	3.71	3.73	3.85	3.76	3.73	3.79	3.71	3.69

.Source : BAM

Chart 4.2: Term structure of TB interest rates in the Treasury securities market



**Observation of the second quarter of 2014 corresponds to the daily average of data from April 1st to May 27, 2014.*
Source : BAM.

dropped from 3.51 percent to 3.48 percent and the one-year deposit rate decreased from 3.86 percent to 3.83 percent.

Concerning Treasury bond yields on the primary market, after significant increases in 2013, short, medium and long-term rates continued broadly to decline in April, with changes ranging to 58 basis points for 5-year bonds. In the secondary market, the same trend pattern was registered for major maturities.

4.1.2 Money. credit and liquid investments

M3 growth

Despite a faster M3 growth from 3.2 percent in the first quarter to 4.2 percent in April, the monetary gap remained negative, indicating the absence of monetary inflationary pressures in the medium term.

Table 4.2: Change in Treasury bond yields on the primary market

	2012		2013				2014	
	Q3	Q4	Q1	Q2	Q3	Q4	Q1	april
21 days	-	-	-	-	-	-	-	-
24 days	-	3.71	-	-	-	-	-	-
35 days	-	3.78	4.12	-	-	-	-	-
43 days	3.48	-	-	-	-	-	-	-
44 jours	3.59	-	-	-	-	-	-	-
45 jours	-	3.97	-	-	-	-	-	-
13 weeks	3.31	3.40	3.93	3.94	3.50	3.48	3.30	3.10
26 weeks	3.42	3.57	4.07	4.11	3.82	3.74	3.45	3.20
52 weeks	3.74	3.84	4.20	4.23	4.11	4.13	3.63	3.27
2 years	3.93	4.24	4.57	4.68	4.61	4.69	4.04	3.47
5 years	4.32	4.52	4.75	-	4.93	5.08	4.62	4.04
10 years	4.51	4.84	-	-	5.42	5.60	5.43	-
15 years	4.74	5.08	5.52	5.69	5.71	5.85	5.87	5.36
20 years	5.01	-	-	-			-	-

Box 4.1: Liquidity and monetary policy implementation

During the first quarter of 2014, bank liquidity improved by 2.4 billion dirhams, despite the restrictive trends of autonomous factors (-4.6 billion dirhams). Indeed, the decline in the required reserve ratio from 4 percent to 2 percent caused a permanent liquidity injection of nearly 7 billion dirhams. The lower bank liquidity resulted from Treasury operations, which caused a drain of 7.1 billion dirhams. Bank subscriptions to T-bond auctions (49.7 billion dirhams) and the collection of the first installment of corporate taxes, combined with a decline in outstanding Treasury operations in the money market (-4.1 billion), significantly exceeded repayments of domestic debt to the banking system (39.3 billion dirhams), payment of civil service salaries (16.7 billion dirhams) and settlement of subsidy costs (6.9 billion dirhams). To a lesser extent, net withdrawals of currency in circulation, which reached 577 million dirhams, also contributed to tightening bank liquidity.

Chart B 4.1.1: Quarterly change in the impact of autonomous liquidity factors (in billion dirhams)

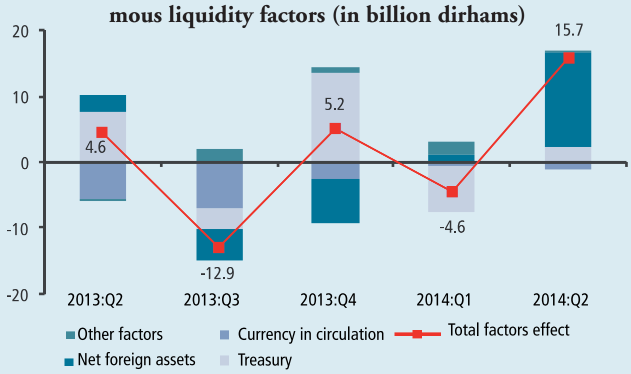


Chart B 4.1.2: Monthly change in the impact of autonomous liquidity factors (in billion dirhams)

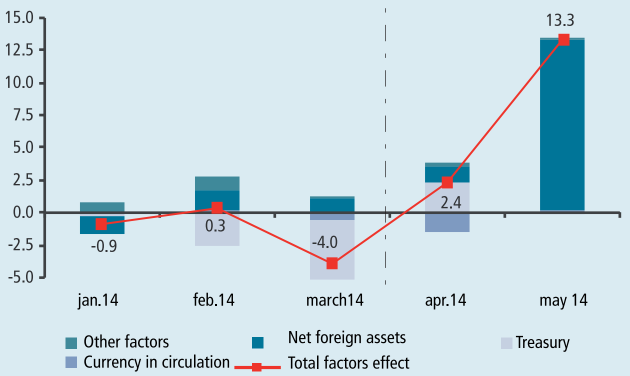


Chart B 4.1.3: Change in reserve requirements (in millions of DH)

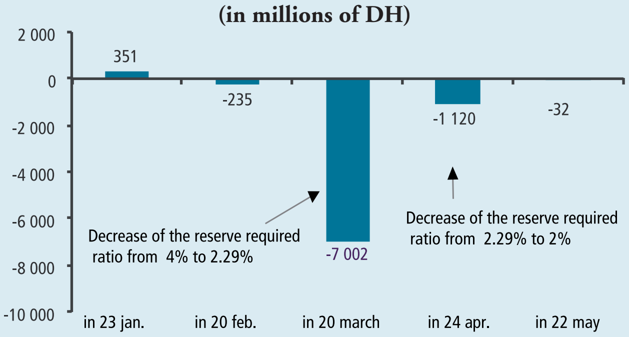
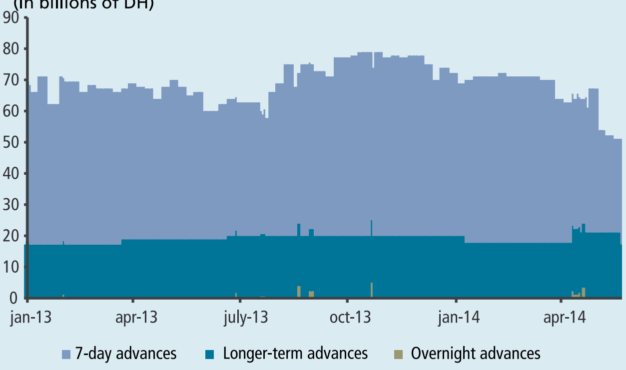


Chart B 4.1.4: BAM interventions on the money market



During the second quarter of 2014[1], bank liquidity continued to improve by 15.7 billion dirhams, due to the expansive trend of autonomous factors, mainly the trend of Bank al-Maghrib net foreign assets.

Indeed, foreign currency transactions had an impact of about 14.5 billion dirhams, mainly due to the sale to the Central Bank of an amount of an OCP bond issue made on international markets, totaling about $1.5 billion.

Similarly, Treasury operations caused a liquidity injection of 2.1 billion dirhams, due to the difference between:

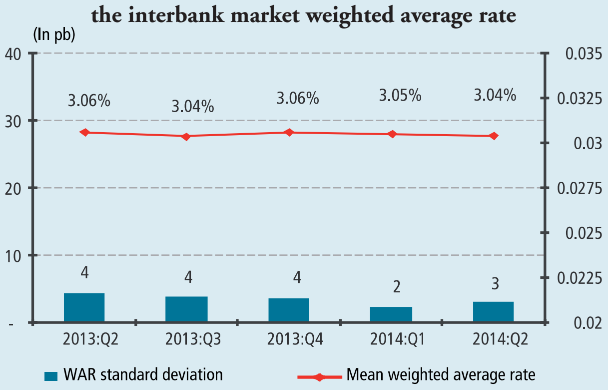
- On the one hand, the repayments of domestic debt to the banking system (14.3 billion dirhams), payment of civil service salaries (5.4 billion dirhams) and settlement of subsidy costs (3.3 billion dirhams), plus a liquidity injection of 9.2 billion from Treasury investments in the money market;
- On the other hand, bank subscriptions to T-bond auctions (12.3 billion dirhams) and tax and customs revenues.

The increase in the currency in circulation caused a liquidity drain of 1.2 billion dirhams.

Given the strong improvement of bank liquidity conditions, the overall outstanding amount of BAM's interventions decreased significantly. Indeed, 7-day advances totaled 38.6 billion on daily average from 52.1 billion in the first quarter. In addition, the outstanding amount of 3-month repo operations decreased by 4 billion dirhams to 6 billion dirhams, while the outstanding amount of secured loan operations under the VSME funding program rose by nearly 3 billion dirhams to 11 billion dirhams.

The money market weighted average rate was down one basis point from the average of the first quarter of 2014, reaching 3.04 percent. Its volatility stood at 3 basis points, up one basis point compared to the previous quarter.

Chart B 4.1.5: Change in the mean and standard deviation of the interbank market weighted average rate



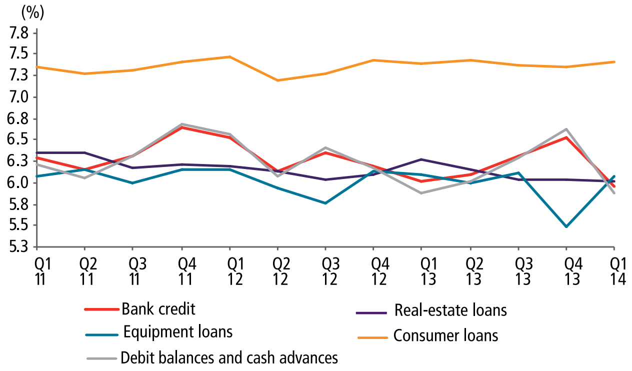
1- The period from April 1 to May 22, 2014.

The improvement in the M3 growth is mainly attributed to a faster growth of net international reserves, particularly following the collection of 1.55 billion corresponding to an OCP bond issue on the international market. Similarly, bank lending and net claims on central government accelerated slightly.

The analysis of the main components of the money supply show divergent trends. Thus, bank money rose by 6.7 percent as against 3.9 percent, mainly due to higher demand deposits with Bank Al-Maghrib. Time deposits showed an annual decrease of 6.6 percent as opposed to 4.1 percent. Overall, the annual growth of deposits, included in M3, decelerated from 3.2 percent to 2.9 percent. The annual growth of the other components of the money supply slowed down from 4.9 percent to 4.7 percent for currency in circulation, from 8.3 percent to 8.1 percent for demand deposits and from 4.3 percent to 1.9 percent for money market fund shares/units.

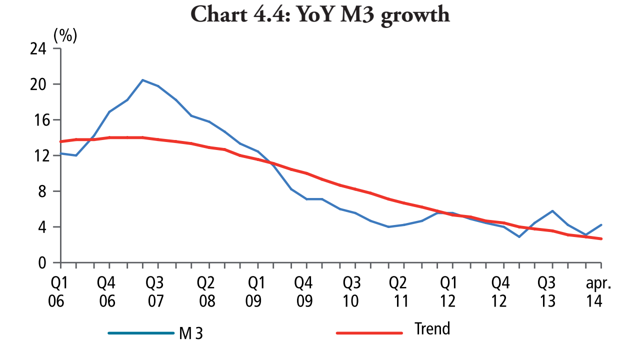
By economic unit, the slower growth of deposits included in M3 from 3.2 percent to 2.9 percent is attributed to a decrease in the contribution of all economic units, with the exception of that of households. The growth of households' deposits accelerated from 5.4 percent to 6.6 percent, thus contributing 5 percentage points to the growth of all deposits. In contrast, deposits of private nonfinancial corporations registered an annual decline of 8.8 percent, as opposed to 0.6 percent in the first quarter, with a negative contribution of 1.4 percentage point. Concerning deposits of financial companies, the annual growth decelerated from 5.3 percent to 4.6 percent, while public sector deposits continued their downward trend since March 2013.

Chart 4.3 : Change in lending rates*



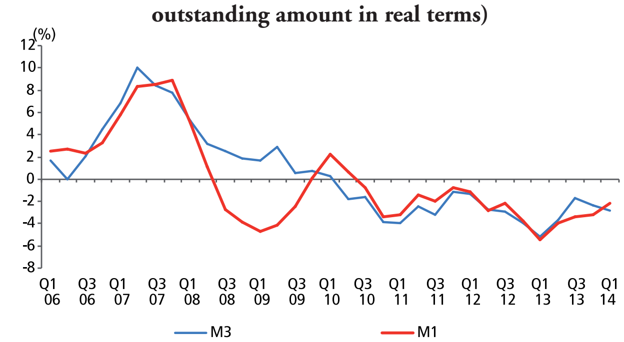
** As from Q3-2010. the survey sample was expanded to 80 percent of loans granted to nonfinancial customers (see the Methodological Note published on Bank Al-Maghrib website).*

Chart 4.4: YoY M3 growth



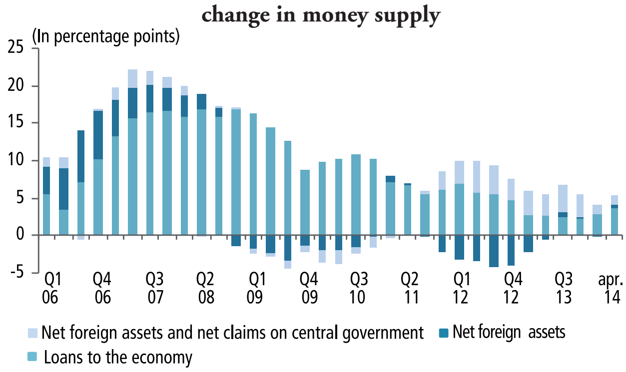
Source : BAM.

Chart 4.5: Money gap[1] (in percentage of M3 and M1 balance outstanding amount in real terms)



1. Money gap is the difference between the money stock recorded and its balance level. The latter. defined based on the quantity equation of money. corresponds to the change rate of the potential economic activity in real terms. minus the average rythm of money circulation velocity decrease.
Source : BAM.

Chart 4.6: Contribution of the major conterparts to YoY change in money supply



**Average between January and provisional figures for February 2014.*
Source : BAM.

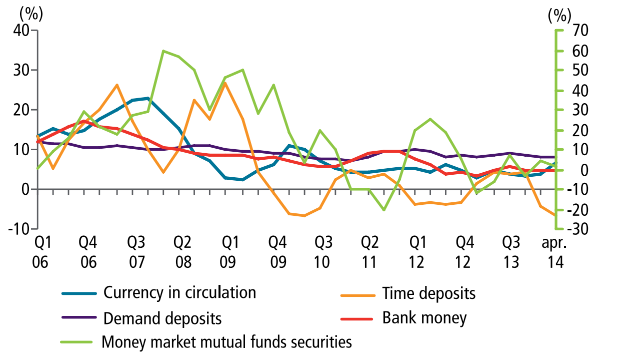
Credit

Data available at end-April 2014 show a faster annual growth of bank lending to 4.4 percent from 3.8 percent on average in the first quarter of 2014.

This change reflects an improved growth of all credit components, with the exception of real estate loans. The latter registered a year-on-year slowdown from 3.9 percent to 2.4 percent, reflecting a deceleration from 6.1 percent to 5.4 percent in housing loans and a further decline of 4.7 percent in loans to property developers, as against 1.9 percent in the previous quarter. However, after a decrease of 2.5 percent in the first three months of the year, cash advances were up 0.1 percent, year on year. At the same time, equipment loans and consumer ones rose by 2.7 percent and 2.1 percent, respectively, as against 1.1 percent and 1.6 percent a quarter earlier. The growth of nonperforming loans slowed down from 25 percent to 23.4 percent in April, with a ratio to bank credit standing at 6.4 percent.

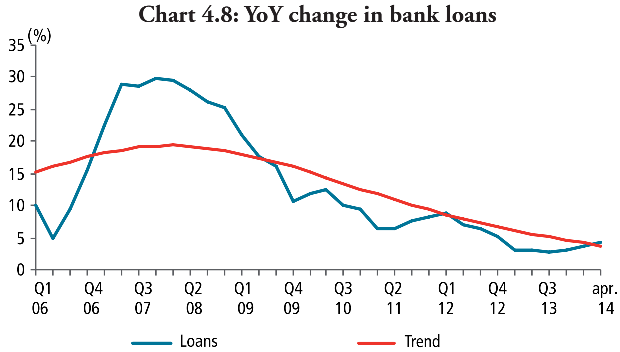
The analysis of bank loans by institutional sector shows an improved growth of credit to private and public sectors, and slower loans to other financial corporations. Indeed, loans to the private sector increased by 3.8 percent in April from 2.6 percent in the first quarter, bringing their contribution to bank credit growth from 2.2 points to 3.2 percentage points. This change reflects a rise of 1.9 percent in loans to nonfinancial corporations, after a decline of 0.6 percent, and a deceleration from 7.6 percent to 7 percent in those granted to households. Similarly, credit to the public sector showed an annual increase of 3.1 percent after a decline of 1.9 percent on average during the

Chart 4.7: YoY change in the major M3 components



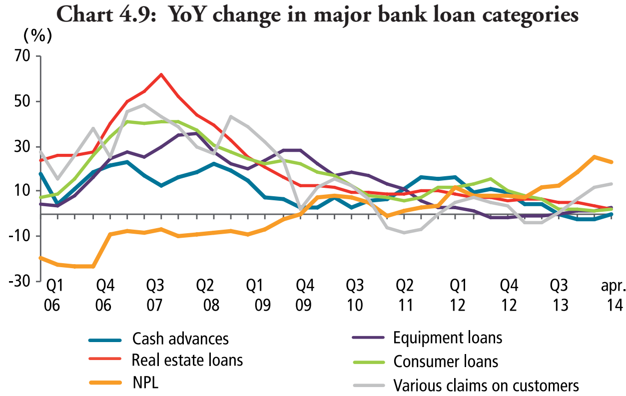
Source : BAM.

Chart 4.8: YoY change in bank loans



Source : BAM.

Chart 4.9: YoY change in major bank loan categories



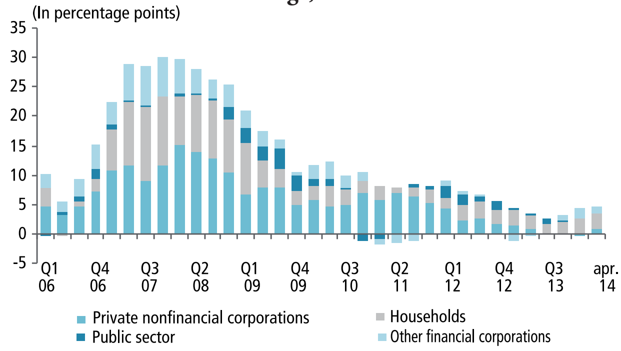
Source : BAM.

first three months of 2014. Conversely, the annual growth of loans to other financial corporations slowed down from 14.8 percent to 8.8 percent in April, thus bringing their contribution to credit growth from 1.7 percentage point to one point.

BAM's lending conditions survey indicates overall a tighter supply conditions in the first quarter 2014 compared to the fourth quarter of 2013. This tightening would have concerned individuals in particular, mainly housing loans and consumer ones. As to businesses, credit supply conditions would have remained almost unchanged from the fourth quarter of 2013. Credit demand would have fallen for companies and concerned equipment loans and credit to property developers, while loans to individuals remained unchanged from one quarter to another.

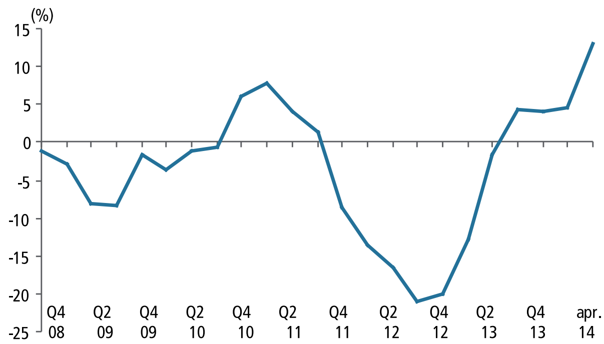
Regarding loans to nonfinancial sectors not included in the money supply counterparts, data as at end-March 2014 indicate a 1.8 percent increase in loans granted by finance companies, as against 0.3 percent in the fourth quarter of 2013, year on year. This trend is particularly due to an increase of 15.2 percent in factoring loans, after a decrease of 3.6 percent in the previous quarter. Conversely, the leasing annual growth slowed down from 0.5 percent to 0.2 percent, while consumer loans showed a decline of 0.7 percent, as against an increase of 0.5 percent. Loans accorded by offshore banks scored an annual contraction of 8.6 percent as opposed to 2.4 percent in the previous quarter, reflecting a decline of 1.4 percent in cash advances, as opposed to a 3.3 percent increase, and an easing in the decrease of equipment loans from 11.8 percent to 6.6 percent.

Chart 4.10: Contribution of institutional sectors to credit change, YoY



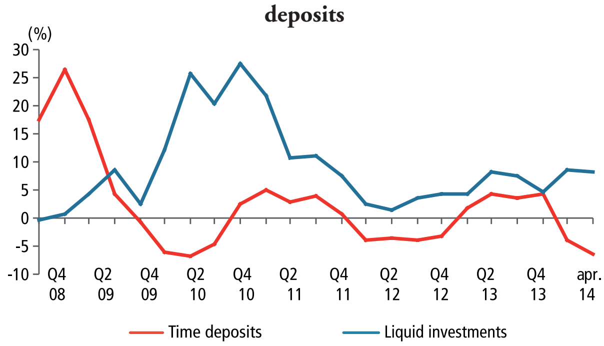
Source : BAM.

Chart 4.11: Annual growth of net international reserves



Source : BAM.

Chart 4.12: YoY change in liquid investments and time deposits



Source : BAM.

Other sources of money creation

Net international reserves (NIR) strengthened by 13.1 percent in April from 4.6 percent in the first three months of the year, mainly in conjunction with the collection of 1.55 billion corresponding to a OCP bond issue on the international market.

Net claims on central government rose 8.2 percent, year on year, as against 8 percent in the previous quarter. This change reflects an acceleration from 13.3 percent to 18.8 percent in the growth of Treasury bills held by banks and a sharp decline in money market shares/units to 40.7 percent as against 4.8 percent a quarter earlier .

Liquid investments

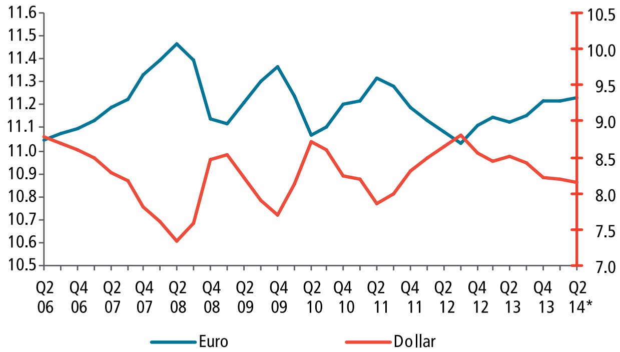
Liquid investment aggregates increased by 8.2 percent in April 2014, as against 8.7 percent in the first quarter. This change was mainly due to a slower growth of the LI1 aggregate from 9.3 percent to 3.8 percent, mainly reflecting a deceleration from 11.3 percent to 6.2 percent in the growth of negotiable Treasury bonds1. Meanwhile, bond fund shares/units included in the LI2 aggregate showed an increase of 18.3 percent in April, compared to 8.4 percent on average during the first three months of 2014, particularly in conjunction with a higher asset value following a decline registered overall in Treasury bond yields in the secondary market. In the same vein, equity and diversified fund shares/units, which compose the LI3 aggregate, rose 6.7 percent in April, as against 3.8 percent in the first quarter.

Exchange rate

In April and May 2014, the dirham depreciated by 0.10 percent against the euro, while it appreciated by 0.49 percent versus the dollar.

The dirham's effective exchange rate, calculated on the basis of the bilateral exchange rates with Morocco's major trading partners and competitors, appreciated 0.57 percent in nominal terms compared to the fourth quarter of 2013. The appreciation of the national currency is slightly less significant in real terms, or 0.34 percent, due to an inflation rate of Morocco broadly lower than that of the main partners and competitors.

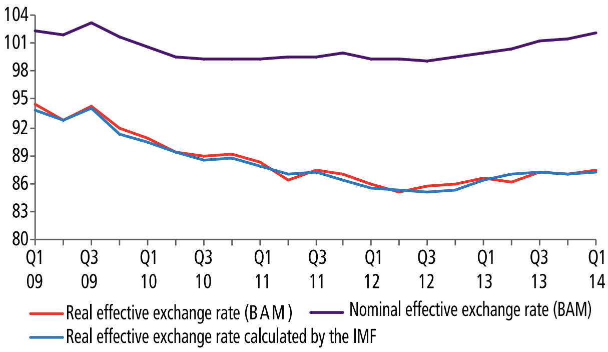
Chart 4.13: Exchange rate of the dirham



** Observation of the second quarter 2014 corresponds to the arithmetic average of data from April 1 to May 22, 2014.*

Source : BAM.

Chart 4.14: Real and nominal effective exchange rate of the dirham (2000=100)



Sources: IMF and BAM calculations.

1 They include outstanding Treasury bills, property of money holders.

4.2. Asset prices

4.2.1 Real estate assets

In the first quarter of 2014, real estate prices almost stagnated, quarter on quarter, following a 0.4 percent decline in residential property prices, and respective increases of 0.4 percent and 3.8 percent in land prices and commercial property ones. In contrast, the number of transactions decreased by 2.6 percent, after a 6.4 percent increase in the previous quarter, mainly reflecting respective declines of 3.3 percent and 6.3 percent in residential property transactions and land ones. Commercial property sales rose by 16.9 percent.

Compared to the same period of 2013, prices rose slightly in the first quarter of 2014, or 0.1 percent. This trend mainly covers a 4.4 percent increase in commercial property prices and a slight decrease in residential ones. The number of transactions moved up 10.1 percent, due to higher sales of all property types.

4.2.2 Financial assets

4.2.2.1 Shares

In late May, the MASI rose 4.2 percent, as against 4.4 percent in the first quarter of 2014. This trend, which confirms a further recovery since the last quarter of 2013, was primarily driven by respective performances of 13.3 percent, 6.3 percent and 2.6 percent in the sectors of "construction and building materials", "real estate" and "telecommunications".

Regarding the valuation indicators, after having declined in the first quarter of 2014, the Price Earnings Ratio appreciated by 2.2 basis points to 17.7 and the Price to Book Ratio stood at 2.39 from 2.31 at the end of March 2014.

Chart 4.15: Change in real estate price index

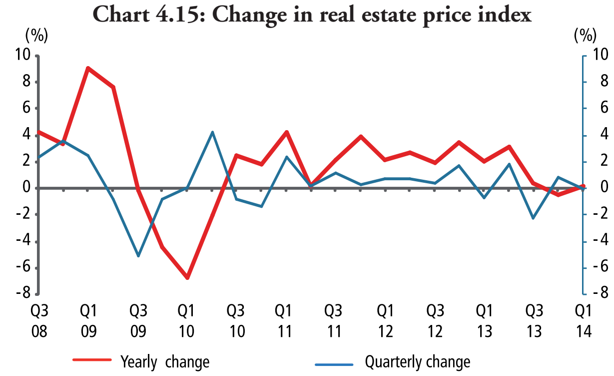
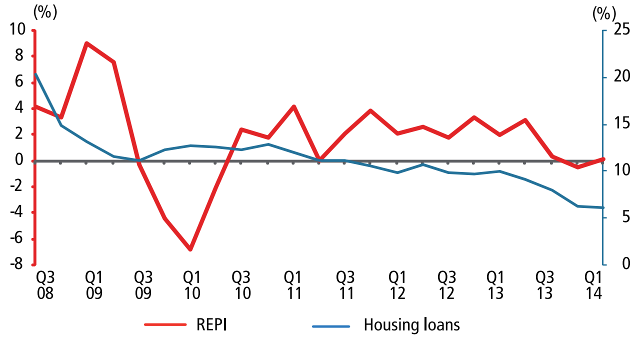


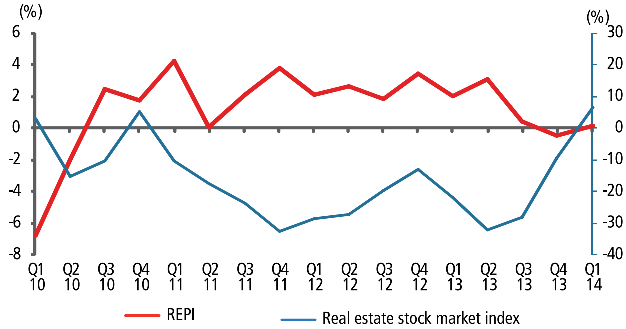
Chart 4.16: YoY change in the REPI and housing loans*



** Housing loans do not include loans to real estate developers.*

Sources: BAM and ANCFCC.

Chart 4.17: YoY change in the REPI and the real estate stock market index

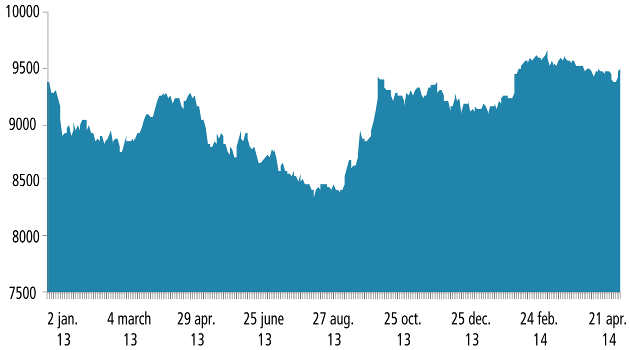


Sources: BAM, ANCFCC and Casablanca Stock Exchange.

Market capitalization stood at end-May at 469.4 billion dirhams, up 4 percent since the beginning of the year, mainly due to the appreciation of the MASI over the same period.

During the first two months of the second quarter, the average daily volume of transactions on the central market declined significantly to 57.1 million from 85.2 million dirhams in the first quarter of the year. On the block market, the total trading volume during the first two months of the second quarter stood at 3.4 billion dirhams from 2.9 billion in the first quarter.

Chart 4.18: Daily change in MASI

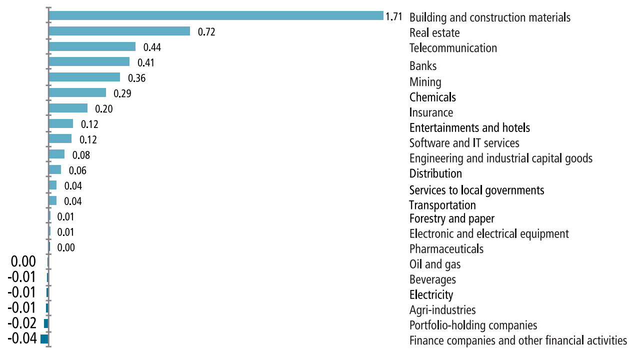


Source: Casablanca Stock Exchange.

4.2.2.2 Treasury bonds

Until late May, Treasury bond issues reached 62.7 billion dirhams from 75.6 billion over the same period of 2013. The breakdown of these issues by maturity reveals that the Treasury focused since the beginning of 2014 on medium and long terms, with respective shares of 33.7 percent and 59.3 percent. Taking into account repayments of 46.3 billion dirhams, outstanding treasury bills reached 427.9 billion dirhams.

Chart 4.19: Year-to-date performance of sectoral indexes, in %



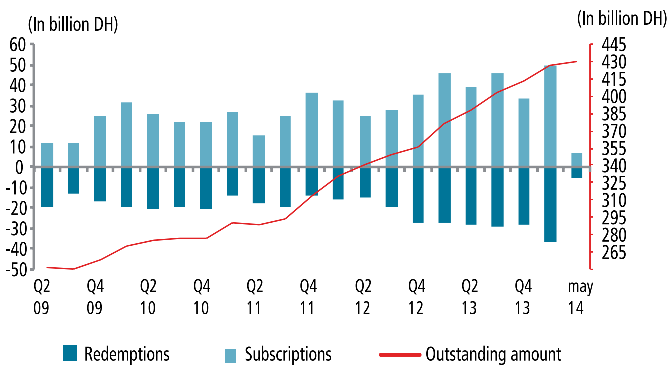
Source: Casablanca Stock Exchange.

4.2.2.3 Other debt securities

In the first five months of 2014, issues of negotiable debt securities rose by 74 percent compared to the same period of 2013, to 29.7 billion dirhams. This change reflects a significant increase in banks' bill issues, which totaled 23.7 billion dirhams from 12.5 a year earlier.

In contrast, corporate emissions on this compartment reached 4.5 billion, almost stagnating compared to the same period of last year. Taking into account

Chart 4.20: Change in outstanding Treasury bonds

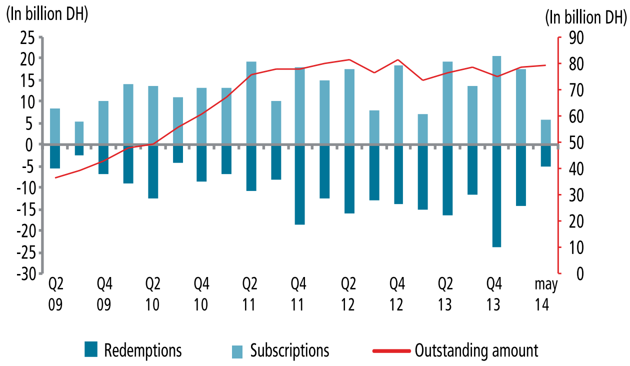


repayments of 25.9 billion dirhams, the outstanding amount stood at-end April at 78.9 billion.

4.2.2.4 Mutual funds

At the end of the first quarter of 2014, the net assets of mutual funds reached 253.5 billion dirhams, up 3.3 percent from one quarter to the next. This change is primarily attributed to respective increases of 7.2 percent and 1 percent in bond funds and equity ones. Data as at May 25, 2014 indicate that the net assets of mutual funds increased by 7.2 percent since the beginning of the year.

Chart 4.21: Change in Treasury bonds outstanding amount



5. RECENT INFLATION TRENDS

The first months of 2014 were marked by a persistently and relatively lower inflation rate, standing at 0.4 percent in April and on average in the first quarter, while it stood at 1 percent in the fourth quarter of 2013 and 1.9 percent throughout the previous year. In addition to the sharp decline in volatile food prices, this trend was mainly due to a deceleration in core inflation (CPIX), down from 1.5 percent in 2013 to 1.3 percent in the first quarter and 1.1 percent in April 2014. By component, this decline covers a stable inflation of tradables (CPIXT) at 1.5 percent, in a context of continued disinflationary trends in Morocco's main trading partners, and a decrease in inflation of nontradables (CPIXNT) from 1.7 percent in 2013 to 0.9 percent in the first quarter and 0.6 percent in April 2014. Moreover, in a context of continued decline in global commodity prices, industrial producer prices continued to drop since February 2013, with a decline of 1.2 percent in April after that of 3.7 percent in March.

5.1 Inflation trends

After having averaged 1.9 percent in 2013, the inflation rate was low during the first four months of the year, mainly due to lower volatile food prices and slower core inflation.

Indeed, between March and April, it remained stable at 0.4 percent, covering a stability at 4.8 percent in the pace of decline of volatile food prices, mainly covering drops of 41.1 percent in prices of citrus and 5.3 percent in prices of fresh vegetables. The contribution of all these products to inflation stood at -0.7 percent in the last two months.

Prices of "fuels and lubricants" grew faster from 7.3 percent in March to 9.9 percent in April, primarily due to a diesel subsidy reduction on April 16. The price increase in other administered products decelerated from 1.4 percent in February to 0.7 percent in March and April, reflecting the dissipation of the effect of higher tobacco prices in March 2013.

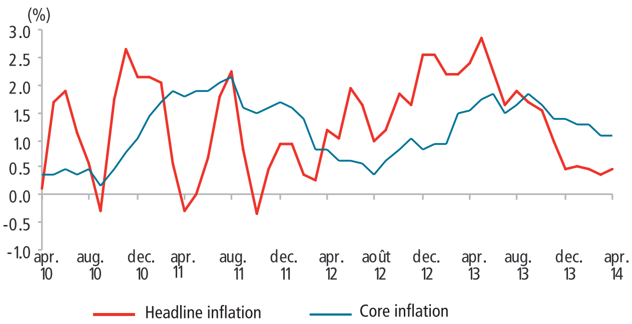
Excluding volatile food and administered products, core inflation remained stable at 1.1 percent. This change reflects a faster increase from 0.7 percent to 1.3 percent in transport prices, a decline

Table 5.1: Inflation and its components

	Monthly change (%)			YoY (%)		
	Feb. 13	March 14	Apr. 14	Feb. 13	March 14	Apr. 14
Inflation	**-0.2**	**-0.3**	**0.1**	**0.4**	**0.4**	**0.4**
- Volatile price food products	-2.3	-2.3	-0.2	-5.7	-4.8	-4.8
- Fuels and lubricants	5.6	0.2	2.4	7.1	7.3	9.9
- Administered goods excluding fuels and lubricants	-0.1	0.1	0.1	1.4	0.7	0.7
Core inflation	**0.0**	**-0.1**	**0.1**	**1.3**	**1.1**	**1.1**
- Food products	0.0	-0.1	-0.1	1.1	1.0	0.9
- Clothing and footwear	0.0	0.0	-0.2	2.6	2.5	2.5
- Housing. water. gas. electricity and other fuels*	0.0	0.0	0.4	2.5	2.1	1.8
- Furniture. household appliances and common house maintenance	0.2	0.3	0.0	0.6	0.8	0.8
- Health*	0.6	0.5	0.0	3.1	3.5	3.4
- Transportation*	0.0	0.0	0.6	1.0	0.7	1.3
- Communication	0.0	0.0	0.0	-9.0	-9.0	-9.0
- Entertainment and culture	-0.4	0.0	0.0	-1.0	-1.0	-1.0
- Education	0.0	0.0	0.0	3.5	3.5	3.5
- Restaurants and hotels	0.0	0.3	0.0	3.3	3.7	2.6
- Miscellaneous goods and services	0.0	0.0	0.0	1.6	1.1	1.0

** Excluding administered goods.*
Sources: HCP. and BAM calculations.

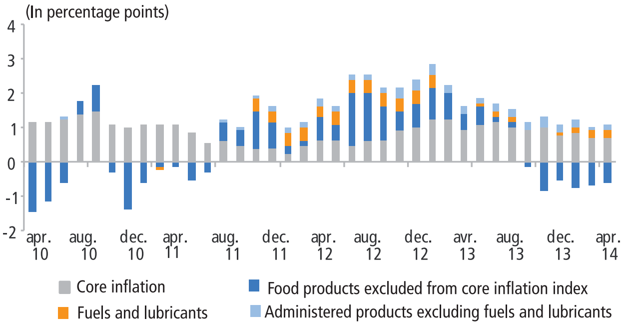
Chart 5.1: Headline inflation and core inflation, YoY



Sources: HCP, and BAM calculations.

from 3.7 percent to 2.6 percent in "restaurants and hotels" prices and a virtual stagnation in other headings.

Chart 5.2: Contribution of the prices of major CPI items to inflation, YoY



Sources: HCP, and BAM calculations.

Table 5.2: Domestic oil selling prices

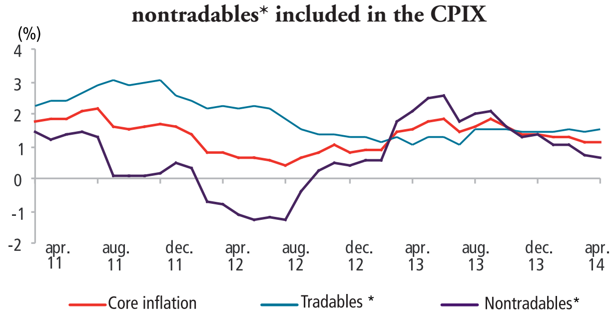
Products (DH/Liter)	As from 16 march 14	1 apr. 14.	16 apr. 14	1 may 14	16 may 14	1 June 14
Premium gasoline	12.91	12.98	13.12	13.32	13.13	13.27
Diesel 50	8.88	8.88	9.20	9.20	9.20	9.20
Industrial fuel (Dh/Tonne)	5 846.5	5813.2	5 837.8	5 837.9	5 752.2	5 883.2

Source : Ministry of Energy and Mining.

5.2 Tradable and nontradable goods

Price analysis by category of goods indicates that core inflation trend results from a relative stabilization of inflation of both tradable (CPIXT) and nontradables (CPIXNT). Indeed, in a context of continued disinflationary trend in Morocco's key trading partners, prices of tradables remained almost unchanged at 1.5 percent since August 2013. Their contribution to core inflation remained constant at 0.8 percentage point over the same period.

Chart 5.3: YoY change in the prices of tradables* and nontradables* included in the CPIX



** Excluding volatile food and administered products.*

Sources: HCP, and BAM calculations.

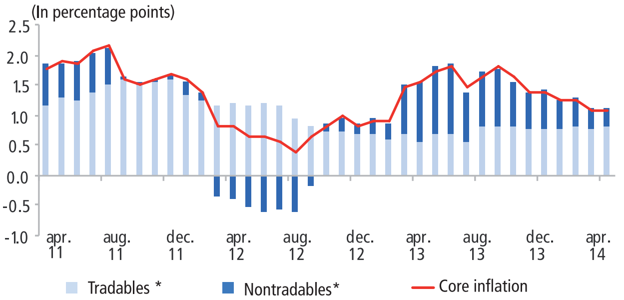
Table 5.3: Change in the price indexes of tradables* and nontradables* included in the CPIX

	Monthly change (%)			YoY change (%)		
	Feb. 14	March 14	Apr. 14	Feb. 14	March 14	Apr. 14
Tradables	0.1	0.0	0.0	1.5	1.4	1.5
Nontradables	0.0	0.0	0.1	1.0	0.7	0.6

Sources: HCP, and BAM calculations.

Inflation of nontradables remained almost unchanged at 0.6 percent between March and April, as against 1 percent in January and February and 1.7 percent on average in 2013. Their contribution to core inflation decreased from 0.8 percentage point in 2013 to 0.5 in January and February and to 0.3 in March and April, thus constituting the main source of deceleration of core inflation. However, the change in inflation of nontradables covers divergent trends across its components. The growth of restaurant and renting prices slowed down, while transportation prices recorded an acceleration. Other headings, mainly "education" and "communications" evolved at the same pace as the previous month.

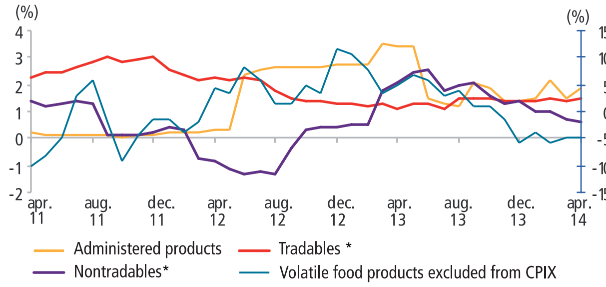
Chart 5.4: Contribution of tradables* and nontradables* to core inflation



** Excluding volatile food products and administered goods.*

Sources: HCP, and BAM calculations.

Chart 5.5: YoY change in the prices of tradables* and nontradables*



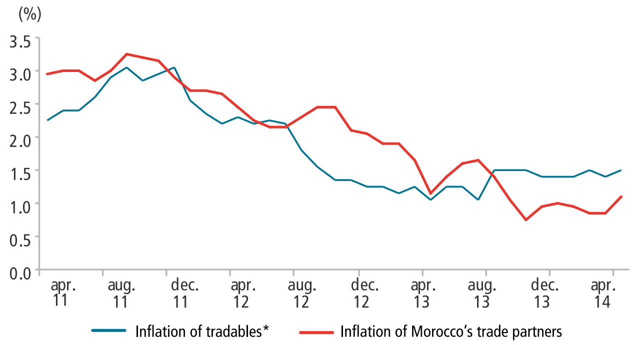
** Excluding volatile food and administered products.*

Sources: HCP, and BAM calculations.

5.3 Goods and services

The breakdown of the consumer price index (CPI) in goods and services shows that the stable inflation rate at 0.4 percent covers a slight deceleration from 1.1 percent to 1 percent in inflation of processed goods excluding fuel and lubricants, while the inflation rate of unprocessed goods remained at -2.9 percent. These trends more than offset a slight acceleration from 1.2 percent to 1.3 percent in prices of services and an increase from 7.3 percent to 9.9 percent in prices of fuels and lubricants. The contribution of these two components to inflation stood at 0.7 percentage point from 0.6 point a month earlier.

Chart 5.6: YoY change in inflation of tradables* and inflation in trade partner countries



** Excluding volatile food and administered products.*

Sources: HCP, IFS, and BAM calculations.

Table 5.4: Price indexes of tradables and nontadables excluding volatile food and administered products

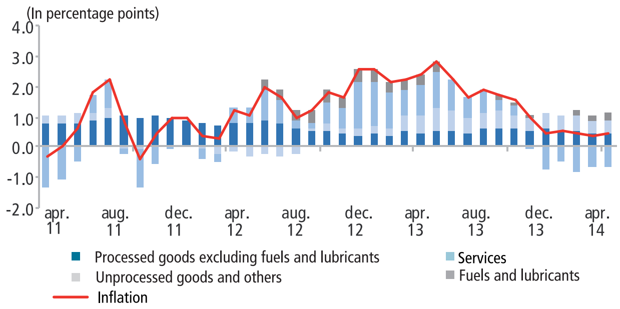
	Monthly contribution to inflation		Yoy contribution to inflation	
	March 14	Apr. 14	March 14	Apr. 14
Products excluded from core inflation index	**-0.3**	**0.1**	**-0.4**	**-0.3**
Including:				
Administered products	-0.3	0.0	-0.7	-0.7
Volatile food products	0.0	0.1	0.3	0.4
Tradables*	**0.0**	**0.0**	**0.5**	**0.5**
Nontradables*	**0.0**	**0.0**	**0.2**	**0.2**

** Excluding volatile food and administered products.*
Sources: HCP, and BAM calculations.

5.4 Industrial producer price index

Industrial producer price index showed a monthly decline of 0.1 percent in April, after rising 0.1 percent a month earlier. This change reflects drops of 1.1 percent in "coke and refining" prices and 0.6 percent in prices of "clothing industry" and "electrical machinery and equipment", as well as increases of 0.1 percent in food prices and 1 percent in prices of "wood and wood products".

Chart 5.7: Contribution of goods and services prices to inflation, YoY



Sources: HCP, and BAM calculations.

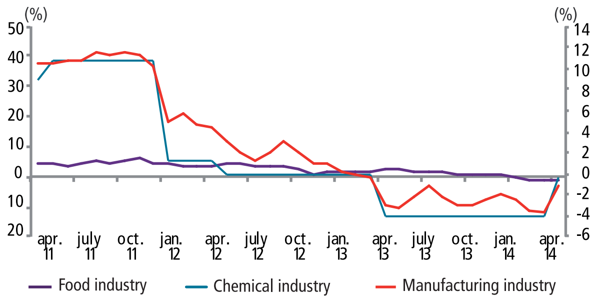
Table 5.5: Price indexes of goods and services

	Monthly change (%)			YoY change (%)		
	Feb. 14	March 14	Apr. 14	Feb. 14	March 14	Apr. 14
Processed goods*	0.0	0.0	-0.1	1.3	1.1	1.0
Unprocessed goods and others	-1.3	-1.4	-0.1	-3.4	-2.9	-2.9
Services	0.0	0.0	0.3	1.5	1.2	1.3
Fuels and lubricants	5.6	0.2	2.4	7.1	7.3	9.9

** Excluding fuels and lubricants.*
Sources: HCP, and BAM calculations.

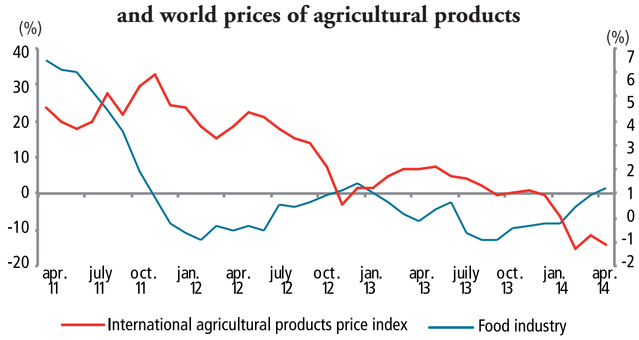
Year on year, the decline in industrial producer prices that started in February 2013 eased in April to -1.2 percent after declines of 3.7 percent in March and 3.4 percent in February. This trend reflects mainly changing prices of "coke and refining" from -8.9 percent to -7 percent and "chemical industry" from -13.6 percent to 0 percent. At the same time, prices rose by 2.9 percent for "wood of wood products" and by 3.4 percent for "paper and cardboard".

Chart 5.8: YoY change in industrial producer price indexes



Sources: HCP, and BAM calculations.

Chart 5.9: YoY change in domestic food industrial producer prices and world prices of agricultural products

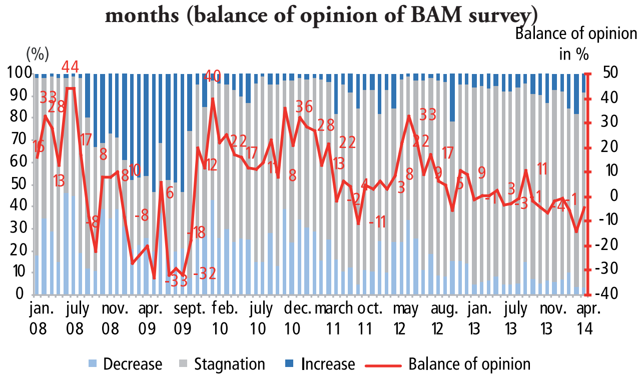


Sources: World Bank, HCP, and BAM calculations.

5.5 Inflation expectations

The findings of BAM's business survey for April 2014 indicate that industrial producer prices should not change significantly over the next three months. Indeed, 88 percent of corporate managers anticipate a price stagnation, 8 percent expect a decrease and 4 percent project an increase (Chart 5.10).

Chart 5.10: Trend in industrial producer prices in the next three months (balance of opinion of BAM survey)

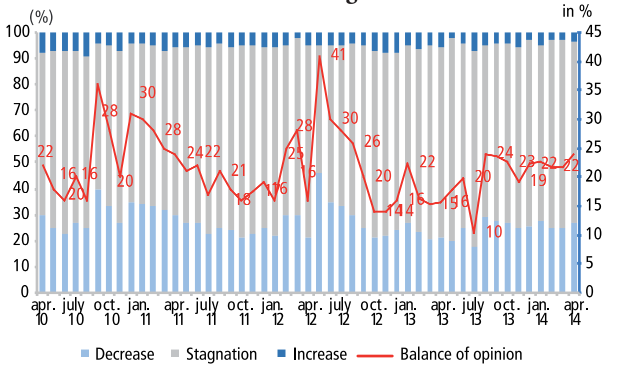


Source: BAM monthly business survey.

The same survey also indicates a continued moderation in inflation within three months. Thus, 70 percent of corporate managers expect in April a stagnation of inflation, while 27 percent expect an acceleration of the general price level over the same period (Chart 5.11).

Moreover, according to the findings of the quarterly survey of Bank Al-Maghrib on inflation expectations for the first quarter of 2014, the financial sector experts expect a moderate increase in inflation over six quarters from 2.3 percent to 2.4 percent.

Chart 5.11: Corporate managers' inflation expectations for the three coming months



Source: BAM monthly business survey.

6. INFLATION OUTLOOK

This section presents the inflation trend deemed most probable (central forecast) over the next six quarters and examines the major risks associated thereto (balance of risks). The baseline forecast scenario depends on the assumptions and developments considered for a series of variables affecting economic activity and inflation. This scenario takes into account the recent government decision to partially index some energy prices, as provided for by decrees No. 3-01-14 and No. 31-14. Assuming the non-realization of the major risk factors identified, the inflation trend over the next six quarters remains in line with the price stability objective, with an average forecast of about 1.3 percent, below the average rate predicted in the last MPR (2 percent). In 2014, inflation should be around 0.9 percent. In the first three quarters of 2015, it should average around 1.5 percent. In this forecasting exercise, the balance of risks is broadly neutral. Externally, risks are associated with a lower-than-expected growth in key partner countries and potential increases in international prices for energy commodities and staple products. Internally, they come from a weaker-than-expected momentum of domestic demand and a more pronounced -than-expected effect of higher oil prices and minimum wage.

6.1 Baseline scenario assumptions

6.1.1 International environment

The reversal of global growth dynamics becomes more marked from one quarter to the next, reflecting the consolidation of fundamentals in advanced countries and greater uncertainties in many emerging countries. Indeed, despite an unusually severe winter in the United States and the escalation of geopolitical tensions in Europe, production trended positively in these economies. It took advantage of stable commodity prices, gradually relaxed fiscal adjustments and an accommodative monetary policy. Meanwhile, emerging economies continue to suffer from pressures coming from intensified investors' concerns following the worsening of macroeconomic imbalances, especially in countries with higher inflation and increasingly significant current account deficits. In addition, the expected improvement in yields in developed countries, due to the gradual withdrawal of non-standard monetary policy measures announced by the Fed could further weaken capital flows to some emerging countries, thus increasing the volatility of financial markets and fears about depression of their currencies. However, the stronger recovery in the United States, Europe and Japan should have positive effects on exports of emerging economies.

In this context, the euro area should register in the first quarter of 2014 a growth of 0.9 percent from 0.5 percent in the fourth quarter of last year. This estimate reflects faster growth in Germany (to 2.3 percent in Q1 2014 from 1.4 percent in Q4 2013), positive economic trends in France (0.8 percent in both Q1 2014 and Q4 2013), a recovery in production in Spain after several quarters of negative growth (0.5 percent after a decline of 0.2 percent in Q4 2013) and gradual easing of recession in Italy (-0.5 percent as against -0.9 percent in Q4 2013).

These changes primarily reflect a renewed vigor in both consumption and investment. Indeed, household spending rose, as evidenced by the volume of retail sales, which moved up by 0.7 percent in the first quarter of 2014, after declining 0.5 percent in the fourth quarter of 2013. Similarly, during the first months of 2014, the average level of production of capital goods, an advanced investment indicator, rose slightly by 1.2 percent, due to a 0.8 percent increase in the fourth quarter of 2013. In addition, after several quarters of mixed trends, the production of the construction sector increased slightly at the beginning of the year (0.1 percent), particularly thanks to relatively favorable winter conditions in Europe.

In contrast, the positive profile of growth in the euro area remains constrained by a number of weaknesses. In this regard, passenger car registrations fell 2.6 percent in the first quarter of 2014, after increasing 5.2 percent in the last quarter of 2013. Furthermore, the latest survey from the European Commission with manufacturing corporate managers showed that the capacity utilization rate declined in the first quarter of 2014 and for the first time since early 2013. Finally, despite its higher volume, foreign trade contributed negatively to growth in the first quarter of 2014, due to a more significant change in imports compared to exports.

Unlike production, recent data on the euro area's labor market point to a mixed trend. On the one hand, the slight drop in the unemployment rate, from 12 percent in the fourth quarter of 2013 to 11.7 percent in April of this year, would suggest the first signs of a trend reversal. On the other hand, strong disparities still persist across countries. Indeed, the lowest level in Germany, where unemployment stagnated at 5.2 percent between December 2013 and April 2014, contrasts with the rate of 12.6 percent registered in Italy during the same period and the slight increase in France (from 10.2 percent to 10.4 percent). Meanwhile, Spain is still experiencing one of the highest unemployment rates in Europe, although it continues its downward trend from 25.6 percent in December 2013 to 25.1 percent in April 2014.

Against this backdrop, inflation remains relatively low in the euro area. It still evolves below the ECB target levels, mainly due to moderation in commodity prices and persistently significant underutilized productive potentials. Thus, the downward price trend observed at the end of 2013 continued in 2014, as inflation fell from 0.8 percent in December to 0.5 percent in May.

With regard to the U.S. economy, despite the difficult weather conditions at the beginning of the year, a growth rate of 2 percent is expected in the first quarter of 2014, down compared to the fourth quarter of 2013 when growth had reached 2.6 percent. This change reflects the uptrend of private consumption spending, residential investment and government expenditure, which offset the decline in non-residential investment, inventories and exports.

In line with the positive trend of the economic activity, the labor market continues to show a favorable profile in the United States. Indeed, unemployment fell from 6.7 percent in December 2013 to 6.3 percent in April 2014. In addition, based on the OECD economic outlook of May, the short-term unemployment almost returned to its pre-crisis level and the previously discouraged workers increasingly reenter the labor market.

Inflation, which is still following the trend observed in recent months, continued its upward change in the United States from 1.5 percent in December 2013 to 2 percent in April of this year. This trend is due to a rebound in energy prices and an increase in food prices, albeit moderate.

Taking into account all these developments, the IMF, in its update of April, projects a growth of 1.2 percent in 2014 and 1.5 percent in 2015 in the euro area. For the United States, it forecasts a growth of 2.8 percent and 3 percent in 2014 and 2015, respectively. Compared with March MPR, the growth forecasts were kept unchanged for the U.S.

economy and revised slightly upward for the euro area from 1 percent and 1.4 percent in 2014 and 2015, respectively.

Downside risks to the economic outlook persist, although the resilience of advanced economies in recent quarters has reduced the intensity of these risks. Thus, the low inflation rates, particularly in the euro area, still raise concerns. The continuation of this trend could raise prematurely real interest rates, increase the actual public and private debt burden and increase risks of deflation in case of downturn. In the banking sector, concerns persist regarding the lack of reforms in restoring the viability of banks' balance sheets. Indeed, these reforms aim at restoring market confidence and encouraging banks to pass on the improvement in their funding conditions to borrowers. However, a limited success of this policy could jeopardize corporate debt restructuring, whose balance sheets remain fragile. Regarding the monetary policy, a faster-than-expected withdrawal of non-standard measures adopted by the Fed could exacerbate tensions in U.S. financial markets and spread to other financial markets through spillover effects. Finally, the escalation of geopolitical tensions in oil, gas, food (mainly corn and wheat)-exporting regions would result in a surge in commodity prices, which could undermine prospects for stronger global growth.

Under these conditions, the weighted average growth rates of Morocco's major trading partners (Germany, Spain, France, Italy and the United Kingdom) assumed in this forecasting exercise stand at 1.1 percent in 2014 and 1.3 percent in 2015. Compared to March MPR projections (growth rates of 0.9 percent and 1.2 percent in 2014 and 2015, respectively) and in line with recent developments, the growth forecast of Morocco's key partners was revised slightly upward. For the record, these rates are calculated on the basis of an average weighted by these countries' respective shares in Moroccan foreign trade.

Regarding inflation forecasts, the Fed, in its latest monetary policy report, anticipates inflation to range between 1.4 percent and 1.6 percent in 2014 and between 1.5 percent and 2 percent in 2015. Meanwhile, the ECB, in its bulletin of May, expects inflation at 0.9 percent in 2014 and 1.3 percent in 2015, down from the previously reported levels. In the medium term, risks to inflation in the euro area remain broadly balanced, due to uncertainties surrounding the economic activity, exchange rates and commodity prices.

Against this backdrop, projections of non-energy import prices, included in the forecasting models developed by Bank Al-Maghrib, expect a decline in 2014. In 2015, the indicators point to a stagnation of import prices in conjunction with the mixed prospects for demand from emerging countries, major non-energy commodity-importing countries.

6.1.2 National environment

Domestic growth prospects for 2014 remain broadly in line with those of the previous Monetary Policy Report. However, economic growth was revised slightly downward, particularly owing to uncertainties about the domestic demand trend. In addition, after boosting domestic growth in 2013, the agricultural component would show an average profile.

Indeed, the Ministry of Agriculture and Fisheries announced that cereal production in the crop year 2013/2014 should reach 67.3 million quintals, a level slightly below the projections reported in the March MPR (70 million quintals). This change should lead to a decline in the agricultural value added in 2014, after a 19 percent increase in 2013. For 2015 and given the lack of visibility, an average cereal production is assumed.

With regard to nonagricultural activities, the expected recovery, due to an improved international outlook, seems to assert itself in the first half. Thus, tourism performs well, as evidenced by a 3.8 percent increase in receipts in late April. Similarly, Morocco's new global business sectors confirmed their export performance, with the automotive industry being the most notable sector, as it increased by about 50 percent in the first quarter 2014. Nevertheless, traditional sectors (phosphates, construction and textiles) accumulate underperformances, thus continuing negative trends that started since last year.

In terms of demand, household consumption would continue to support growth, thanks to the continued price moderation, positive trends of consumer loans, albeit under deceleration (2.1 percent in April 2014), expected recovery of remittances from Moroccan living abroad and recent increases in the minimum wage. Private investment remains surrounded by uncertainties, as evidenced by the stabilization of the equipment loan growth (2.7 percent in April) and the continuous decline in imports of capital goods (-9 percent at end-April). However, after several quarters of recession, the return to growth in partner countries is likely to support national non-phosphate exports.

In view of all these developments, nonagricultural GDP should rebound to 4 percent in 2014 from 2.3 percent a year earlier. Hampered mainly by the contraction of the agricultural value added, overall growth would thus be between 2.5 percent and 3 percent. The main uncertainties surrounding these forecasts relate to the extent of recovery in foreign demand and its impact on traditional export sectors, as well as future trends in domestic demand.

On the labor market, the unemployment rate showed in the first quarter of 2014 its third consecutive increase. Data for the first quarter of 2014 indicate a year-on-year increase in the unemployment rate of 0.8 percent, thus standing at 10.2 percent from 9.4 percent in the first quarter of 2013. This change covers a 0.9 percent increase in urban unemployment to 14.6 percent and a 0.7 percent rise in rural areas to 5.1 percent.

However, according to the BAM's quarterly business survey, manufacturers broadly anticipate a virtual stagnation of employed workforce in the current quarter, covering stability in chemical and related industries, and food and textile industries, as well as a slight decline in employment in mechanical and electronic industries. Furthermore, in accordance with the decisions taken as part of the social dialogue, the central scenario of this forecasting exercise includes a 10 percent increase in the minimum wage announced by the government (5 percent in July 2014 and 5 percent in July 2015).

Finally, in connection with improved supply conditions and moderating growth in emerging countries, the World Bank, in its April edition, revised slightly downward its forecasts for oil prices, which now stands at $103 and $99 dollars in 2014 and 2015, from $103.5 and $ 99.8 per barrel reported earlier. The IMF, in its update of April, revised slightly upward its oil price forecasts in 2014, from $103.8 to $104.1, while 2015 projections were revised downward from $98.4 to $ 97.9. Overall, these estimates remain subject to uncertainties, due to the persistence of production disruptions in Libya and a possible escalation of the Ukraine crisis tensions.

Against this backdrop, taking into account the new provisions of the indexation system, as provided for in the Head of Government's decrees No. 3. 01.14 of January 15, 2014, the diesel price at the pump should increase gradually in 2014.

6.2 Inflation outlook and balance of risks

Assuming the non-materialization of the major risks described below, the central forecast for the next six quarters is expected to stand at 1.3 percent, below the average rate projected in the last MPR (2 percent). Similarly, inflation forecast for 2014 shows an average rate of 0.9 percent, lower than the rate reported in the previous March MPR. In the first quarter of 2015, inflation should stand at about 1.6 percent, which is lower than the rate reported in the previous MPR. In the second quarter, inflation should stand at 1.5 percent from 2.3 percent reported in the previous MPR and will stagnate at the same rate in the third quarter of 2015.

These projections are based on assumptions deemed most probable. However, there are several sources of uncertainty stemming from both the future developments of exogenous variables and forecasting models, which may affect the inflation rate either upward or downward. The analysis of the balance of risks generates a forecast range, represented as a fan chart. It is a probabilistic assessment of uncertainty areas surrounding the central forecast (Chart 6.1).

The balance of risks to the baseline scenario of this exercise is neutral. Externally, the risks are associated with a lower-than-expected growth in key partner countries and a potential increase in international prices for energy commodities and staple products. Internally, they come from a weaker-than-expected domestic demand and a more pronounced-than expected effect of higher oil prices and minimum wage. The materialization of one or more of these risks could cause the inflation rate to deviate from the central forecast, at a value included in the forecast range represented in the fan chart (with a probability 90 percent).

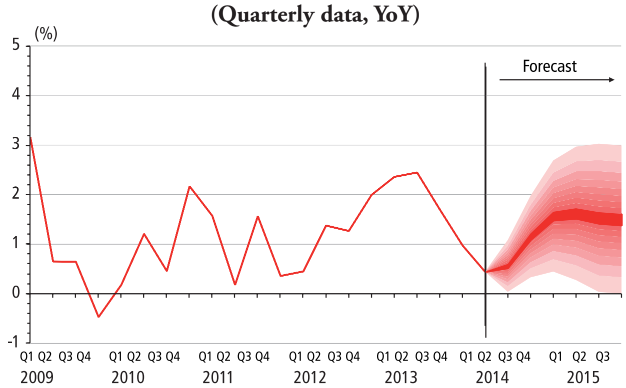
Table 6.1: Inflation outlook for 2014 Q2 –2015 Q3

	2014			2015			Average	FH*
	Q2	Q3	Q4	Q1	Q2	Q3	2014	
Central forecast (%)	0.6	1.2	1.6	1.6	1.5	1.5	0.9	1.3

(Quarterly data. YoY)

**Forecast horizon*

Chart 6.1: Inflation forecast, 2014 Q2 – 2015 Q3 (Quarterly data, YoY)



(*) This chart represents the confidence interval of inflation forecast based on the baseline scenario (dark red); confidence intervals between 10 percent and 90 percent are also reported. Each addition of intervals with the same color. on both sides of the central forecast. increases by 10 percent the probability that inflation would fall within the range set by these intervals. Therefore. if we consider the range delimited by the fifth interval around the central forecast. this means that we have a 50 percent chance that inflation would fall within this range in the future

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