



## Monetary Policy Report

Document prepared for  
the Bank Board  
19 June 2007

بنك المغرب

بنك المغرب  
بنك المغرب

---

## LIST OF ABBREVIATIONS AND SYMBOLS

AWI	:	Average Wage Index
BAM	:	Bank Al-Maghrib
CLI	:	Cost of Living Index
CNSS	:	Caisse nationale de sécurité sociale (National Social Security Fund)
GFCF	:	Gross fixed capital formation
GDP	:	Gross Domestic Product
HCP	:	High Commission for Planning
IMF	:	International Monetary Fund
INAC	:	Institut national d'analyse et de conjoncture (National Institute for Analysis and Economic Condition)
MASI	:	Morocco All Shares Index
OCP	:	Office chérifien des phosphates
CIH	:	Crédit immobilier et hôtelier (Real Estate and Hotel Sector Credit)
CAM	:	Crédit agricole marocain (Moroccan Agricultural Credit)
OMPIC	:	Office marocain de propriété industrielle et commerciale (Moroccan Industrial and Commercial Property Office)
VAT	:	Value Added Tax

## TABLE OF CONTENTS

<b>Overview</b>	<b>5</b>
<b>1. Overall demand trend</b>	<b>6</b>
1.1 Output	6
1.2 Consumption	7
1.3 Investment	7
1.4 Foreign trade	8
<b>2. Pressures on output capacity</b>	<b>9</b>
2.1 Pressures on capacity	9
2.2 Pressures on the labor market	9
<b>3. Import prices</b>	<b>11</b>
3.1 World inflation	11
3.2 Oil prices	11
3.3 Import prices	11
<b>4. Monetary conditions and asset prices</b>	<b>13</b>
4.1 Monetary conditions	13
4.2 Asset prices	19
<b>5. Recent inflationary trends</b>	<b>20</b>
<b>6. Inflation outlook for 2007</b>	<b>21</b>
6.1 Central forecast assumptions	21
6.2 Inflation outlook and balance of risks	22

---

## OVERVIEW

Price indices at the end of April 2007 show a moderation in the general trend of prices, compared to the same period of the previous year. The cost of living index was up 2.2%, year-on-year, while underlying inflation increased by 1.4%, compared to 3.1% and 2.9% respectively a year earlier. This slackening is confirmed by the evolution of the other indicators which reflect an easing of pressures on demand and, therefore, on the general level of prices.

Given a still lower-than-expected cereal harvest of 20.5 million quintals, the revised growth data indicate a contraction of about 18% in the agricultural added value while activity in the other sectors is expected to keep rising at a sustained pace. Against this background, overall growth, estimated at nearly 2%, should stand below its potential pace, particularly during the first three quarters. Moreover, the output capacity utilization rate in the industrial sector was still trending downwards at the end of April. Taking into account the let-up in activity, output capacity should undergo no significant pressures.

Concerning non-oil import prices, their moderating impact on inflation is projected to wane compared to the trend observed over the last few years. Oil price is still high and will probably remain so in the short and medium-term.

As regards monetary conditions, the current monetary policy decisions and the recent development of liquidity put upward pressures on interest rates, especially short-term rates. Monetary growth, for its part, remained strong, mainly thanks to increase in loans which is due, in turn, to solid non-agricultural growth.

For the year 2007 as a whole, inflation is most probably expected to hover around 2.3% as opposed to 3.3% in 2006 (central forecast). Compared to the projections of 27 March 2007 Monetary Policy Report, it was slightly revised upwards (+0.2%). Over the forecasting horizon (from the 2nd quarter of 2007 through the 1st quarter of 2008), inflation is expected to stand at 2.2%.

## 1. OVERALL DEMAND TREND

Growth outlook for 2007 seems less favorable than expected. The latest estimates show a contraction of about 17.2% in the agricultural added-value. Taking into account the consolidation of growth in the other sectors, overall GDP is expected to increase by 1.6%. National final consumption is forecast to grow more slowly than last year, owing to a fall-off in resident household expenditure notably under the effect of dropping rural revenues. On the other hand, investment is projected to increase in most sectors, except agriculture, while exports should evolve differently depending on product categories.

### 1.1 Output

Economic growth during the first half of 2007 seems less promising, owing to a nearly 18% decrease in the agricultural output. At 35% compared with a standard year, the rainfall deficit had a negative impact on crop yield, especially cereals.

Non-agricultural GDP performed better and should grow at 4.6% in the first quarter of 2007. This evolution should concern all branches of activity, with relatively high growth rates in building and public works, trade, transportation and telecommunications (see Table 1.1).

Mining activities should keep dynamic in the first half of 2007. Their growth could reach 5% in the first quarter on the back of accelerating world demand for this sector, especially for raw phosphates. The latter recorded a 12% increase in exports in the first quarter and are expected to continue at almost the same pace in the second quarter of 2007.

The energy activity, which shrunk during the fourth quarter of 2006, appears to have gone up by 2.3% in the first quarter of 2007. During the second quarter, refining activity should almost stagnate in the event of a slowing down in crude oil imports, which would be due to high international oil prices.

In the industrial sector, growth outlook for the first half of 2007 seems more favorable. The sector's added value is expected to rise by 4.5%, due to the dynamism of clothing industries under the effect of increasing orders from Europe. This rise would also result from the sustained growth in mechanical, metallurgical, electric and electronic industries which benefited from the strengthening of foreign demand for car, electronic, and metallurgical industries. So far as agri-food industries are concerned, they are projected to increase strongly in the first quarter of 2007, driven by the improvement of foreign demand for canned fruits, vegetables and fish.

**Table 1.1 Quarterly GDP growth in volume by main branch of activity (Base year= 1980)**

	2006				2007	
	TI	TII	TIII	TIV	TI*	TII*
<b>Agriculture, forestry and fishing</b>	<b>30.3</b>	<b>32.2</b>	<b>29.9</b>	<b>30.3</b>	<b>-18.0</b>	<b>-18.0</b>
<b>Non-agricultural GDP</b>	<b>3.4</b>	<b>4.4</b>	<b>3.2</b>	<b>4.6</b>	<b>4.6</b>	<b>4.3</b>
Mining industry	-2.9	0.2	0.3	9.1	5.0	3.5
Energy	-0.1	1.9	-1.6	-1.0	2.3	2.0
Processing industries	3.9	5.1	2.9	2.7	4.5	4.4
Building and public works	7.7	6.0	6.6	6.3	7.5	7.0
Trade	8.8	8.9	6.7	6.5	6.3	6.7
Transport and communication	6.2	5.6	6.2	5.0	6.5	6.0
Other market services	3.4	3.5	3.1	4.1	3.2	3.5
General government	-1.5	1.2	-0.3	3.8	3.2	3.5
Import duties and taxes	3.6	5.0	4.9	4.	3.5	2.5
<b>Gross Domestic Product</b>	<b>6.7</b>	<b>7.9</b>	<b>6.5</b>	<b>7.4</b>	<b>1.3</b>	<b>0.9</b>

Source: HCP, BAM calculations

(\*) BAM forecasts

#### GDP at current prices Yearly evolution in%

	2004	2005	2006	2007
<b>Gross domestic product</b>	<b>4.8</b>	<b>4.5</b>	<b>10.1</b>	<b>4.2</b>
<b>National final consumption including :</b>	<b>6.2</b>	<b>3.7</b>	<b>7.0</b>	<b>5.8</b>
- Resident household	5.1	2.7	7.8	4.6
- General government	9.4	6.9	4.6	9.4
GFCF	10.8	11.7	10.9	11.8
Exports of goods and services	8.2	13.3	14.8	
Imports of goods and services	<b>15.3</b>	<b>14.8</b>	<b>11.9</b>	<b>14.5</b>

Building and public works will continue to grow at a high rate over the first half and during the remainder of the year given the important volume of public and private investments. The development of residential construction should also contribute to this boom, sustained by the growth in real estate loans.

Trade, transportation and telecommunication activities should keep on an uptrend, with growth rates above 6% and 6.5% over the first half of 2007.

For the year 2007 as a whole, HCP forecasts, which were revised downwards based on a cereal harvest of 20.5 million quintals, show a 17.2% decline in the agricultural added value, whereas secondary activities and services should post an overall rise of 4.7%. On the whole, GDP is projected to increase by 1.6% at constant prices, compared to 8% in 2006, and by 4.2% at current prices.

### 1.2 Consumption

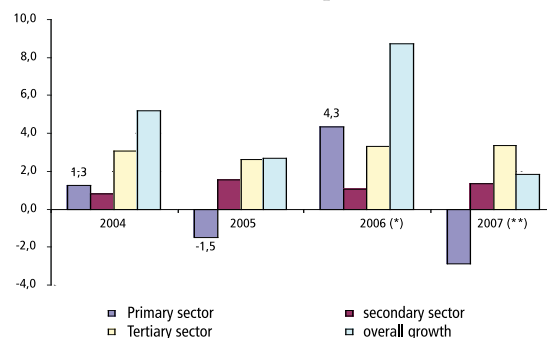
After a 7% increase at current prices in 2006, national consumption should rise by around 5.8% in 2007. This slowdown should mainly result from resident household consumption, due to increase by 4.6%, compared to 7.8% in 2006, following the drop in agricultural revenues. On the other hand, the readjustment of the income tax rates and the growth in remittances by Moroccans living abroad, at 15.1% at the end of April, would reinforce household disposable income. Moreover, the expansion of consumer credit (+39.5% at the end of April 2007, year-on-year) should sustain consumer spending.

General government consumption is expected to grow by more than 9.4%, compared to 4.6% in 2006.

### 1.3 Investment

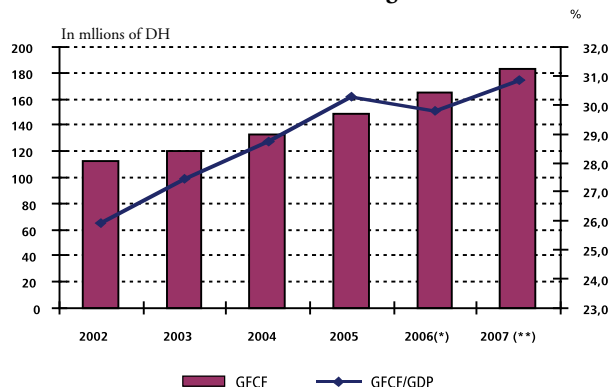
Gross fixed capital formation is forecast to increase at a sustained rate of 11.8% throughout 2007. This dynamism should particularly concern the sectors of industry, building and public works as well as services with growth reaching 11%, 12% and 14%. Concerning the building and public works sector, its expansion is attributed to the implementation of basic infrastructure projects and rising demand for housing, owing to the measures implemented to support social housing and the growth of real estate credit.

Chart 1.1: Sectoral contribution to overall growth (in number of points)



Source: HCP and BAM estimates

Chart 1.2: Investment growth



Source: HCP and BAM estimates

In addition to the development of existing capacities, business creation is considerably growing, as evidenced by the 35% rise in the number of incorporation certificates issued by the OMPIC (Moroccan Industrial and Commercial Property Office) in the first two months of 2007.

Furthermore, foreign direct investments grew by nearly a quarter, amounting to 8.3 billion dirhams, thus keeping on the uptrend observed over the last five years.

Throughout the year 2007, capital expenditure, at around 191 billion dirhams, is projected to increase by 4.9%, compared to the previous year. The investment rate, excluding changes in inventories, is expected to move up from 28.7% in 2006 to around 30.4% in 2007.

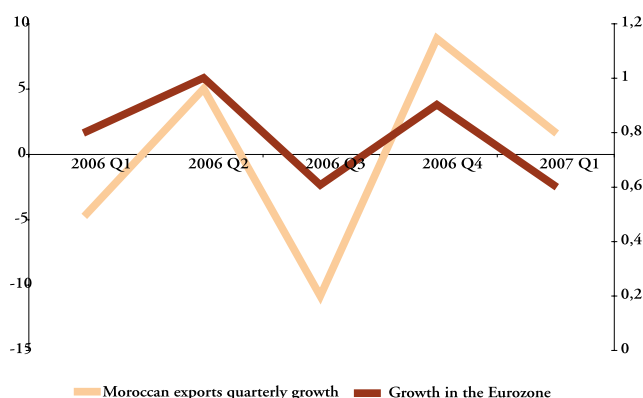
### 1.4 Foreign Trade

During the first quarter of 2007, the slowdown of economic growth in the Eurozone contributed to the deceleration of foreign demand for Moroccan goods. Under these circumstances, Moroccan exports almost stagnated while imports grew considerably, thus widening the trade deficit by 22.2%, compared to the first quarter of 2006.

Exports value dropped 0.5% from one quarter to the next. This evolution is due, in particular, to the decline of deliveries of capital and consumer goods and of phosphoric acids whose price decreased on the international market.

Conversely, imports increased again by 6% in the first quarter of 2007. This rise is notably the result of growing domestic demand linked mainly to the strong productive activity, which was reflected in the marked increase in capital goods orders and the growing foodstuff imports. On the other hand, the easing of oil prices uptrend, from 59 dollars to 57.2 dollars a barrel from one quarter to the other, brought the energy bill down 9.7% during the period under review.

Chart 1.3 : Moroccan exports and growth in the Eurozone



Source : Foreign Exchange Office, IMF



## 2. PRESSURES ON OUTPUT CAPACITY

Bank Al-Maghrib estimates of the overall output gap, measuring the difference between actual and potential output, show that it was negative during the first quarter of 2007, on account of the substandard agricultural performance at the beginning of the 2006-2007 campaign. As to non-agricultural output gap, it was positive, though lower than last year, which points to less inflationary pressures. Likewise, the evolution of the output capacity utilization rate in the industrial sector revealed the existence of spare output capacities, which should allow to meet the growing demand and avoid pressures on price.

### 2.1 Pressures on capacity

During the first quarter, economic growth was lower than the potential growth of the national economy.

The HCP estimates for the first quarter of 2007 show a slowdown of overall GDP growth, from 6.7% in 2006 to 1.3% in 2007 as a result of the weak agricultural performance. On the other hand, non-agricultural growth sped up in the first quarter of 2007 to about 4.6%, up 1 point of percentage, compared to the same period of 2006. Therefore, although on the decrease, non-agricultural output gap remains positive in the first quarter of 2007.

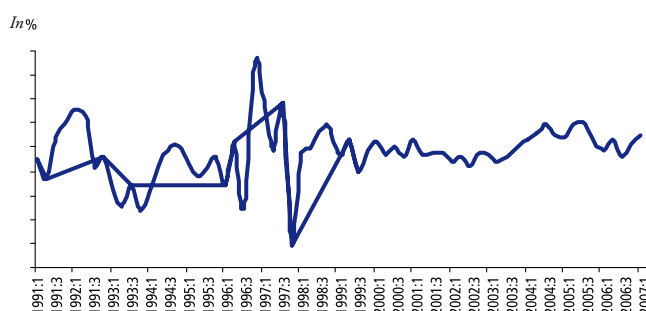
In the industrial sector, output capacity utilization rate continued to drop. After falling from 76.5% to 72.7% between the fourth quarter of 2006 and the first quarter of 2007, it stood at 69% in April. This change in the output capacity utilization rate indicates an easing of demand pressures on industrial products prices.

The development of the apparent labor productivity, measured as the non-agricultural GDP/urban employment ratio, also highlights the pressures on output capacity. Started since 2003, the upward trend of the apparent labor productivity in the non-agricultural sector slightly slowed down in 2006, before resuming its uptrend in the first quarter of 2007.

### 2.2 Pressures on the labor market

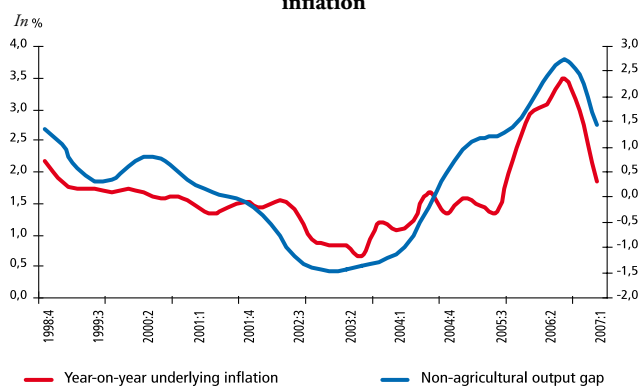
In the first quarter of 2007, the labor market recorded a net job creation of 369,000 jobs, 172,000 of which in urban areas, compared to 78,000 new jobs over the same period last year. The main job providers are the sectors of "industry and handicraft", with 104,000 jobs and "agriculture,

Chart 2.1: Year-on-year growth of non-agricultural GDP



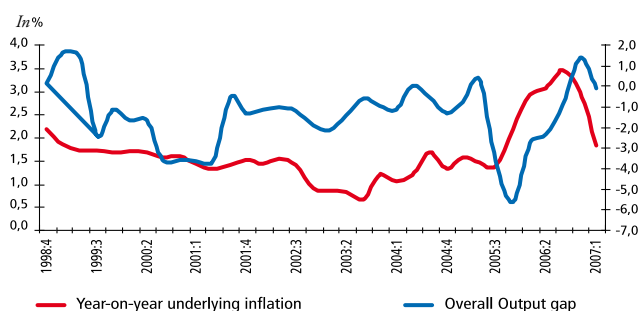
Source : HCP

Chart 2.2: Market non-agricultural output gap and underlying inflation



Source : HCP, Bank Al-Maghrib estimates

Chart 2.3: Underlying inflation and lagged overall output gap



Source : HCP, Bank Al-Maghrib estimates

forest and fisheries” with 228,000 jobs, as the impact of the poor agricultural campaign on agricultural employment only started to be noticed from March 2007.

Nevertheless, job creation turned out to be growing more slowly than the labor force, leading to a rise by 89,000 in the number of the unemployed, and a slight increase in the unemployment rate which stood at 15.8% in urban areas and 10% at the national level (Table 2.1).

Regarding wages, the latest data available from the quarterly index, calculated by the HCP on the basis of CNSS data, show a rise of 4.2% in nominal terms and 0.9% in real terms for the year 2006 as a whole. Combined with the decrease in 2006 of the apparent labor productivity in the non-agricultural sector, this evolution indicates that the unit costs of work in real terms have probably increased in 2006.

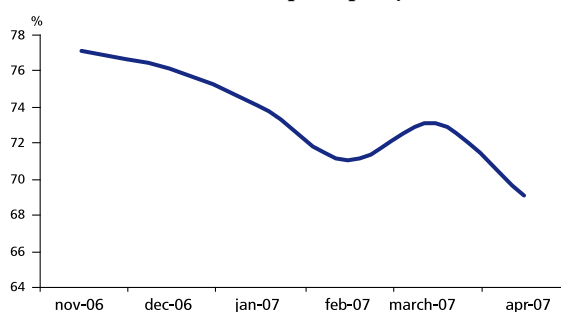
**Table 2.1: Labor market indicators**

	2004	2005	2006	2007
Rate in %	Q1	Q1	Q1	Q1
National occupied workforce <sup>1</sup>	4.3	-0.8	-0.9	1.3
Urban occupied workforce <sup>1</sup>	5.0	-0.2	0.4	2.2
National employment rate <sup>1</sup>	48.0	47.0	46.3	46.8
Urban employment rate <sup>1</sup>	38.0	37.2	37.9	38.6
National unemployment rate	12.0	11.3	9.8	10.0
Urban unemployment rate	19.8	19.2	15.4	15.8
National workforce participation rate	54.6	53.0	51.3	52.0
Urban workforce participation rate	47.4	46.1	44.8	46.9

Source : HCP

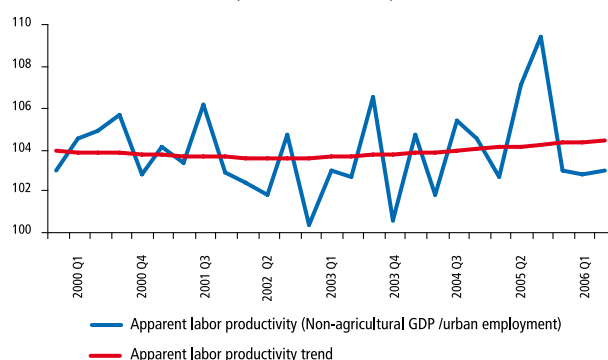
(1) : Year-on-year change.

**Chart 2.4: Industrial output capacity utilization rate**



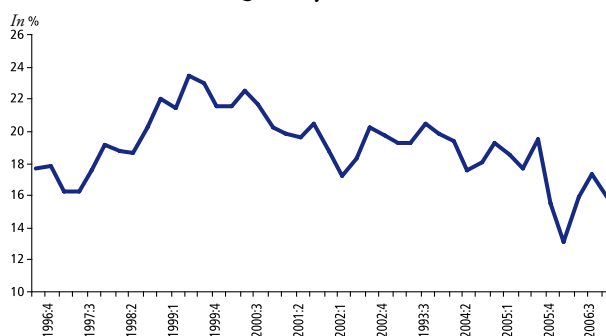
Source: BAM

**Chart 2.5: Apparent labor productivity (Base 100=1998)**



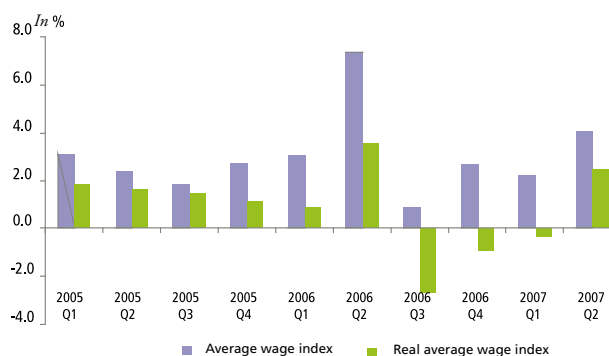
Source: HCP, Bank Al-Maghrib estimates

**Chart 2.6: Urban unemployment rate (Quarterly data)**



Source: HCP

**Chart 2.7: Average wage index in the private sector in real and nominal terms**



Source: HCP, CNSS

### 3. IMPORT PRICES

The import prices of consumer goods continued the uptrend started since the third quarter of 2006. As to oil prices, they picked up during the first five months of 2007, thus breaking off with the downtrend observed since September 2006, but remained below their level in the same period of the previous year.

#### 3.1 World inflation

Against a backdrop of monetary policy tightening by the main central banks, inflation slowed down in the main industrial countries at the beginning of the second quarter of 2007 (Table 3.1).

This trend is expected to continue in 2007 on the assumption that oil prices would remain below their level in 2006 and that restrictive monetary policies would be kept in force.

**Table 3.1: Recent evolution of world inflation**

On a year-to-year basis

	2005	2006	2007		
	april	april	april	2006	2007
United States	3.5	3.5	2.6	3.2	1.9
Eurozone	2.1	2.5	1.9	2.2	2.0
France	1.8	1.7	1.3	1.9	1.7
Spain	3.5	3.9	2.4	3.6	2.6
Japan	0.1	-0.1	0.0	0.2	0.3

Sources: International Monetary Fund

#### 3.2 Oil prices

After the drop recorded since September 2006, oil prices were trending upwards in the first five months of 2007. The barrel price averaged 60.36 dollars in the first five months of the year, compared to 63.92 in the same period of last year.

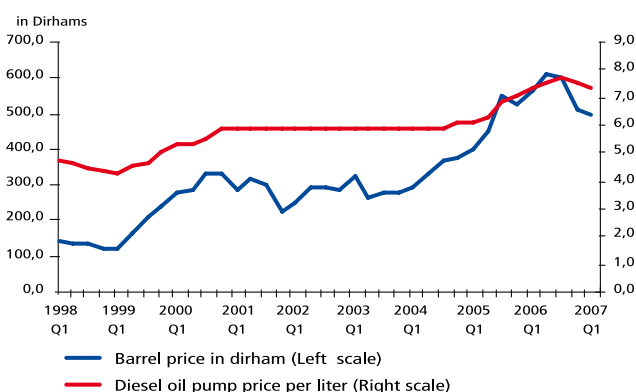
For the year 2007 as a whole, the barrel price should not exceed 60.75 dollars according to the last estimates of the IMF. However, the short-term outlook is uncertain due mainly to geopolitical tensions and falling refinery output capacity and demand.

In Morocco, pump prices, which are indexed to international oil prices, have remained unchanged since their reduction in January 2007. Assuming that the increase in international prices would not exceed 10%, these prices should not change during the remainder of 2007.

#### 3.3 Import prices

During the last few years, import prices kept trending downwards mainly due to the level of international prices and to the process of tariff dismantling. The average import prices of consumer goods eased markedly, especially for dollar-denominated products, thus having moderating effects on inflation.

**Chart 3.1: International oil prices and pump prices in Morocco**



Sources: Ministry of energy and mining and IMF

**Table 3.2: Domestic selling prices of oil products**

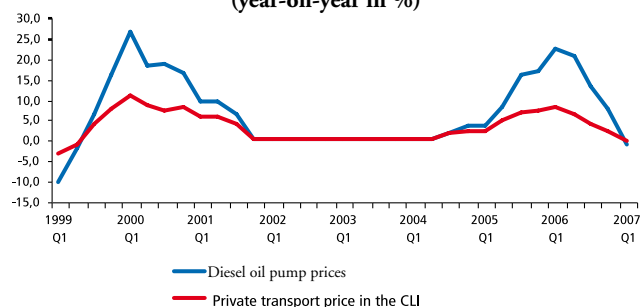
In DH

	2005		2006				2007	
	may	aug.	feb.	april	sept.	oct.	jan.	apr.
Premium gasoline	9.85	10.35	10.51	10.5	11.07	10.5	10.25	10.25
Regular gasoline	9.45	9.45	-	-	-	-	-	-
Lamp oil	6.46	6.96	7.46	7.46	-	-	-	-
Diesel oil	6.46	6.96	7.46	7.46	7.98	7.47	7.22	7.22
Diesel 350	7.7	8.2	9.34	9.34	9.93	9.38	9.13	9.13
Industrial fuel (Dh/Ton)	2581	2881	3307.	3307	3374	3174	2874	2874

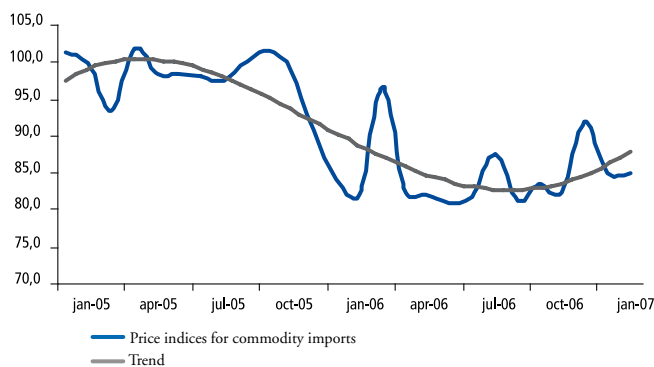
Sources: Ministry of Energy and Mining.

As of the third quarter of 2006, these effects seemed to lessen as the average import price of consumer goods had started to move upwards, a trend that continued during the first two months of 2007.

**Chart 3.2: Fuel pump prices and transport price (year-on-year in %)**



**Chart 3.3: Price indices for commodity imports**



Sources: Foreign exchange office and BAM estimates

## 4. MONETARY CONDITIONS AND ASSET PRICES

At its meeting on 27 March 2007, the Board decided to keep the Bank's intervention rates unchanged after raising in December 2006 the rate for 7-day liquidity withdrawals on call for tenders by 25 basis points, bringing it up to 2.75%.

Monetary conditions tightened markedly at the end of the first quarter of 2007 and during April and May, especially following the raising of the liquidity withdrawal rate in December 2006 and the contraction observed in the money supply since February. As a result of the significant rise in interbank rates, short-term interest rates went up, with the noteworthy exception of rates for bank deposits which, after increasing sharply in 2006, have adjusted downwards since the beginning of this year. The decline in the rates for Treasury bills, with a maturity of two or more years, first slowed down in the first quarter of 2007 before starting to move up at the end of the first two months of the second quarter. Concerning medium- and long-term lending rates, they were less affected by the recent increase in interbank rates, as they generally continued on the downtrend observed in 2006. For its part, money supply growth, driven by expanding loans, especially overdraft and real estates loans, was still accelerating at the end of the first quarter and the beginning of the second quarter of 2007, thus, reinforcing the excess cash holdings accumulated earlier.

### 4.1 Monetary conditions

#### 4.1.1 Liquidity and implementation of monetary policy

At the end of the first three months of 2007, bank liquidity declined appreciably on the back of the restrictive evolution of autonomous factors, which began in October 2006, and the increase in reserve requirements, particularly high since early 2007. Depletion of excess liquidity resulted from Bank Al-Maghrib's currency sales and the strengthening of the Treasury's net position with the Bank.

The Board's decision of 19 December 2006 to increase liquidity-withdrawal rates by 25 basis points, coupled with contracting excess liquidity, led to the increase of interbank rates in the first quarter of 2007. Thus, the quarterly average overnight interest rate on the interbank money market rose by 54 basis points, to 2.98% compared to 2.44% in the fourth quarter of 2006 (Chart 4.1).

Liquidity tightened further in the second quarter of 2007 (Chart 4.2). The average market liquidity position went down by 4.3 billion dirhams, resulting in an average shortage of 3.1 billion dirhams during April and May 2007.

This change is due both to the restrictive impact of autonomous factors, which induced a two-billion dirhams' contraction in liquidity between 1 April and 27 May 2007 and the increase of reserve requirements.

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

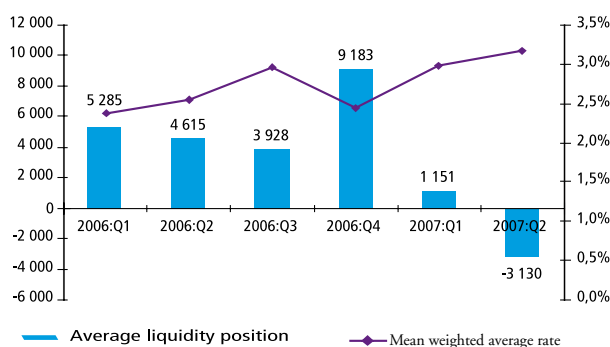
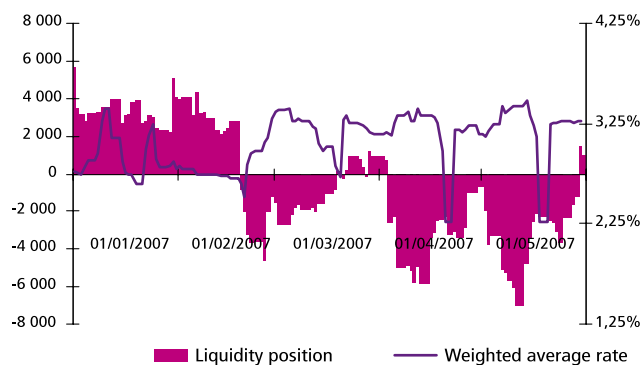


Chart 4.2: Liquidity position (in millions of dirhams) and weighted average rate of the interbank money market



The growth in the reserve requirements, which has accelerated since the beginning of the year, reached 1.4 billion dirhams during the months of April and May 2007 (Chart 4.3).

During the second quarter of 2007, foreign asset operations led to the withdrawal of 1.6 billion dirhams, owing to currency sales by Bank Al-Maghrib which totaled 7.9 billion, mainly due to financial transactions. Furthermore, the increase of currency in circulation reached 606 million dirhams.

On the other hand, the Treasury's net assets offset the restrictive impact of the other factors on liquidity by 2.8 billion dirhams. Since the Treasury enjoyed exceptional revenues from corporate tax in the first quarter of 2007, the accumulation of excess cash holdings resulted in the absence of the Treasury from the primary market of Treasury bills, on the one hand, and in the acceleration of expenditure during the second quarter of the year, on the other.

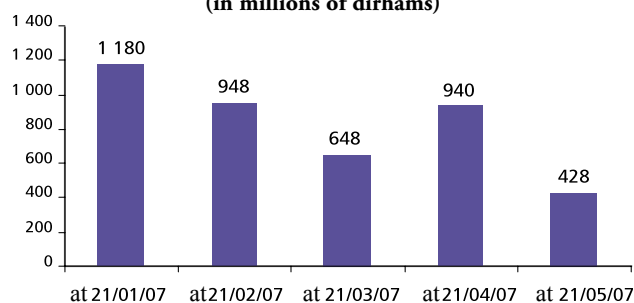
Due to liquidity shortage on the interbank market during the considered period, Bank Al-Maghrib intervened principally by means of 7-day advances on call for tenders at a 3.25% rate. These advances' average daily amount reached 2.9 billion dirhams against 817 million dirhams in the previous quarter.

With a view to keeping under control the upward pressures that were temporarily exerted on the interbank rate, the Bank also used fine-tuning operations such as repurchase agreement on Treasury bills. The average daily amount of these operations amounted to 374 million dirhams compared to 161 million dirhams in the previous quarter (Chart 4.5).

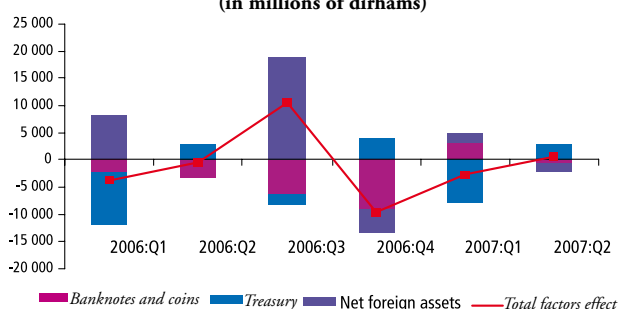
Consequently, the interest rate on the interbank market remained close to the 7-day advances rate, averaging 3.17% compared to 2.98% previously.

Finally, it is worth mentioning that forward operations are expanding even if overnight transactions still prevail on the interbank market. Forward transactions on the unsecured interbank market concerned maturities of one week to three months with a preponderance of one-month loans and borrowings. For this last maturity, rates reached 3.50% on average.

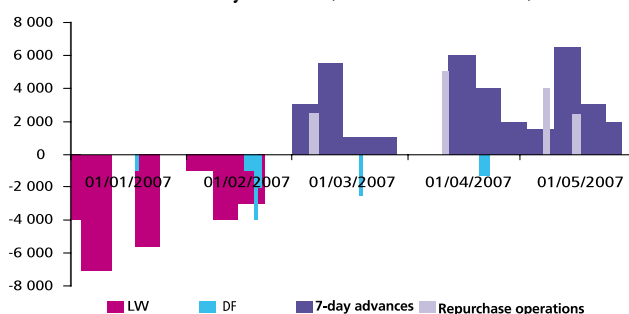
**Chart 4.3: Reserve requirements increase (in millions of dirhams)**



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



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



### 4.1.2 Interest rates

Short-term Treasury bills rates rose significantly in the first quarter of 2007, following the money market tightening caused by the increase in liquidity-withdrawal rates by Bank Al-Maghrib and the contraction of liquidity on the interbank market. This evolution continued later as confirmed by the high rates on TBs issues of early June 2007 (Table 4.1).

The decrease of long-term interest rates first slowed down in the first quarter of 2007 before moving up in April and May, as evidenced by the rising rates on the secondary market.

Regarding borrowing rates, 6 and 12-month deposit rates dropped in the first quarter of 2007, as well as at the end of April. Against a background of a generalized rise in short-term rates, this decrease is mainly the result of the readjustment of borrowing rates, which increased strongly in 2006, despite the decline of interbank rate.

Lending rates evolved differently depending on maturities, as shown by the quarterly survey data on interest rates. As to interest rates applied to overdraft facilities, whose level is more influenced by money market conditions, they rose by 65 basis points between the last quarter of 2006 and the first quarter of 2007. In contrast, medium- and long-term interest rates declined significantly, except for rates on financial loans, which trended upwards after stagnating in the fourth quarter of 2006.

### 4.1.3 Currency, credit and liquid investments

#### M3 evolution

In the first quarter of 2007, as well as in April, M3 year-to-year growth accelerated again to 17.5% and 18.9% respectively, far beyond economic growth pace.

The short-term momentum shows no noticeable signs of moderation. Despite a slowdown in economic activity, particularly in agriculture, quarterly growth stood at 4.3% in the first quarter of 2007 compared to 3% in the same quarter of 2006. The monthly data confirm this evolution as they indicate a 0.5% rise in April, driven essentially by bank loans, against a decline by 0.2% a year earlier.

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

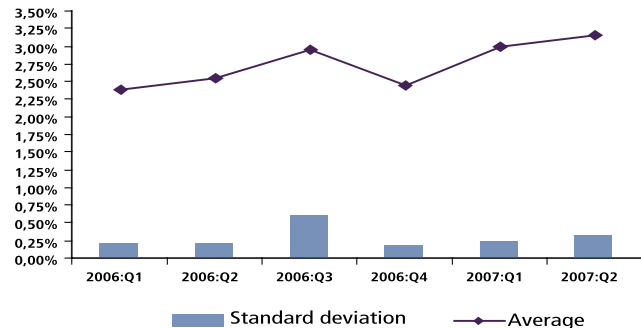


Table 4.1 Short-term rates

	2005	2006				2007	
		Q1	Q2	Q3	Q4	Q1	Q2*
13-week Treasury bills	2.45	2.65	2.62	-	2.52	2.73	3.30
26-week Treasury bills	2.54	-	2.78	-	2.62	2.85	3.35
52-week Treasury bills	2.89	3.06	3.00	-	-	2.97	2.88
6 and 12-month deposits	3.40	3.43	3.52	3.65	3.77	3.49	3.48

(\*Data on early June issues. It is worth noting that 52-week Treasury bills issues represented an insignificant amount, and therefore, do not indicate a decline in the rates on this maturity.

Table 4.2: Medium and long-term Treasury bills rates

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

\* The observation of the second quarter of 2007 corresponds to the average of April and May

Table 4.3 Lending rates in 2006

Weighted average rate	Jun	Sept	Dec. 06	Mar. 07
Debtor accounts and overdraft facilities	6.79	7.00	6.81	7.54
Equipment loans	8.67	7.60	6.58	6.53
Real estate loans	6.73	6.31	6.34	5.49
Financial loans and sundry debtors	6.95	8.37	7.05	9.59
Consumer loans	8.24	8.66	8.65	6.96

**Box 4.1 : Bank Al-Maghrib operational framework**

Bank Al-Maghrib controls the interbank rate through the monetary policy's operational framework which comprises all its instruments and intervention procedures as stipulated in Circular No. 41/G/2004 dated 31/12/2004. The operational framework allows the central bank to manage liquidity and indicate the monetary policy's general trend in the short- and medium-terms, in line with Bank Al-Maghrib Board decisions.

To implement the monetary policy, Bank Al-Maghrib uses four instrument categories:

1. The main operations, which constitute the main channel through which liquidity is supplied into or withdrawn from the banking system, are intended for injecting or absorbing liquidity on a regular basis. They are carried out by the Bank through weekly calls for tenders. Their interest rates constitute the monetary policy's key rate. In the case of a market excess liquidity, Bank Al-Maghrib resorts to liquidity withdrawals as the major intervention instrument. When the market is short of liquidity, 7-day advances represent the main instrument of liquidity injection.
2. Standing facilities allow the injection or withdrawal of liquidity on an overnight basis. They are used by counterparts of monetary policy transactions to make the remaining cash holding adjustments that could not be carried out on the interbank market during the day. They consist of the deposit facility and the 24-hour advance. The deposit facility rate (2.25%) is the floor call rate while the 24-hour advance interest rate (4.25%) represents the interest rate cap, constituting together the corridor within which the interbank rate can fluctuate.
3. Fine-tuning operations are carried out occasionally by the central bank to cushion the effects of unforeseen fluctuations in bank liquidity on interest rates. Fine-tuning operations are mainly carried out through temporary purchases or sales of Treasury bills but can also consist in foreign exchange firm transactions or swaps.
4. The reserve requirements represent the amount of assets banks are required to keep with the central bank. Their average level and rule of constitution contribute to absorb the overnight interest rate fluctuations on the interbank market. The amount of the reserve requirements to be constituted by each institution is set according to its balance sheet: the arithmetic average of the daily balances of banks' ordinary accounts with Bank Al-Maghrib must be at least equal to 16.5% of their dirham-denominated sight liabilities, except for convertible dirham-denominated liabilities. Banks' reserve requirements are remunerated at 0.75%.



At the same time, the evolution of M3 continues to reflect the consolidation of time investments which, despite the fall in borrowing rates, posted the highest annual growth among M3 components, with 20.8%<sup>In</sup> in the first quarter and 26.7% in April.

**Bank loans**

Bank loans grew at an annual rate of 20.5% in the first quarter of 2007, compared to 12.6% in the last quarter of 2006. This rate reached 25% in April 2007, while it did not exceed 5.1% in the same month of 2006.

Overdraft facilities, despite the new increase in rates applied by banks, together with real estate loans, were behind this acceleration. Their contribution to quarterly growth in bank loans averaged 41% and 34%, respectively, over the last four quarters, against 19% for equipment loans.

As shown by Chart 4.9, overdraft facilities have been expanding since early 2005, thus significantly contributing to the boom of bank loans and, by corollary, of money supply.

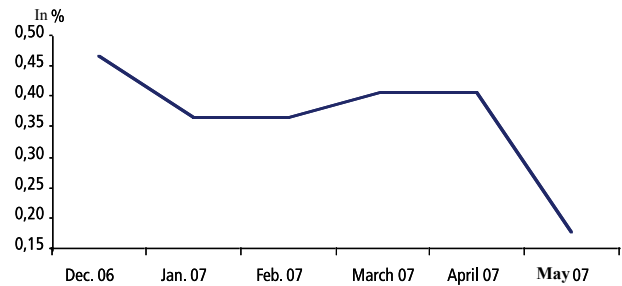
The analyses conducted by the Bank show that this momentum is closely associated with the acceleration observed in non-agricultural economic activity in the same period (Chart 4.10). On the demand side, this relation<sup>1</sup> is mainly due to the development of firms' needs for working capital. On the supply side, it is attributable to the improvement of risk profile, in parallel with continuing dynamism in economic activity.

In the light of these findings, the risk to price stability that may be induced by the strong growth in overdraft facilities still depends on the position of the non-agricultural sector within the cycle. In view of the industrial sector survey data and the macroeconomic data, which point to the existence of spare capacity and decreasing pressures on the labor market, the continued expansion of liquidity loans should not intensify inflationary pressures.

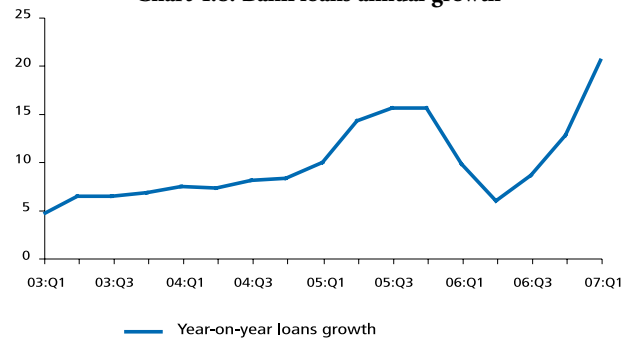
**Other sources of money creation**

in connection mainly with the widening trade deficit, the increase of net foreign assets has markedly slowed down since the beginning of the year.

**Chart 4.7: Rates differential between maturities**



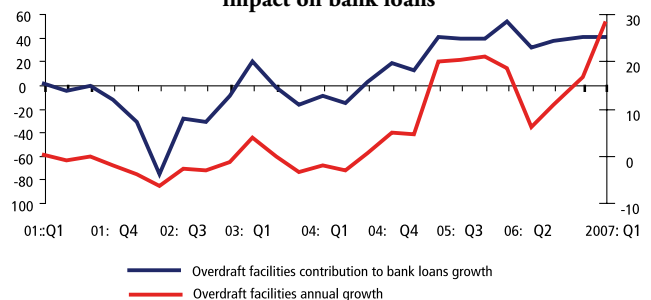
**Chart 4.8: Bank loans annual growth**



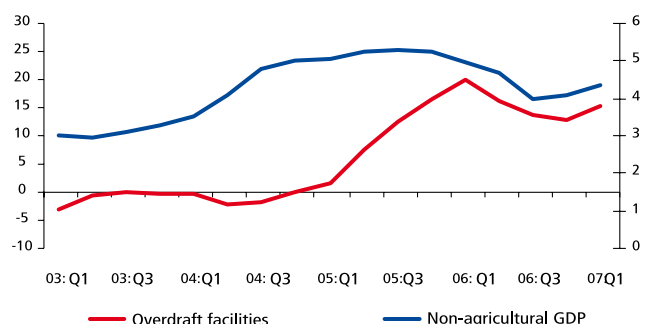
**Table 4.4: Contribution of the main categories to loans growth from one period to the next (in %)**

	Overdraft facilities	Real estate loans	Equipment loans
2006 : Q2	41.9	52.6	15.3
2006 : Q3	37.6	24.8	21.7
2006 : Q4	39.8	26.6	20.0
2006 : Q1	44.4	31.4	19.0
Average	40.9	33.8	19.0
April 2007	61.1	28.5	-12.9

**Chart 4.9: Overdraft facilities growth and its impact on bank loans**



**Chart 4.10: Overdraft facilities and economic activity**



<sup>1</sup> Given the volatile character of overdraft facilities' growth, its relationship with real growth can only be determined in medium term

In fact, the annual growth rate of foreign exchange reserves went down to 14.4% in the first quarter of 2007, compared to 20% in the fourth quarter of 2006 (Chart 4.11). The quarter-to-quarter rise in reserves did not exceed 0.7%, bringing their contribution to money creation down to 6% as opposed to 15% in the previous quarter and 63% in the same period of 2006.

In April, their monthly growth rate did not exceed 0.4% against 1.9% in the same month of 2006. This change covers a stagnation in the central bank's net reserves, whose level remains below that of December 2006, in addition to an increase in banks' reserves.

Regarding net claims on Government, their annual growth rate is still very volatile. It stood at 9.4% in the first quarter of 2007 while it had stagnated in the fourth quarter of 2006, after increasing by 14.7% a year earlier (Chart 4.13). In April, they dropped by 3.4% as a result of the reduction of the Treasury debt to banks.

### Liquid investments

After a steady acceleration in 2006, these aggregates' annual growth dropped to 29.8% in the first quarter of 2007, against 35.1% in the fourth quarter of 2006.

This slowdown, which was more marked for the monetary and bond UCITS securities, is attributable to the rise observed in Treasury bills rates since the beginning of 2007, which limited the appreciation of these UCITS' market value.

Though still strong, the increase in securities of share and diversified UCITS also slowed down due to the slight decline in the annual performance of the Casablanca Stock Exchange (Chart 4.16).

#### 4.1.4 Foreign exchange rate

At the end of the first quarter of 2007, the dirham appreciated by 1.26% against the dollar, while it fell by 0.28% against the Euro, compared to the fourth quarter of 2006. This trend intensified in April and May, as the national currency was, on average, up 2.57% against the dollar and down 0.56% against the Euro, compared to the first three months.

Chart 4.11: Annual growth of net foreign assets

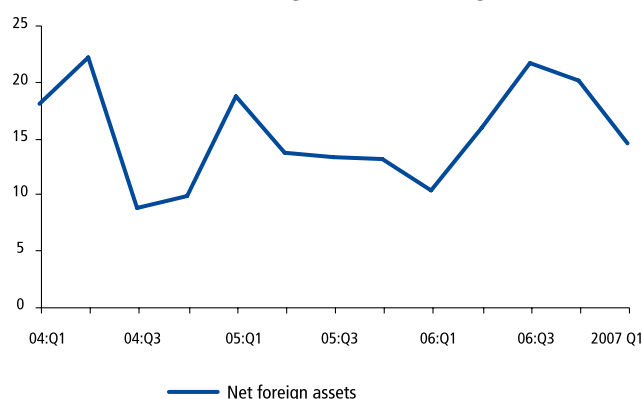


Chart 4.12: Structure of net foreign assets growth

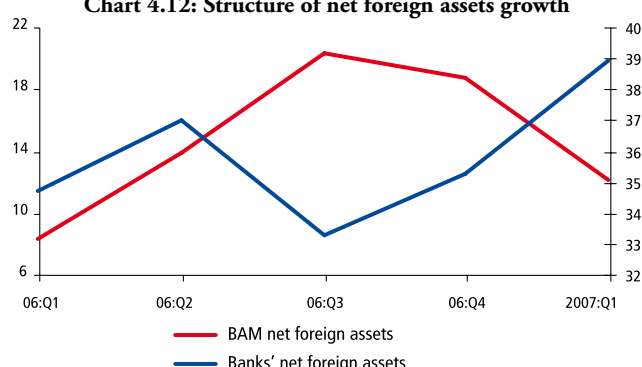


Chart 4.13: Annual growth of net claims on the Government

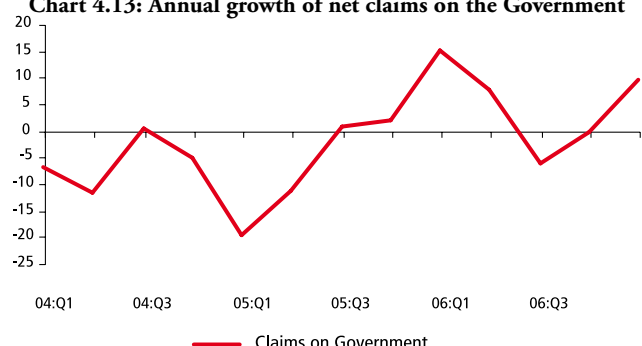
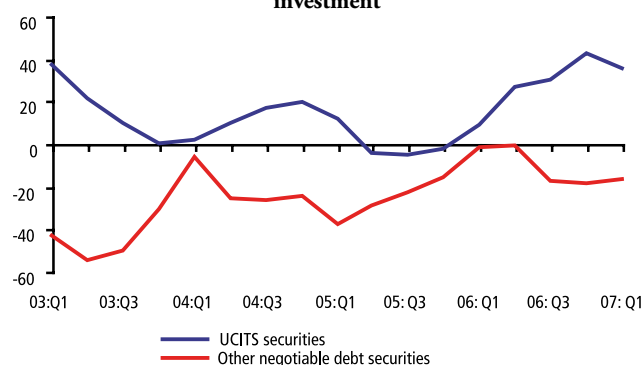


Chart 4.14: Annual growth of non financial agents' liquid investment



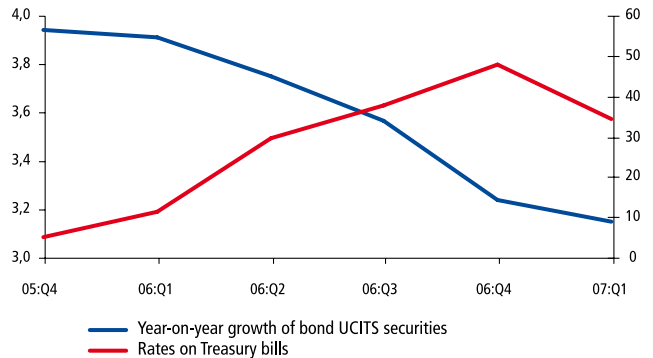
## 4.2 Asset prices

The Masi index grew by 21.3% at the end of the first quarter of 2007 and market capitalization reached 500.1 billion dirhams. This trend continued in April, with a 7.2% rise in stock exchange prices, bringing the Masi index up to 12,330.32 points.

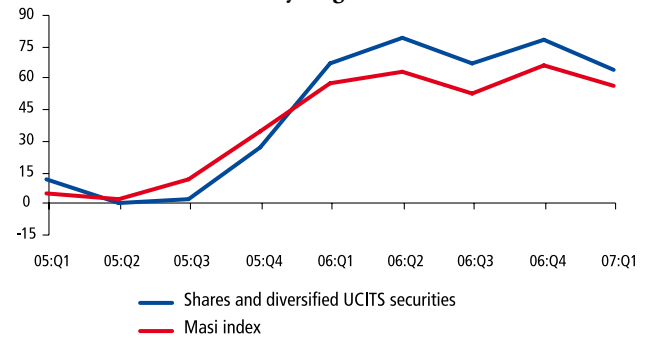
A stock market correction occurred in the second week of May and concerned mainly bank shares, as a result of large profit taking. Consequently, the Masi index depreciated by 3.8% compared to the preceding month and the market capitalization declined by 22.2 billion. In a seller's market, the stock exchange turnover went up from 15.8 billion to 25.3 billion dirhams, from one month to the other.

Concerning real estate assets, their prices are still trending upwards. On the basis of fragmented data, price surge concerns several cities in the Kingdom due, in particular, to the growth of both domestic and foreign demand.

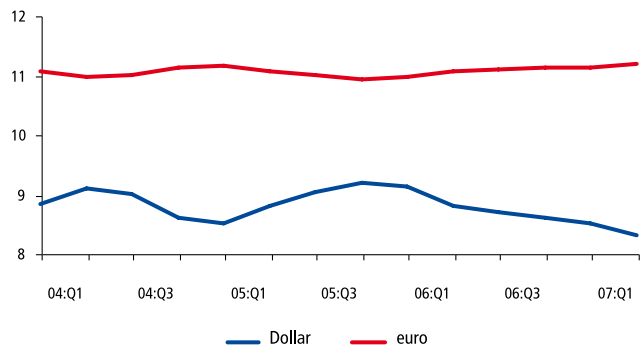
**Chart 4.15: Evolution of LI3 and 5-year Treasury bills issues rates**



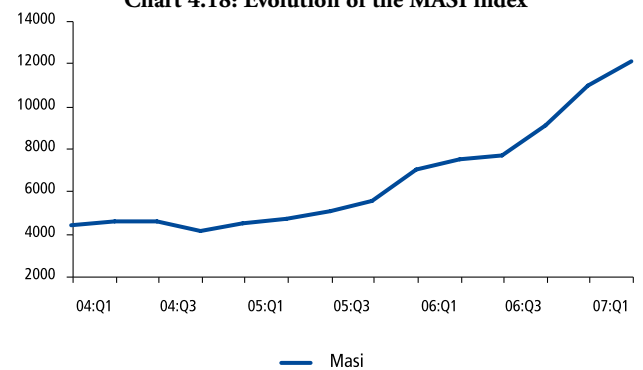
**Chart 4.16: Year-on-year growth of LI4 and Masi**



**Chart 4.17: Dirham's bilateral exchange rate**



**Chart 4.18: Evolution of the MASI index**



## 5. RECENT INFLATIONARY TRENDS

The rise in the cost of living index slowed down appreciably in April 2007, standing at 2.2% year on year, compared to 3.1% the previous year. Moreover, this rise underlines, for the most part, the increase in fresh produce price. In fact, underlying inflation did not exceed 1.4% against 2.9% in April 2006, reflecting a moderation in the general trend of prices.

### Situation at the end of 2007

The cost of living index recorded, in April 2007, a monthly rise of 0.7%, chiefly attributable to the prices of fresh produce, particularly vegetables (+15.9%) and fruits (+8.1%) while meat prices fell by 3%.

In fact, the underlying inflation index grew by 0.2% from month to month after a 0.7% drop during the previous month. The headings that contributed to this growth were mainly milk products, canned vegetables, in addition to rent, clothing, household equipment, healthcare and articles of personal use.

On a year-to-year basis, the cost of living index grew by 2.2%, compared to 3.1% one year earlier. This deceleration results mainly from the 0.8% decline in private transport prices, which rose by 8.5% the previous year.

Underlying inflation saw, for its part, a slowdown from 2.9% to 1.4%. This is mostly attributable to a 16.1% fall in "communication" prices, especially, as a result of the 50% reduction, at the end of February, of the cost of telephone calls from phone shops and public phones. Moreover, fats prices, which increased by 16.3% in April 2006, fell by 2.6%. Finally, the price rise in public transportation, healthcare and articles of personal use and education saw a deceleration compared to the same period of the previous year.

With respect to the industrial output, ex-works prices also softened, as the producer price index, excluding oil refining, increased by barely 0.6%, compared to 2.8% in 2006. This slowdown concerned, in particular, prices of the food industry and those of textile and clothing.

In the short term, the monthly survey conducted by Bank Al-Maghrib on the economic situation of the industrial businesses shows an expected upward trend in the prices of finished produce over the next three months, in the majority of industrial branches, except for electrical and electronic industries.

Chart 5.1: Year-on-year inflation and underlying inflation

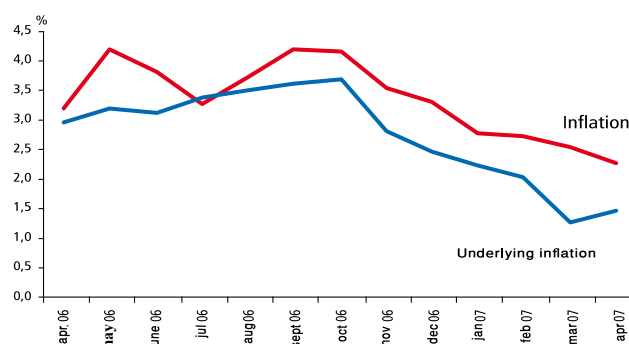


Table 5.1: Inflation and underlying inflation

	Quartely evolution on year-to-year basis					Monthly evolution on year-to-year basis	
	2006		2007			apr. 06 apr. 05	apr. 07 apr. 05
	1 <sup>st</sup> Q	2 <sup>nd</sup> Q	3 <sup>rd</sup> Q	4 <sup>th</sup> Q	1 <sup>st</sup> Q		
<b>Inflation</b>	2.1	3.7	3.7	3.3	2.6	3.1	2.2
<b>Underlying inflation*</b>	2.8	3.0	3.4	2.9	1.8	2.9	1.4

Source: HCP

\* BAM estimates

---

## 6. INFLATION OUTLOOK

---

*This section outlines the most probable evolution of inflation (central forecast) over the four next quarters and reviews the associated main risks (balance of risks). The scenario of the central forecast is therefore conditioned by the assumptions and developments projected for a number of variables affecting activity and inflation. With the non-occurrence of the main identified risks, the central forecast for the four next quarters continues to suggest, in line with the last Report, an easing of pressures on prices. Accordingly, inflation is expected to hover around 2.3% in 2007, compared to 3.3% in 2006, and around 2.2% over the forecast period (from the 2nd quarter of 2007 to the 1st quarter of 2008).*

---

### 6.1 Central forecast assumptions

#### 6.1.1 International environment

Growth acceleration in Morocco's main partner countries (France, Spain, Germany and Italy) for 2007 and 2008 seems to be confirmed according to the latest forecasts of the OECD. This evolution should favorably affect the activity in Morocco, particularly the exports towards these markets. The average growth in our main partner countries, weighted by their respective shares in Morocco's foreign trade, is expected to hover around 2.4% in 2007 and 2008.

The overall conditions of the financial markets in the partner countries are determined by the interest rate in the Eurozone. A tightening of these conditions is expected for the next quarters: the recent 0.25% rise in the ECB's key rate in June 2007 is taken into consideration, in addition to a new rise that should bring it, by the end of 2007, to 4.25%, a level that is considered to be neutral.

#### 6.1.2 National environment

Overall, the national environment should be characterized by a slow down in growth and a marked drop in private consumption, more important than anticipated based on the data available at the time of writing the previous Report. Growth in non agricultural sectors, such as private and public investment, are, nonetheless, expected to remain very dynamic. Against this background, pressure on output capacity should reduce and global output gap should be contracted to reach a negative territory during the first three quarters of

2007. Afterwards, the output gap should gradually increase to a level close to equilibrium at the end of 2006 - beginning 2007.

According to the last estimates of the Ministry of Agriculture, the 2007 cereal campaign will probably be characterized by a significant decrease in output. The last available forecast sets it around 20.5 millions quintals (compared to a projection of 53 millions quintals at the time of writing the previous Report). This decrease, attributable to an important rainfall deficit, is expected to reduce the agricultural added value by about 18.2%. For 2008 and in the absence of cereal output prospects, we expect an output rebound based on the cereal campaign's history, while keeping the profile of an average year with 60 millions quintals; almost 23% of the real added value of the primary sector.

Inflationary pressures originating from the labor market remain limited. Nevertheless, they are expected to see a slight rise over the next quarters. In fact, if a slight drop is foreseen for the next quarters, the labor market will continue to be relatively dynamic. So far as wages are concerned, the available information indicates a marked rise in real terms for 2006. For the next quarters, considering the ongoing negotiations between the Government and the labor unions, we expect no increase in the minimum wage. It should be noted that the minimum wage re-assessments influence the formation of wages in the private sector, and feed through to inflation in a significant and sustained way.

The persisting pressures on the international markets tend to indicate that oil prices will

continue to remain high on the medium term. This evolution was well projected in the scenario presented in March 2007. Oil prices forecasts for 2007, as indicated in the last Monetary Policy Report, averaged 65\$, seem to be confirmed. The average price observed on the markets for the 5 first months of the year, is set at around 63\$ a barrel. For 2008, oil price evolution is getting more and more uncertain, with a tendency to rise, particularly due to the rapid and likely sustainable increase, of the refining margins. It should be noted that a barrel international price exceeding 52\$ should - in case the indexing mechanism is fully applied - lead to an increase of the diesel domestic price<sup>1</sup>. The assumption of the non-repercussion of international prices rise on domestic prices - the cost of which is covered by the budget up to 65\$ according to the 2007 Finance Act, is yet maintained. The central scenario for 2007 and the first quarter of 2008 assumes that diesel pump prices would be kept at the current level of 7.22 dh per liter.

World inflation slowed down at the beginning of the second quarter of 2007. In the short medium term, forecasts remain uncertain, mainly in connection with the current tensions on the world oil market (see above) and a potentially stronger than-expected increase in world demand. For Morocco, import prices evolution, excluding oil products, is expected, as was the case in 2006, to continue to increase more rapidly than before but at a slower pace than in 2006. In general, inflation pressures arising from import prices, excluding oil products, should be relatively moderated.

## 6.2 Inflation outlook and balance of risks

With the non-occurrence of the main risks discussed below, the central forecast for the next four quarters remains in line with the price stability objective. Thus, this inflation outlook indicates a price rise for the second quarter of 2007, year-on-year, by nearly 2.0%, compared to the same period in the previous year (see Table 6.1). Compared to the forecasts in the Monetary Policy Report of March 27, 2007, inflation

<sup>1</sup> Diesel represents more than 50% of the national consumption of oil products

(central forecast) for the second quarter rose from 1.8% to 2.0%. For the three following quarters

(from the 3rd quarter 2007 to the 1st quarter 2008), year-on-year inflation would range between 2.2% and 2.4%, and stand at 2.1% for the first quarter of 2008. The bad 2007 agricultural campaign, which had a downward impact on the added value of the primary sector, has a positive impact on prices.

For 2007 as a whole, inflation (central forecast) would probably hover around 2.3%, as opposed to 3.3% in 2006. Over the forecast horizon (from the 2nd quarter of 2007 to the 1st quarter of 2008), inflation would stand at 2.2%.

**Table 6.1 : Central forecast of inflation for the year 2007 and the first quarter of 2008**

Year-on-year %	2007		2008		Average 2007
	2 <sup>nd</sup> quar.	3 <sup>rd</sup> quar.	4 <sup>nd</sup> quar.	1 <sup>st</sup> quar.	
Inflation forecast	2,0	2,4	2,2	2,1	2,3

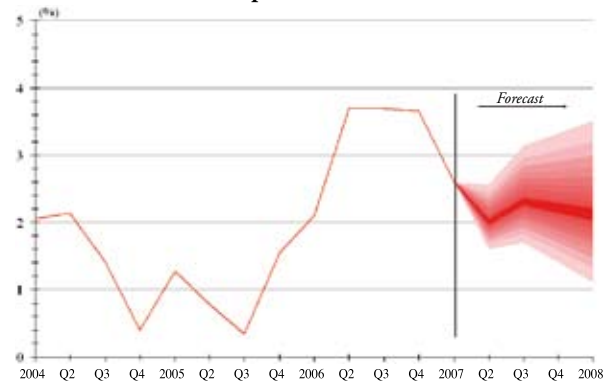
These projections have been developed on the basis of assumptions deemed the most probable. There exists, however, many sources of uncertainty, arising from both the evolution of the exogenous variables and the forecasting models, which may have an upward or a downward impact on the projected inflation.

The analysis of the balance of risks reveals an asymmetrical forecast range represented in the form of a fan chart. This is an estimated evaluation of the uncertainty areas which surround the central forecast (see Chart 6.1).

The upward asymmetry of the fan chart suggests a higher probability of inflation rise compared to the central forecast. This asymmetry results, on the one hand, from risks associated with uncertainties about the developments of the international economic situation (oil prices pressures, world inflation increase and monetary policy possible tightening in the industrialized countries) and, on the other hand, from the national environment-related risks (pressures on the labor market and a stronger drop

in agricultural output). The materialization of one or several of these risks would put inflation above the central forecast, with a value within (with a 90% probability) the forecasted range represented in the fan chart.

**Chart 6.1: Inflation projections (CLI) for 2007 and the 1<sup>st</sup> quarter of 2008**



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

بنك المغرب  
بنك المغرب



Legal deposit: 2007/0033

ISBN: underway

**BANK AL-MAGHRIB**

Central Administration  
277, Avenue Mohammed V - B.P. 445 - Rabat

Phone: (212) 37 70 26 26

Fax: (212) 37 20 67 76

[www.bkam.ma](http://www.bkam.ma)

بنك المغرب