

RESEARCH REPORT

CURRENCIES

MARCH
2020

Widening of MAD fluctuation bands Trust accumulation

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A reading of the decision

After Bank Al-Maghrib's opinion, the Ministry of Finance decided to proceed, starting Monday March 9th 2020, to a widening of the dirham's fluctuation band from $\pm 2.5\%$ to $\pm 5\%$ compared to a central rate set by Bank Al-Maghrib at 60% EUR and 40% USD basket. The press release adds that the widening comes after the achievement of the objectives assigned to the first phase initiated in January 2018. It specifies that this further step takes place in a favorable macroeconomic and financial context and recalls that this voluntary process, which is scheduled over several stages, will allow for a strengthening of the economy's capacity to absorb shocks and to support its competitiveness. In this context, BAM reassures that it will continue to play its role as a market regulator if necessary. We believe that the **timing** used to implement this reform is **appropriate** for two reasons:

- ⇒ **Announcement effect:** This reform was announced on Friday March 6th for an implementation the Monday March 9th, which ensures the smoothest transition possible.
- ⇒ **Fundamentals state:** Although this may seem paradoxical, this kind of measures is appropriate as well when (1) the fundamentals are in good shape and this proves that an economy has a good resilience or when (2) an economy is in a situation of shock and such a measure acts as a catalyst to restore balance.

In our case, we claim to be in the first case where the Moroccan economy shows a satisfactory level in terms of indicators linked to fiscal and external trade balances; although Morocco aspires to a more sustained growth.

Likewise, we have several reasons to believe that **the foreign exchange market has gained maturity:**

- **An interbank market which is gaining in depth** and which displays an increasing level of activity allowing to bring out a reference price for customers quotations;
 - **Bank Al Maghrib** perfectly fits its role of last instance, with an **absence of interventions** since April 2018;
 - **A self-functioning of the interbank market** making it possible for operators to mutually meet their foreign exchange needs.
- ⇒ In perspective, by authorizing a variation of $\pm 5\%$ compared to the central rate, Bank Al-Maghrib starts a new phase of MAD flexibility with more considerable issues:
- **Permission for more flexibility:** In order to reach a MAD equilibrium price, with a potential volatility as collateral, where it is noted that the MAD volatility is due to a Supply and Demand confrontation rather than an EUR/USD basket effect.
 - **Expectation of greater economic benefit** with the target of supporting the exporting sectors, and the creation of a currency adjustment mechanism which could help absorb any external shock. Not to mention an effect on inflation, which is an aggregate to be closely monitored after the reform.

Enjoy reading.

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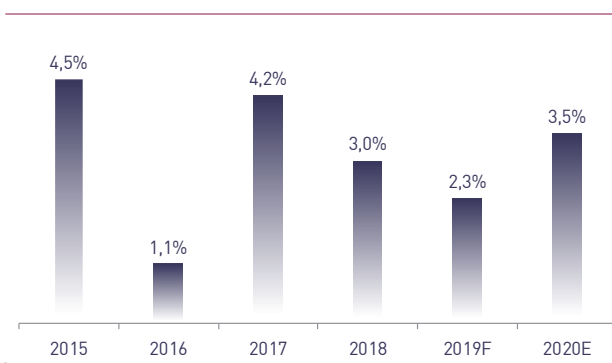
An appropriate timing

We believe that the chosen timing to implement this reform is appropriate for two reasons:

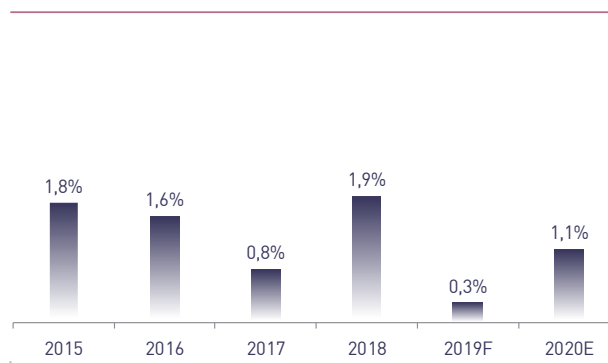
- ⇒ **Announcement effect:** This reform was announced on Friday March 6th for an implementation the Monday March 9th, which ensures the smoothest transition possible. This corroborates Bank Al-Maghrib's desire to pursue this reform in a voluntary and orderly manner.
- ⇒ **State of the fundamentals:** Although this may seem paradoxical, this kind of measures is appropriate whether:
 - The fundamentals are in good shape and this proves that an economy has a good capacity to resist a sudden conjuncture downturn; or when
 - An economy is in shock and such a measure is a catalyst for restoring balance or boost growth.

In our case, we believe that we figure in the first case where the Moroccan economy shows a satisfactory picture in terms of inflation indicators and fiscal and external trade balances although Morocco aspires to more sustained growth [\[Cf. Morocco Report Dec. 2019\]](#).

GDP GROWTH

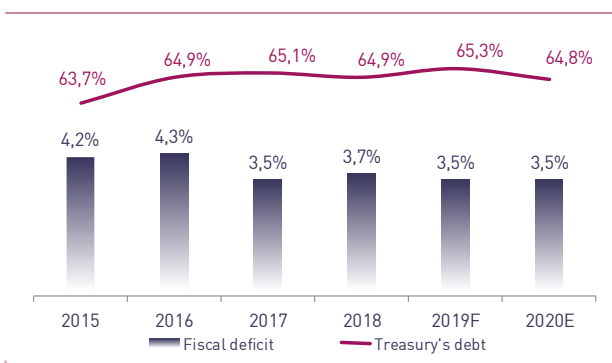


INFLATION

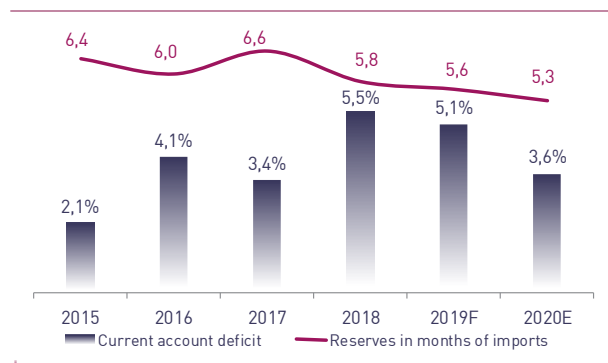


As for inflation, we are recording a particularly low level in Morocco which could be explained in particular by the absence of imported inflationary pressures or even less vigorous domestic Demand. Without this being particularly expected, this situation leaves a leeway for any inflationary risk linked to a MAD shift within a wider fluctuation interval.

FISCAL DEFICIT VS TREASURY'S DEBT



CURRENT ACCOUNT DEFICIT VS EXCHANGE RESERVES



In terms of debt, Morocco has a reassuring physiognomy. Contrasting with the typical profile of several African countries, Morocco has a dominant local debt with almost 79% of the Treasury debt.

As for the external balance, and although foreign exchange reserves are trending downward, their absolute level of 5.3 months of imports is nothing to worry about. Not to mention, the Precautionary and Liquidity Line to which Morocco is eligible for an amount of USD 2.97 Bn corresponding to almost 0.6 additional months of imports of goods and services and which ends in December 2020.

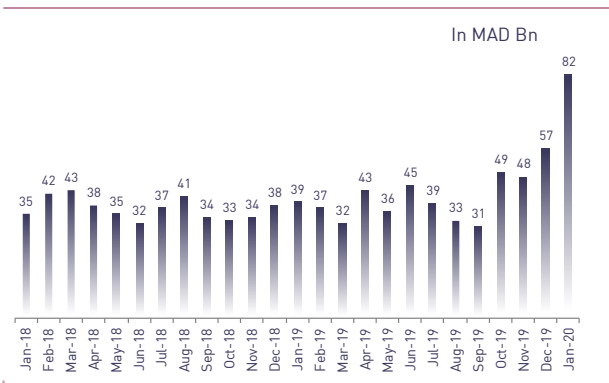
Sources : HCP, Bank Al-Maghrib, MEF, AGR Computations

A progressive maturity of the foreign exchange market

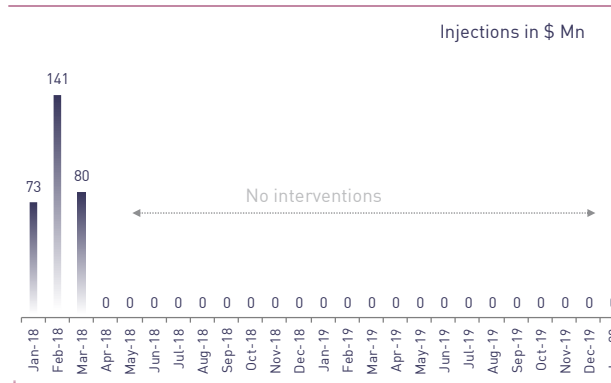
This first phase of the MAD flexibilization which lasted nearly 26 months [from January 12th, 2018 to March 5th, 2020] recorded a significant development of the foreign exchange market. Indeed, the implementation of new regulations alongside the launch of the flexibility's first phase has enabled the market to gain maturity [Cf. [Flexibilization Report Jul-19](#)]. Thus, we note:

- An interbank market which is gaining in depth thanks to a new quotation system with the involvement of "market makers". As such, the average monthly volume of the last 3 months [Nov. 19 - Jan. 20] stands at MAD 62 Bn against MAD 37 Bn a year earlier. Thus, this volume allows to constitute a credible reference price for customers quotations.

INTERBANK MARKET IN FOREIGN CURRENCIES

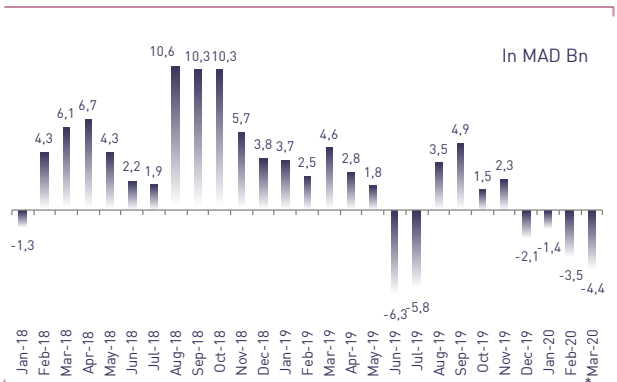


BAM INTERVENTIONS (MONTHLY BASIS)



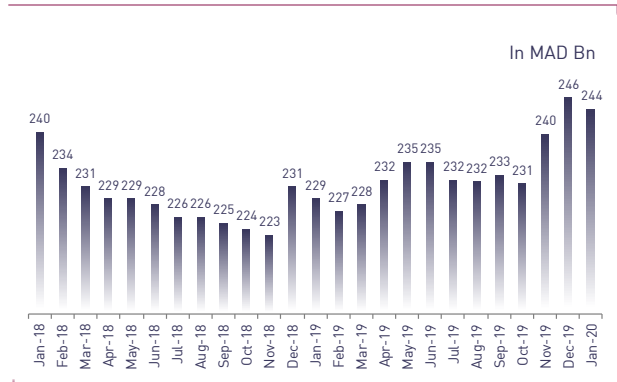
- Bank Al-Maghrib perfectly fits its role of last instance, with an absence of interventions since April 2018. Indeed, after the reform's monitoring through a global injection of \$ 294 Mn in Q1-2018, the regulator estimated that the market mechanisms were working properly.

BANK'S NET POSITION (END OF MONTH)



* At March 3rd

NET INTERNATIONAL RESERVES



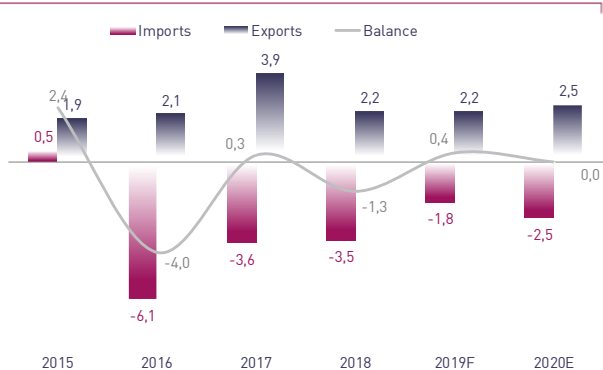
- A self-functioning of the interbank market : since the new system's implementation, the appreciation in MAD's value requires a parallel analysis of the net position of banks with that of the international reserves of Bank Al-Maghrib. Thus, the monitoring of the first component shows that the banks are able to mutually meet their foreign exchange needs with positions which are generally in surplus during this study period.

Outlook

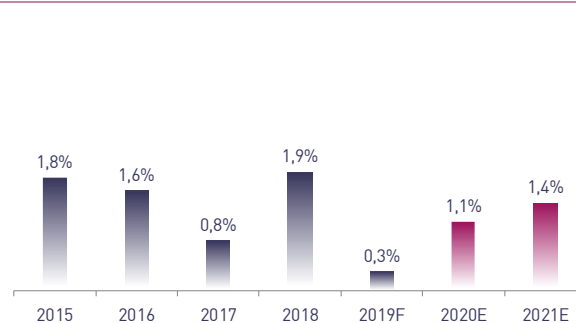
By authorizing a $\pm 5\%$ variation compared to the central rate, Bank Al-Maghrib is entering a new phase of MAD flexibility with more considerable challenges:

- **Permission for more flexibility:** In order to reach a MAD equilibrium price, with a potential volatility as collateral, where it is noted that the MAD volatility is a result of the Supply and Demand confrontation rather than an EUR/USD basket effect.

EXCHANGES CONTRIBUTION TO GROWTH (PTS)



INFLATION PROJECTIONS (SOURCE BAM)



⇒ Expectation of greater economic benefit

- **Spin-offs on foreign trade:** it should be recalled that the two main targets of the MAD flexibilization process are the support for exporting sectors and the creation of a currency adjustment mechanism which could help absorb any external shock. Indeed, the trade balance is still a handicap for growth in Morocco and this reform works so that foreign trade comes to support the latter.
- **Effect on inflation:** The latest projections communicated in the central bank's quarterly press release suggest a resumption of inflation without moving away from its structural level in Morocco. This exchange rate regime reform would encourage increased monitoring of this aggregate.

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