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## Analysis of the possibility of moving to a new stage in the process of flexibilization of the exchange rate regime in Morocco

Análise da possibilidade de passar a uma nova etapa  
no processo de flexibilização do regime cambial em Marrocos

**Ahmed Hrifia**, National School Of Business and Management of Settat, Morocco  
(ahmedhrifa00@gmail.com)

**Abstract:** Given the profound structural changes in the national economy and its increasingly increased openness to the outside world, the transition to a more flexible exchange rate regime constitutes a fundamental reform in order to strengthen the competitiveness of the economy, its resilience to exogenous shocks and the level of its potential growth. However, the transition to more flexibility is not without risk, it would be accompanied by massive inflows of foreign capital motivated mainly by expectations of appreciation of the national currency and the interest rate differential, which will result in excess bank liquidity and excessive growth of reserves causing greater inflationary pressures and aggravation of financial fragilities and exchange rate risk. The objective of this article is therefore to question the capacity of the Moroccan economy through its macroeconomic fundamentals, its financial markets and its institutions, to support the transition to a new stage in the process of flexibilization of the exchange rate regime. The results show that this transition still has to wait, the ground needs to be further prepared.

**Keywords:** Exchange rate regime, exchange rate, flexibility, Morocco.

**Resumo:** Face às profundas alterações estruturais da economia nacional e à sua cada vez maior abertura ao exterior, a transição para um regime cambial mais flexível constitui uma reforma fundamental para o reforço da competitividade da economia, da sua resiliência a choques exógenos e o nível de seu crescimento potencial. No entanto, a transição para uma maior flexibilidade não é isenta de riscos, pois seria acompanhada por entradas maciças de capitais estrangeiros motivadas essencialmente por expectativas de valorização da moeda nacional e do diferencial de taxas de juro. Algo que levaria a uma situação de excesso de liquidez bancária e crescimento excessivo das reservas provocando maiores pressões inflacionistas e aumento das fragilidades financeiras e do risco cambial. O objetivo deste artigo é, portanto, questionar a capacidade da economia

marroquina através de seus fundamentos macroeconômicos, seus mercados financeiros e suas instituições, para suportar a transição para uma nova etapa no processo de flexibilização do regime cambial, ou seja, metas de inflação. Os resultados mostram que esta passagem ainda deve esperar, o terreno deve ser mais preparado.

**Palavras-chave:** Regime cambial, taxa de câmbio, flexibilidade, Marrocos.

### **Introduction**

Since the collapse of the Bretton Woods fixed exchange rate system in the 1970s and underpinned by a series of currency crises in several countries, the issue of exchange rate stability has received particular attention. In this wake, empirical work proves that it is not easy to maintain a system of long-term fixity, especially in a context of liberalization of capital flows. Indeed, fixity regimes have been considered unsustainable and crisis-generating (Esmak, 2016). To this end, the transition to a more flexible exchange rate regime has become inevitable for some emerging and developing countries. For other countries, the path to flexibility was much smoother and the transition to more flexible regimes was mainly determined by the degree of economic and financial openness.

In Morocco, the exchange rate regime put in place by the monetary authorities has made it possible to maintain a framework of macro-economic stability. However, our country has been engaged, since the beginning of the 1980s, in a broad process of liberalization of its economy which has affected almost all sectors (Sabar & Belhouari, 2018). Consequently, the Moroccan economy is increasingly exposed to external shocks and requires, for this purpose, a greater capacity for adjustment and absorption of shocks. Therefore, it is important to choose the right exchange rate regime for the country's economy.

The objective of this article consists in questioning the capacity of the Moroccan economy through its macroeconomic fundamentals, its financial markets and its institutions, to support the passage to a new stage in the process of flexibilization of the exchange rate regime, namely inflation targeting. To do this, we first present the economic foundations of exchange rate regimes. Secondly, we will trace the trajectory of the management of the exchange rate regime in

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Morocco, correlated with the main macroeconomic effects. Thus, we are interested in what follows to discuss the merits of the arguments that militated for the adoption of the progressive regime of flexibility. It is fundamentally a matter of questioning the expected effects of the very long-term floating of the dirham in terms of adjustment, liquidity and confidence (credibility).

The examination of these factors will lead us to evaluate the role of the exchange rate policy in the macroeconomic adjustment in Morocco as well as the prospects for the choice of an optimal exchange rate policy. Finally, the last axis of the article will be devoted to the experiences of the transition to floating of certain economies and the main lessons to be learned in order to cushion the negative impacts of the transition to a floating exchange rate regime.

## **1. State of the art on exchange rate regimes: the economic foundations and their historical environment**

### **1.1 Definition and classification of exchange rate regimes:**

The exchange regime or system designates the set of principles and rules organizing the framework which determines the nominal value of the domestic currency. This value, called the nominal exchange rate, can be fixed in relation to one or more foreign currencies or in relation to a commodity such as gold or silver. Therefore, the exchange rate regime governs the interventions of the monetary authorities in the foreign exchange market and possibly the conduct of monetary policy in order to defend or influence the evolution of the exchange rate (Camara, 2014).

Historically, the classification of exchange rate regimes has been the subject of controversy. Placing such and such a regime in such and such a category turns out to be today, even for specialized institutions such as the IMF and the World Bank, one of the greatest challenges at the empirical level. Since 1950, the IMF's annual report "Exchange Arrangements and Exchange Restrictions" has consistently been the primary source of information on nations' exchange rate regimes.

Indeed, there are at least two ways of classifying countries according to their exchange rate regime. We have the so-called "de jure" classification, which was introduced by the Bretton Woods SMI, and the "de facto" classification, which is based on empirical analyzes.

### **1.1.1 De jure classification:**

The de jure classification is the IMF classification which asked the country to proclaim the exchange rate regime they put in place as belonging to one of the categories defined beforehand. Indeed, this classification grouped countries into three categories of exchange rate regimes, namely:

- Fixed exchange rate regimes;
- Limited flexibility plans;
- High flexibility plans.

This type of classification has the advantage of covering a wide range of countries and can be automatically and frequently updated and provide a consistent historical database. However, experience has shown that some countries apply exchange rate regimes other than those they officially declare. These are de facto exchange rate regimes, hence the de facto classification.

### **1.1.2 De facto classification:**

Since 1998, the IMF takes into account the degree of exchange rate variability and the economic policies that affect the Nominal Exchange Rate (NER ).

There are various de facto classifications, because a de facto classification depends on the criteria and methods retained by each author proposing a classification. De facto classifications are obtained using either:

- The statistical method, or,
- The analytical method of economic policies, or
- The method combining the first two.

According to the de facto classification of the IMF (2021), there are ten categories of exchange rate regimes which are presented as follows:

**Table 1:** Classification of exchange rate arrangements by the IMF in 2021

Type	Categories				
<b>Hard pegs</b>	Exchange arrangement with no separate legal tender	Currency board arrangement	-	-	
<b>Soft pegs</b>	Conventional pegged arrangement	Pegged exchange rate within horizontal bands	Stabilized arrangement	Crawling peg	Crawl-like arrangement
<b>Floating regimes</b>	Floating	Free floating	-	-	
<b>Residual</b>	Other managed arrangement	-		-	

Source: IMF, Annual Report on Exchange Arrangements and Exchange Restrictions, 2021.

## 1.2 The choice of an exchange rate regime

The choice of an exchange rate regime is a question of capital importance, because it calls into question the economic policy of a country and determines the methods of its insertion into the international fabric.

**Table 2:** Exchange rate arrangements, percent of IMF members in 2021

Exchange Rate Arrangement	2021
Hard peg	13%
Soft peg	47,6%
Floating	33,2%
Residual	6,2%

Source: IMF, Annual Report on Exchange Arrangements and Exchange Restrictions, 2021

Debates the question of choice of the optimal exchange rate regime are old, but not yet exhausted (Alhadj et al., 2019). In short, two series of new facts have updated this question of the choice of the optimal exchange rate regime, namely:

- The adoption of unsustainable exchange rate regimes has been widely seen as one of the causes of the recent succession of exchange rate crises, including the European Exchange Rate Mechanism crisis of 1992, the Mexican Peso crisis of 1994-1995, and the Asian crisis of 1997 (Esaka, 2010) and

preventing financial crises in general has become one of the priorities of political decision-makers in many countries (Nakatani, R., 2018).

- The effects of the exchange rate regime on the economy. Even if most of the work carried out so far has focused on the impacts of exchange rate regime choices on the variability of output and inflation (Alhadj et al., 2019).

### **1.3 Literature Review**

Over time, the issue of choice of exchange rate regime has been examined from different theoretical angles. The emergence of new theoretical viewpoints has been influenced by developments and crises in the international monetary system. In what follows, the theories are discussed in chronological order, with the exception of political and institutional factors. The chronological order of the theories makes it easier to understand new developments; this does not mean that the first theories have been forgotten. The optimal currency area theory and the Mundell-Fleming model remain key elements of macroeconomic theory in the open economy today. However, before going on to examine the various determinants of the choice of the exchange rate regime, the advantages and disadvantages of the various exchange rate regimes will be examined first.

The choice of exchange rate regime depends on the economic environment and the economic policy objectives of the country, a major change that has affected economic policy and, in particular, exchange rate policy in recent decades has been the liberalization of movements of capital. International capital movements have made it possible to maintain a fixed exchange rate even if a country has a current account deficit. On the other hand, the free movement of capital can also make it more difficult to pursue the desired monetary policy and maintain a fixed exchange rate (Sylviane, 2019).

Hefnaoui and Iataren (2022) concluded that all exchange rate regimes are feasible when fundamentals are good. The problems only show up in the behavior of the exchange rate; they are not caused by the exchange rate regime. But such a conclusion would be too extreme. The experience that began with the collapse of the Bretton Woods system and was followed by many other episodes, including the East Asian crises. The problem lies in the combination of tight control of fixed

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rates with monetary independence and high capital mobility. This does not mean that extremes, pure floating and rigidly fixed diets are the only options.

Jouamaa and Rhiati (2021) found that the exchange rate is one of the most influential variables in a given economy, because any fluctuation in exchange rates can affect the stock of external debt, the competitiveness of import and export companies, and the income and transfers from tourism of Moroccan nationals abroad. The crucial role of the exchange rate is therefore further strengthened within the framework of the system of managed flexibility and the continuation of the liberalization process. This notion of exchange rate loses its meaning in the event of persistent differences in inflation rates between the country in question and its trading partner.

EL Yamani et al., (2021) analyzed the relationship between the exchange rate and economic growth in Morocco. They found that considering the exchange rate as a facilitating condition for growth is important, but this does not mean that the exchange rate policy can replace the presence of efficient, disciplined and creative human capital; at a sustained level of investment; a favorable climate for foreign investment; to developed financial markets; a sound monetary policy framework; to a high level of institutional quality and to a competitive and technologically sophisticated exportable offer.

## **2. Methodology**

The notion of methodology, as a set of rules and approaches adopted to conduct research, so important in the history of the structuring of scientific disciplines, is crucial (De Mourat et al., 2015).

In this article, we have adopted two research methods, namely: documentary research and comparative research.

Documentary research consists of collecting information in relation to one's research subject from reliable sources. Depending on his subject, the investigator selects the most relevant documents, likely to provide him with essential information for the advancement of his research.

However, the comparative research can be defined as a decision support tool which is based on the work of collecting, analyzing and comparing information with a given purpose.

### 3. Analysis of the historical overview of the evolution of the exchange rate regime in Morocco

From the introduction of Islam in Morocco, the monetary question was one of the major state bases, in fact, the Arab-Muslim civilization has adapted two main currencies since its entry into Morocco. It was either a <sup>1</sup>gold-silver bimetallism, dinar in gold and dirham in silver and Okaya in bronze. The exchange between the Moroccan and foreign currency was not regulated by any text, it was the business of traders and money changers installed in the cities and the enclosures of the ports. The banking network was practically non-existent: only a few foreign banks had branches in Morocco, like the national discount counter in Paris, which had three branches in Tangier, Casablanca and Essaouira. Exchange rates could also vary from city to city and the lack of means of communication accentuated these disparities. All these conditions and many others led to the creation of the state bank in Morocco with the intervention of several foreign powers (Mezen & Echkoundi, 2020). Then, from 1912, date of the beginning of the French protectorate on Moroccan territory, the Moroccan franc was the main monetary unit of the Kingdom. The latter circulated until October 17, 1957, date of the creation of the Moroccan dirham which remained attached to the French Franc (FF) by a fixed parity, of which: 1 Dh = 100 centimes = 100 old Moroccan francs and fixing its parity at 175 .61 mg gold (El Yamani et al., 2018). From May 1973, the link with the French franc was broken, the monetary authorities chose to adopt an administered regime with the objective of managing the stability of the effective parity vis-à-vis a basket of currencies (Esmak, 2016).

**Table 3:** The Moroccan DH peg weights in the 1973 and 1980 baskets

Currencies	FF	US \$	ESP	LI	£	DM	FS	FB	FH
1973	38%	15%	15%	8%	8%	7%	4%	3%	2%
1980	25%	32%	15%	5%	8%	7%	2%	4%	2%

Source: Bank Al-Maghrib

<sup>1</sup>This bimetallism worked somehow, according to the inclinations of the power which, sometimes, did not respect the content of the coins and proceeded, in a search for signs of power, to unjustified coinage.



The three-year plan (1970-1980) was unable to achieve its objectives because of the structural nature of the imbalances, which could not be corrected by timid temporary measures; until 1980 the exchange rate was not used as an instrument of trade protection. BAM refused to use it as a means of regulating trade policy, giving priority to the stability of the dirham. Indeed, the stabilization policy implemented by the monetary authorities was followed by a restrictive policy with the aim of fighting against inflation, through the control of the creation of Moroccan cash and based on policies of credit supervision and selectivity. However, after this period, the monetary authorities accepted the principle of a long-term impact of the exchange rate on the structure of foreign trade, making the exchange rate policy active. In reaction to the above, since 1983, the adoption of a SAP marked the beginning of a series of reforms undertaken by the public authorities to modernize and liberalize the economy in order to meet the requirements of the new environment international economy, by implementing a policy of gradual and continuous economic and financial liberalization, the aim of which is to remedy external imbalances. In May 1990, in view of the association agreement between Morocco and the European Union and greater integration of the Moroccan economy in this area, the dirham was devalued by 9.25 %. Notwithstanding, the exchange rate policy aimed at a significant real depreciation was insufficient. Once again, the devaluation policy did not really have the expected positive effects. The expected result was not up to the means used. In fact, the devaluation of the dirham did little to contain the expansion of imports in particular. The limit of the exchange rate policy, the structural difficulties of the Moroccan economy and the rise in the import prices of raw materials entering into the intermediate consumption of exported products penalized Moroccan exports and pushed the country to undertake a reform comprehensive strategy centered on the liberalization of the economy which was also accompanied by an overhaul of the monetary and exchange rate policy. Moreover, The 90s saw an accentuation of the liberalization movement. In January 1993, a process of liberalization of the current account and the capital account began, which culminated in June 1996 in a passage towards a regime with a fluctuation band around a central parity in relation to a basket of currencies. In 1999, with the creation of the euro, the monetary authorities rearranged the basket

by replacing the old European currencies with the euro. This exchange rate policy did not exempt the Moroccan dirham from revaluation, following the depreciation of the dollar since 2001 and because of the latter's high weight in the reference basket. Such a policy has affected part of the competitiveness of its exports due to the appreciation of the dirham against the currencies of its direct competitors, in particular Tunisia and Egypt, pushing BAM to rearrange the basket by limiting its composition to Euro and US Dollar (respective weightings of 80% and 20%). This change resulted in a devaluation of about 5% of the national currency. Morocco's exchange rate regime has always had the mission of ensuring a certain stability of the dirham in relation to its main partners, with the aim of maintaining a balanced balance of payments. The real exchange rate of the dirham has been on a slow but steady downward trend since the early 2000s (Henri-Louis, 2019). The phase from 2007 to 2010 constitutes the first reflections on the reform project of the exchange rate regime, well before Morocco obtained the agreement for the Liquidity Precautionary Line (LPL) and at the same time to accompany the project Casablanca Finance City (CFC) and the free trade agreements signed with several countries. Morocco as opposed to Egypt and Turkey wants a gradual and orderly transition to a flexible regime under the assistance of several international bodies such as central banks, the International Monetary Fund & the World Bank to multiply the chances of success. From 2010 to 2015, Morocco moved to the phase of analysis, benchmarking and preparation for reform. On April 15, 2015, the monetary authorities had decided to update the currency weightings of the dirham quotation basket, but in favor of the American dollar, to become 60% for the Euro and 40% for the American Dollar, in order to reflect, at best the structure of foreign trade. This last update of the trading basket should constitute a first step in the process of transition towards a more flexible exchange rate regime aimed at supporting the capacity of the Moroccan economy to attract more direct investment from the European Union. Between 2008 and 2016, the euro-dirham exchange rates evolved almost symmetrically with the dollar-dirham exchange rates. Then, it was from 2016 that Morocco began preparing all stakeholders. The objective is to acquire the human, organizational and efficient information system resources necessary for the accomplishment of this reform project. The first interested party is

BAM (forecasting model, etc.). Preparation assistance also goes to economic operators, public and private, especially in terms of hedging against exchange rate risk. Awareness and assistance aims to prepare the banking system for this change. It remains undeniable that the exchange rate regime applied up to this stage has contributed to ensuring a certain stability of the national economy, the fact remains that the effects of the international financial crisis have highlighted certain limitations of this diet. Indeed, the current account deficit widened gradually to reach -9.5% of GDP in 2012 and the level of foreign exchange reserves returned to the equivalent of 4 months of imports of goods and services <sup>2</sup>at the level of the same year. These developments militate in favor of the transition towards greater flexibility of the exchange rate regime, in particular in the current context marked by the gradual improvement of macroeconomic balances. In July 2017, the Moroccan monetary authorities canceled the implementation of the floating exchange rate regime following a campaign of speculation against the Moroccan dirham. On January 15, 2018, Morocco decided to switch from a fixed exchange rate regime to a flexible regime, within fluctuation edges of +/- 2.5% (instead of +/- 0.3%) <sup>3</sup>. Under this new regime, the central bank will continue to intervene in the foreign exchange market to ensure its liquidity. The need for this reform and its timing can be explained by two reasons. The first is the predisposition of the Moroccan economy to make this change of course since it reconciles all the prerequisites (foreign exchange reserves, controlled deficit, currency in line with its real value, etc.). The second reason is the turbulent environment in which the global economy operates, which involves strong external risks. From March 9, 2020, the Ministry of Economy, Finance and Administrative Reform, after consulting the central bank, decided to widen the fluctuation band of the dirham by +/- 2.5% to +/- 5% compared to a central rate set by BAM on the basis of a basket of currencies composed of the euro (EUR) and the US dollar (USD) up to, respectively, 60 % and 40%. This expansion comes after the objectives assigned to the first phase have been achieved. The second phase has begun in a favorable internal macroeconomic and financial context, marked in particular by an appropriate level of foreign

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<sup>2</sup>Bank of Morocco (2015). Report presented to His Majesty the King. Financial year 2015.P91

<sup>3</sup>Bank Al Maghrib (2017). Reform of the exchange rate regime, Press Workshops, 13 February.

exchange reserves, controlled inflation (less than 1% in 2019), sustainable public debt and a solid financial sector with an absence of any pressure on the MAD and stability of its value. BAM continues, in accordance with its statute, to ensure the proper functioning of the foreign exchange market and will intervene, if necessary, on this market to ensure its liquidity. Among the expected objectives of this widening of the MAD fluctuation band:

- Give a strong signal to operators on the irreversibility of the reform of the exchange rate regime.
- Strengthen the role of the market in determining the exchange rate to deal with exogenous shocks, easing pressures on foreign exchange reserves and preserving export competitiveness.
- Boost the foreign exchange market and encourage economic operators to make greater use of hedging mechanisms.
- Avoid a forced widening of the band in the event of quotation of the MAD at the end of this band.

#### **4. Analysis of the motivating factors of the flexibilization of the exchange rate regime in Morocco**

Since the 1980s, the increased openness of the national economy to the outside has engaged us in a process of liberalisation, hence the need to adapt a competitive exchange rate regime to reduce exchange rate distortions and for greater adjustment.

In an increasingly turbulent environment, Morocco needs a competitive and dynamic exchange rate in line with the structuring projects undertaken and the major reforms initiated, with a view to improving the competitiveness and productivity of the economic fabric. national. Therefore, a more flexible exchange rate is undeniably important to the proper functioning of the productive fabric.

Today, it is easier to demonstrate that the current exchange rate system is no longer suited to the economic and social context, nor to the issues related to Morocco's intention to be a global platform between Africa and the rest of the world (Hefnaoui & Iataren, 2022).

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In addition, the Moroccan exchange system has not experienced fundamental changes for more than 30 years, while over this same period; the country has experienced a profound change in its economic and financial architecture.

In this regard, it is time to lead a change in the exchange system given the number of preconditions fulfilled. Indeed, the choice of an optimal exchange rate regime is strictly linked to the characteristics of the national economy in the light of the main orientations of the monetary authorities as well as the economic stakes of the country.

Firstly, Morocco aims to support trade openness with financial integration; for this the case of Morocco also has its specificities and it would be necessary to identify them in order to clearly define the target. If Morocco is open in commercial terms this is not the case in financial terms.

In fact, openness is all the more fundamental for economic development in that it offers Moroccan companies and operators a number of opportunities to enhance their competitiveness, and this, due to the fact that it bears real potential for attract investment, knowledge and know-how from abroad. It is also a lever for improving the quality of services and the performance of organizations, for improving the level of training provided and for creating, in the long term, more jobs. In this sense, exchange rate liberalization aims to improve competitiveness; it is important to check the theorem of critical elasticities or else the condition of Marshall-Lerner <sup>4</sup>.

In order to stimulate competitiveness, the liberalization of the exchange rate regime is an inevitable choice with the aim of considerably improving the business environment as well as promoting the emergence of young and successful companies and attracting productive foreign companies. In addition, the choice of exchange rate flexibility aims to mitigate external imbalances and exogenous shocks. Thus, limiting the pressure on foreign exchange reserves is a very solid argument that is sufficient in itself, without yet being explained, to

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<sup>4</sup> The condition of Nawal-Marshall-Lerner also called theorem of critical elasticities makes it possible to solve in an economic model taking into account the trade balance of the current balance (exports less imports), the indeterminacy on this one of a variation of the rate exchange rate (real or not). In other words, this condition makes it possible to ensure that the sensitivity of trade to upheavals in the exchange rate is greater than the reaction of inflation following a similar variation in the exchange rate.

justify the transition to exchange rate flexibility. This transition would also allow the Moroccan economy to acquire a macroeconomic instrument that acts as a shock absorber (Khattab & Salmi, 2021).

Another argument in favor of flexibility lies in the fact that the monetary authorities retain full freedom to act in terms of monetary policy, mainly to conduct counter-cyclical monetary policies.

The tourism sector will also benefit more, relying on the attractiveness of the Moroccan destination which will become more accessible. Also for MREs as long as the value of the dirham decreases, which will indirectly benefit the economy.

However, the adoption of a floating exchange rate would make it possible, on the one hand, to weaken the negative effects due in particular to the lack of diversification of the Moroccan economy, and on the other hand, to attach monetary policy more to the national economy and less to an external anchor.

Indeed, Morocco has repeatedly expressed its desire to pursue a policy of diversification in terms of products and partners. The challenge is to find new partners outside the so-called classic ones such as the European Union, with which the country has experienced several problems. In addition, the global growth map is turning into the profit of some emerging economies. However, less competitive companies will have to disappear to make way for others who will be able to adapt to the new decimeters of the market.

Finally, this reform aims to create a stimulating business environment that is a prerequisite for improving the productivity and performance of the economy while reducing the dependence of economic growth on climatic conditions. This reform is also a means of strengthening Morocco's institutional capacities and improving its anticipatory management style through the establishment of effective risk management. Thus, the fragility of the fixed exchange rate regime in the face of the possibility of a major external shock played a pivotal role in the liberalization of the exchange rate regime.

## 5. The “optimal” exchange rate policy and its role in macroeconomic adjustment in Morocco

Since the structural adjustment plan, the Moroccan economy has entered an era of macroeconomic stabilization conducive to the conduct of structural reforms and strategies for the future of the national economy. As a result, Morocco has long maintained its historical and traditional choice of anchoring to a basket composed of two main currencies: the Euro and the Dollar. However, this choice will no longer serve the economic interests of Morocco, which leads the monetary authorities to build a new model based on the flexibility of the dirham exchange rate while exploring an optimal exchange rate policy capable of improving competitiveness and absorb both internal and external shocks in order to achieve the country's growth and development (Mezen & Echkoundi, 2020).

No one can deny that the success of an exchange rate regime remains dependent on the quality and relevance of macroeconomic policies. On the other hand, the question that arises is: *With the current economic and structural conditions, could Morocco benefit from the advantages that the transition to a more floating exchange rate regime could provide and could it protect itself from the risks inherent in this transition?*

The exchange rate has become an economic policy mechanism in Morocco as in the rest of the world, which requires the establishment of a set of accompanying procedures and structural reforms such as the independence of monetary authorities and the accentuation of their decision (modeling and forecasting inflation and its relationship with the international situation).

The adoption of a floating exchange rate regime also requires priority reforms of the financial and banking system, in addition, the establishment of a rigorous legal and institutional framework to better meet international standards.

Moving to a more flexible exchange rate regime also requires improving market efficiency and liquidity. The central bank is supposed to take the hand off gradually and improve transparency and the transmission of information.

At the same time, the liberalization of the capital account must be done in a gradual way to maintain the dynamic transition towards a stable financial system. These reforms must be complemented by rigorous control of capital flows in order to avoid unforeseen events.

On the other hand, fiscal policy should be countercyclical. It should rely primarily on automatic stabilizers and respond symmetrically to the business cycle (i.e., it should ease in bad times and tighten in good times) <sup>5</sup>.

In short, there is unanimity on the benefit that the transition to a more flexible regime will generate and that it should take place when the conditions are favourable. In the case of Morocco, the question is no longer to choose between a fixed or flexible exchange rate regime but to specify the degree of management of the exchange rate under a floating regime. In short, the Moroccan economy is not ready to move to the total liberalization of the exchange rate of the dirham. The Kingdom has therefore decided to wait until the effects of Covid-19 are overcome.

## **6. International benchmark for the transition to a floating exchange rate regime**

In order to draw lessons from the transition to a floating exchange rate regime and to identify the macroeconomic effects that a country may suffer from its transition to such a regime, we are going to shed light on a panel made up of several countries.

### **6.1 Experiences of a gradual transition to a flexible exchange rate regime**

#### **Case study of Chile (1980-2022)**

In Chile, the flexible system was implemented after good preparation of the ground and agreement between the decision to change the regime and the elements that support it (implementation of a gradual and implicit inflation targeting framework, provision of conduct of monetary policy under a more flexible regime and preparation of market participants).

After the collapse of the Chilean fixed exchange rate regime in the early 1980s, due to the country's high indebtedness, the authorities decided to implement a "*crawling peg*" regime in 1982 essentially aimed at promoting a depreciation of the exchange rate to boost exports, generate resources to refinance the external deficit and reduce inflation. Between 1990 and 1997, the macroeconomic aggregates improved markedly: an increase in the annual growth

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<sup>5</sup> IMF Fiscal Monitor (2017), "Achieving More with Less", April Edition.



rate accompanied by an increase in exports, a fall in inflation and the unemployment rate and a massive movement of capital inflows.

In 1998, the Asian crisis hit the country. The sources of financing have deteriorated as well as the terms of exchange. The depreciation of the exchange rate led to interventions by the authorities on the foreign exchange market through a restrictive monetary policy and a contraction of the band (from 12.5% to 2% at the top and 3.5% at the bottom).

Authorities spent several months defending the peso and then adopted a 7% band. In 1999, the country moved to a flexible exchange rate regime.

On June 29, 2022, the exchange rate of the Chilean peso against the US dollar reached a record high, flirting with 930 pesos per dollar, after having exceeded the mark of 900 pesos per dollar on June 23.

The depreciation of the Chilean peso is explained by several internal and external factors. Among the external factors, we obviously include the impact of the reduction in monetary policies in the advanced countries, in particular that of the Fed in the United States. Added to this is also, in particular because of the slowdown in China's growth, the fall in the price of copper, which reached very low levels at the end of June, falling below the floor of 4 \$ per pound on June 22 and reaching around 3.7 \$ per pound on June 30 (-15% over one month), i.e. its lowest price since February 2021. Internal factors are also at work, such as the uncertainty linked to the new Incorporation.

Among the results of this transition to floating:

**Table 4:** Results of the transition to floating - case of Chile

<b>Indicator</b>	<b>Main results</b>
Change market	<ul style="list-style-type: none"> <li>- Authorization of swap transactions</li> <li>- Gradual lifting of regulations</li> </ul>
Monetary Policy	<ul style="list-style-type: none"> <li>- Reduction of inflation</li> <li>- Gradual abandonment of the exchange rate anchor for an inflation anchor.</li> </ul>
Capital account	<ul style="list-style-type: none"> <li>- Gradual liberalization of capital outflows</li> </ul>
Banking sector	<ul style="list-style-type: none"> <li>- Low level of dollarization</li> </ul>

Source: compiled by the author

### Case study of Poland (1990-2022)

The country has gone through a gradual flexibilization. The transition stages were in response to domestic and international economic changes, as well as to the multiple objectives set by the government: maintaining competitiveness, reducing inflation and integrating domestic markets. During the 1980s, Poland experienced external and internal imbalances. With a high debt ratio, weak growth and a large current account deficit, the country thus adopted an adjustment plan which consisted of a reallocation of resources between the public and private sectors and a liberalization of prices leading to hyperinflation.

A deterioration of the economic situation in Europe, and in particular in Germany, would have a much more harmful impact on Polish growth. The country is by far Poland's largest trading partner, accounting for 28.7% of its exports and 20.9% of its imports. A recession in Germany could thus drag the Polish economy in its wake, given the strong integration of the Polish economy in the German value chain.

The National Bank of Poland has been carrying out a continuous tightening of monetary policy since October 2022, having raised rates at each of its meetings since October. The key rate has now stood at 6% since the beginning of June 2022. In addition, the outbreak of war in Ukraine had led to a sudden depreciation of the zloty, which reached its historic low of 5 against the euro in early March before falling again.

**Table 5:** Results of the transition to floating – the case of Poland

Indicator	Main results
Financial market	- Stability and strengthening of the financial system
Monetary Policy	- Monetary policy stability
Capital account	- Cautious capital account liberalization
Banking sector	- The decisions taken were never revoked, otherwise they will influence the credibility of the central bank imposing large costs on the economy.

Source: compiled by the author

## 6.2 Experiences of an abrupt transition to a flexible exchange rate regime

### Case study of Brazil (1990-2022)

Brazil's transition to a flexible exchange rate regime was motivated by the resorption of imbalances due to the inconsistency of exchange rate policy, fiscal policy and monetary policy. In the early 1990s, Brazil implemented a stabilization plan that led to:

- The appreciation of the REER resulting in an appreciation of the local currency and a decline in competitiveness;
- The considerable drop in inflation;
- The massive influx of capital.

The weak results of fiscal policy leading to very high domestic interest rates have all led to the increase in consolidated net public debt (42% of GDP in 1998) and to the deterioration of the macroeconomic situation. Several external shocks hit the country's economy, such as: the Mexican crisis in 1995, the Asian crisis in 1997 and the crisis in Russia in 1998.

Faced with the constant rise in inflation (from June 2020 to June 2022), the Central Bank has had to raise its key rate by 1175 bps since March 2021 to 13.75% at the end of 2022. According to the forecasts of the Central Bank, maintaining the key rate at 13.75% until June 2023 is envisaged at this stage. It should be noted, however, that the increase in public expenditure planned for 2023, combined with uncertainties as to the compensation measures necessary to avoid a greater imbalance in the public accounts, favor the depreciation of the real against the USD, which could feed imported inflation and postpone a possible monetary easing in the year.

**Table 6:** Results of the transition to floating - case of Brazil

Indicator	Main results
Foreign exchange reserves	- Reduced to half due to speculative attacks and lack of trust.
Monetary Policy	- The rapid implementation of a monetary and fiscal policy made it possible to limit market instability

Source: compiled by the author

### Case study of Uruguay (1990-2022)

The transition from a "crawling band" to a floating regime, in a context of a real financial crisis followed by a severe depreciation of the peso and the insolvency of economic agents. The tape was dropped without the necessary prerequisites. The country's experience shows how the transition to floating in a context of absence of necessary elements and a lack of perception of exchange risks can make the transition process difficult.

Uruguay implemented a stabilization plan between 1990 and 2002, which made it possible in particular to reduce hyperinflation; even after the abandonment of the stabilization plan during the 2002 crisis, inflation did not exceed 10%.

The current account deficit should almost completely shrink to -0.2% of GDP in 2022 (against -1.9% of GDP in 2021), boosted by the dynamism of exports (soya, meat, dairy products) which benefit from sustained prices. The external debt is on the rise and reaches nearly 86% of GDP in 2021, of which around 15% of the total is to be repaid/refinanced within 1 year, which should be easily achieved. The Uruguayan peso has also tended to appreciate since the start of the year, boosted by sustained commodity prices and inflows of foreign capital.

The Central Bank should continue its monetary tightening in the face of rising inflationary pressures. In May 2022, inflation thus reached 9.4% y/y, i.e. the highest level in 13 months.

Faced with rising inflation, the Central Bank raised its key rate by 75 bps to 9.25% last May (+475 bps since the start of the tightening in August 2021).

**Table 7:** Results of the transition to floating - case of Uruguay

Indicator	Main results
Financial market	- Strong currency depreciation (more than 80%)
Monetary Policy	- Soaring prices and rising inflation
Banking sector	- Insolvent banks have closed (1/3 of the banking system)

Source: compiled by the author

### 6.3 Failed Experiments in the Flexible Exchange Rate Regime: Forced and Disorderly Reform

#### Case study of Ecuador (2009-2022)

A set of macroeconomic conditions and operational aspects contributed to the failure of the move to greater flexibility:

- The underdeveloped and illiquid financial market;
- Limited risk management capacity;
- The absence of an appropriate intervention policy;
- The limited degree of independence of monetary policy;
- Adverse economic conditions and weak macroeconomic policy.

Ecuador's "dollarized" monetary regime has limited macroeconomic policy options for responding to external shocks. As a result, the country's budget deficit increased sharply and reached 5.1% of GDP in 2009, mainly due to lower revenues from oil exports, increased energy subsidies and public investments in strategic infrastructure projects; health, education and social protection to bring about the long-needed improvements in these areas and pave the way for sustainable growth.

Today, Ecuador is expected to post a current account surplus for the 3<sup>rd</sup> successive year in 2022, boosted by the trade balance surplus, supported by oil prices, as well as remittances from expatriate workers who would remain dynamic. This, together with drawings from the IMF credit line, is helping to strengthen the country's foreign currency reserves. The conditions for access to market financing have also returned to pre-pandemic levels, after peaking in Q1 2020 when the country was placed in selective default by the rating agencies (following its request for deferral payment to private creditors).

**Table 8:** Results of the transition to floating - case of Ecuador

Indicator	Main results
Change market	<ul style="list-style-type: none"> <li>- High pressure</li> <li>- Fall in foreign exchange reserves</li> </ul>
Monetary Policy	<ul style="list-style-type: none"> <li>- Acceleration of inflation</li> </ul>
Banking sector	<ul style="list-style-type: none"> <li>- Banking crisis due to lack of regulation and supervision of the sector.</li> </ul>

Source: compiled by the author

### **Case study of Egypt (1991-2022)**

Egypt pegged its currency to the dollar in 1991, but abandoned this policy in mid-2000. Pressures on the pound have increased since 1998, when capital left the country after the Asian crisis, while tourism suffered from terrorist attacks at home and abroad. Furthermore, the appreciation of the dollar against the euro and the yen has exacerbated the loss of competitiveness. Egypt initially responded to these pressures by intervening in the foreign exchange market and tightening its credit policy, but official reserves continued to decline and economic growth slowed. Exchange rate pressures did not ease after an initial depreciation in mid-2000, and in January 2001 the authorities adopted an adjustable fluctuation band. However, pressures on the pound intensified again after the 11 September, leading to a depreciation of more than 35% against the dollar from mid-2000 to early 2003. official currency remained scarce at the prevailing official exchange rate, and a parallel market emerged. After the recent move to a floating regime, the currency depreciated by 20%, and the supply of currencies in the official market increased.

After the Arab Spring of 2011, Egypt requested a 12 \$ billion loan from the IMF in order to escape the economic crisis that hit the country. Therefore, the implementation of a floating exchange rate regime in November 2016 is part of the IMF's conditional rules for obtaining the loan. Egypt has always experienced low and declining levels of foreign exchange reserves, which is the result of several factors such as: political and regional instability, weak investment climate, weakening competitiveness and concerns about matters of security.

In 2022, the Central Bank of Egypt decided to float the Egyptian pound to ensure “monetary and fiscal stability”. Egypt is suffering from a shortage of dollars which is putting pressure on the Egyptian pound and has severely slowed imports, on which the country of 104 million people is heavily dependent. Experts estimate that the Egyptian pound has lost, since the beginning of 2022, between 20% and 25% of its value against the greenback. The local currency has been undergoing a slow depreciation since the end of March and the decision of the Central Bank of Egypt to end the fixed exchange rate system, which had led to a devaluation of more than 16% of the Egyptian pound, in parallel with the 1% increase in interest rates.

**Table 9:** Results of the transition to floating - case of Egypt

Indicator	Main results
Monetary Policy	- Rise in inflation and deterioration in consumer purchasing power
Outdoor sector	- Reduction of external imbalance
Tourism	- Increase in tourism receipts and FDI.

Source: compiled by the author

### **Conclusion & Policy implications**

Through this article, it is clear that Morocco has gone through a long path of reforms in order to seek the stability of macroeconomic fundamentals. It has thus opted for a gradual liberalization and a more flexible exchange rate regime in order to gain more competitive advantage compared to its competitors. This passage, certainly studied and supported by the IMF and the Moroccan authorities are optimistic as to the multiple advantages to be acquired such as the limitation of the pressure on the foreign exchange reserves and the prevention of foreign exchange crises, the strengthening of the resilience of the economy Morocco to external shocks, supporting its competitiveness and improving its level of growth. The reform should accompany the structural reforms experienced by the national economy in recent years, particularly in terms of diversification, openness and integration into the international economy. However, Morocco has a “small economy” which, admittedly, has been opening up to the outside world for four decades, but whose integration into international capital markets is in progress. The transition to more flexibility is not without risk, hence the imperative to set up an “optimal” exchange rate regime. In this current international context marked by the Russo-Ukrainian conflict, the move to a new stage in the process of making the exchange rate regime more flexible, namely inflation targeting, must still wait; the ground needs to be further prepared. The Kingdom is not yet ready for full liberalization of the dirham, but it can further widen the fluctuation band.

The international sphere presents rich lessons for the transition to floating (Egypt, Turkey, Brazil, etc.), tracing the positive but also negative effects, to which Morocco must be vigilant by putting in place the necessary measures to

deal with these effects at the national level in a good time. In short, questions relating to the flexibility of the exchange rate regime are still numerous. The theoretical and managerial issues are also of paramount importance, which gives rise to many future research works and offers a favorable field for the development of scientific research.

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