



Challenges of Transition to a Flexible Exchange Rate Regime in Morocco

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Abstract: This article analyzes the challenges related to the flexibility of the exchange rate regime within the framework of the inflation targeting policy in Morocco. It highlights the evolution of the national economic context, marked by the gradual opening of markets, the liberalization of capital and vulnerability to external shocks. The study of macroeconomic indicators such as GDP, CPI, interest rates and the exchange rate reveals that, despite relative stability, the economy remains sensitive to global crises. In this context, the transition to a more flexible exchange rate regime appears as a strategic step to strengthen economic resilience and ensure the effectiveness of monetary policy oriented towards price stability.

Keywords : Exchange rate flexibility, Monetary policy, Bank Al-Maghrib, Inflation targeting

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1. Introduction

In recent decades, inflation targeting has emerged as a preferred monetary policy framework, particularly in middle-income countries, in response to the limitations of traditional strategies based on intermediate quantitative targets such as the money supply. This regime promotes transparency and the management of expectations, which are essential elements for economic stability in contexts of high volatility (Mishkin, 2000).

Morocco has initiated a gradual reform of its monetary framework, considering a more flexible exchange rate regime and the future adoption of inflation targeting. This approach aims to strengthen resilience to external shocks, stabilize inflation, and enhance the credibility of Bank Al-Maghrib. However, the transition requires a thorough analysis of economic dynamics and monetary transmission mechanisms in an open economy (Batini & Laxton, 2007).

The article focuses on analyzing Morocco's economic context to shed light on the factors driving the transition to a flexible exchange rate regime. Emphasis is placed on exchange rate developments, foreign exchange reserves, export competitiveness, economic openness, capital mobility, and the autonomy of Bank Al-Maghrib, as well as key indicators such as GDP, inflation, and the budget deficit.

2. Literature review

The economic crises that have affected several countries – such as East Asia in 1997, Russia in 1998, Brazil in 1999, and Argentina in 2002 – have often been attributed to the rigidity of their exchange rate regimes. This type of peg, by limiting monetary flexibility, encourages significant capital movements and increases the risk of currency depreciation, which has led many countries to turn away from it.

It is in this context that the inflation targeting policy emerged, designed to compensate for the ineffectiveness of traditional approaches based on the control of monetary aggregates and the fixing of the exchange rate. International experience has demonstrated its effectiveness (Neumann, 1997). However, its success depends on the prior existence of a flexible exchange rate regime, a condition put forward by several research (Masson et al., 1997 & Mishkin, 2000). The exchange rate thus appears as a major determinant of price stability and the effectiveness of this monetary framework, both in Keynesian and monetarist models and in the empirical experiences of countries that have adopted it.

Inflation targeting differs from previous regimes by explicitly targeting an optimal inflation rate for the entire economy. Exchange rate flexibility allows the central bank to strengthen its

independence, broaden its objectives, and improve its responsiveness. This flexibility becomes essential when the central bank faces a trade-off between stabilizing the exchange rate and controlling inflation. In such cases, the accumulation of conflicting objectives can erode the credibility of monetary policy and compromise the anchoring of expectations.

Conversely, the effectiveness of a fixed regime has often been questioned. Some researchers Tornell & Velasco (2000) believe that the apparent stability it provides is not sustainable in the long term. Furthermore, the work of Edwards & Yeyati (2005) shows that this regime is incapable of effectively absorbing shocks, particularly those related to the terms of trade (Broda, 2001). Conversely, a flexible regime favors a rapid reallocation of resources and allows for better adaptation to external disturbances (Marouani et al., 2000).

Dual targeting of inflation and the exchange rate can weaken monetary policy, as Amato & Gerlach (2002) point out. A depreciation of the national currency could force the central bank to raise its rates abruptly, which would weaken the banking sector and undermine the success of the inflation targeting strategy.

Regarding exchange rate volatility, Pétursson (2009) demonstrated that the adoption of inflation targeting, combined with greater exchange rate flexibility, does not lead to excessive instability. A certain degree of volatility remains tolerable and even acts as a buffer in the event of a shock. Edwards & Yeyati (2005) arrive at a similar conclusion, confirmed by other studies using different econometric models (Sabbán et al., 2003).

Finally, the success of inflation targeting does not depend solely on the monetary framework: it also requires institutional and structural prerequisites, among which exchange rate flexibility is a central pillar (Mishkin, 2000 ; Batini & Laxton, 2007). Overall, the literature converges on the idea that fixed regimes are less efficient, less suited to open economies and more vulnerable to external shocks. As Benlamine et al. (2018) have shown, countries under fixed regimes tend to give excessive priority to exchange rate stability and the maintenance of foreign exchange reserves, to the detriment of broader objectives. Their study also reveals that, over the period 2000-2016, the European Central Bank had to intervene much more frequently than Bank Al-Maghrib, which reflects the increased fragility of rigid regimes in the face of international fluctuations.

3. Overview of the Moroccan economic context and challenges of the transition to a flexible exchange rate regime

3.1 Transformations of the exchange rate regime in Morocco

The history of Morocco's exchange rate regime reveals strategic transformations aimed at macroeconomic stability. Before 1973, the dirham was pegged to the French franc, reflecting economic ties with France. After the collapse of Bretton Woods, Morocco opted for a currency peg to reduce its dependence on a single currency and adapt its monetary system to its trade patterns, while strengthening foreign exchange reserve management in an increasingly volatile financial environment.

Between 1973 and 1980, the composition of the dirham basket changed profoundly: the share of the French franc fell from 38% to 25%, while that of the US dollar increased from 15% to 32%, reflecting Morocco's adaptation to the rise of the dollar and the diversification of its trade, particularly with Europe. The transition in 1973 from a fixed parity regime to a currency basket peg aimed to stabilize the dirham in an unstable international context. However, dependence on phosphate revenues and falling prices worsened the debt and external deficit. The adjustment plans implemented in the late 1970s failed to restore balances, forcing Morocco to resort to the IMF in 1981. Despite the reforms, the following decade remained marked by persistent imbalances, requiring deep structural reforms to restore macroeconomic stability.

Since the 2000s, Morocco has gradually reformed its exchange rate regime to strengthen macroeconomic stability and resilience. The composition of the dirham basket was adjusted (2001: 80% euro/20% dollar; 2015: 60% euro/40% dollar) to better reflect trade flows. Between 2007 and 2015, several liberalization measures were introduced, preparing the transition to greater flexibility, although a floating plan was postponed in 2017 due to speculation. In 2018, the fluctuation band was widened from $\pm 0.3\%$ to $\pm 2.5\%$, marking a step towards a more flexible regime.

At the same time, Bank Al-Maghrib has modernized its monetary framework, revised its organic law, strengthened its modeling tools, and implemented a prudent policy, including a reduction in the key interest rate (2014-2016). These reforms, carried out in coordination with the IMF, aim to prepare for the transition to inflation targeting, which would allow price stability to replace the exchange rate anchor as the nominal objective. However, this transition remains conditional on the maintenance of solid macroeconomic balances and strict fiscal discipline.

The IMF believes that Morocco has the necessary conditions to gradually relax its exchange rate regime. The country's strong reserves, improved external position, and operational readiness provide a favorable framework for this transition, which would strengthen the economy's resilience to shocks and competitiveness.

3.2 Impact of foreign exchange reserves on economic stability in Morocco

Foreign exchange reserves are a pillar of economic stability in Morocco, supporting the dirham, cushioning external shocks, and strengthening competitiveness. Their evolution is critical to the successful transition to a more flexible exchange rate regime, while limiting inflationary risks. Studies show that a decline in reserves, especially during periods of current account deficits, puts significant pressure on the foreign exchange market and undermines macroeconomic stability. Between 2016 and 2018, Moroccan reserves experienced significant volatility, falling from 249.2 billion dirhams in December 2016 to a low of 204.1 billion dirhams in June 2017, before recovering to 240.9 billion dirhams in November 2017 and then stabilizing around 224.4 billion dirhams at the end of 2018. These fluctuations illustrate the central role of reserves in monetary management and resilience in the face of external pressures.

Foreign exchange reserves play a key role in Moroccan economic stability, particularly under a fixed exchange rate regime, where their weakness increases vulnerability to crises. Their level depends heavily on the balance of payments: trade surpluses and FDI strengthen them, while deficits and external shocks weaken them. Since the 1990s, they have undergone three phases: accumulation until 2008, decline between 2008 and 2013, then recovery from 2014 thanks to falling commodity prices, rising FDI, and buoyant exports (automotive, aeronautics, tourism). In 2017, they covered 6.4 months of imports, above the IMF threshold. In 2019, the IMF's LPL and the reduction in the current account deficit (4.1% of GDP) consolidated these reserves to MAD 245.6 billion (5.6 months of imports). However, the COVID-19 crisis has led to a further decline, confirming their vital role in absorbing external shocks.

Foreign exchange reserves, held by the central bank (currency, securities, gold, SDRs), are a key indicator of a country's ability to meet its external commitments and absorb shocks. In Morocco, their evolution between 2010 and 2023 reveals fluctuations: a decline in 2012, a recovery after 2015, then a sharp increase in 2020 in the face of the COVID-19 crisis. These dynamics reflect proactive management aimed at supporting the dirham, strengthening resilience, and preserving macroeconomic stability in an unstable international context.

3.3 The opening of Morocco's economy

Morocco has gradually strengthened its economic openness since the 1990s through capital liberalization and increased integration into global markets. This dynamic has stimulated trade and FDI, but has increased financial risks, requiring greater autonomy for Bank Al-Maghrib.

The adoption of a more flexible exchange rate regime has consolidated this autonomy, allowing for greater control over monetary policy, essential for price stability and growth.

Since 1959, the dirham has undergone several adjustments to correct economic imbalances, marked by successive devaluations (1983, 1990, 2001) and revisions of the currency basket. These measures temporarily improved competitiveness, but have shown that devaluation alone is no longer sufficient: sustainable competitiveness depends on effective public policies.

The assessment of these reforms is based on various indicators: balance of payments, FDI, foreign exchange reserves, openness rate, economic freedom and national savings rate. The Real Effective Exchange Rate (REER) is a key indicator, as it measures Morocco's price competitiveness vis-à-vis its trading partners. A high REER reflects a loss of competitiveness, while a low REER improves it. Monitoring it makes it possible to assess the effectiveness of monetary adjustments and guide future exchange rate strategies.

The real effective exchange rate (REER) of the dirham has shown a general appreciation trend, particularly since 2019, which reduces the competitiveness of Moroccan exports. Since its creation, the dirham has undergone several devaluations (1983, 1990, 2001) and adjustments to the currency basket to correct imbalances, but these measures have proven insufficient without structural reforms.

Faced with these limitations, Morocco began a transition to a more flexible exchange rate regime, strengthening monetary autonomy and supporting the progressive liberalization of capital initiated in the 1990s. This opening facilitated financial flows and supported foreign investment.

Foreign direct investment, although fluctuating between 2010 and 2022, remains essential for the Moroccan economy, peaking in 2012 thanks to increased investor confidence in the domestic economic climate.

From 2000 to 2022, Morocco's current account was highly volatile, ranging from a temporary surplus in 2001 to deep deficits around 2012 (-8.95% of GDP) as a result of rising oil prices and the global financial crisis. Economic reforms and export diversification led to a gradual improvement after 2012, despite the impacts of the pandemic and rising energy prices in 2022.

3.4 The autonomy of the central bank of Morocco

At the same time, Morocco has strengthened the autonomy of its central bank, Bank Al-Maghrib (BAM), to better manage monetary policy and fluctuations in the dirham. The adoption of a currency basket in 2001 and the 2006 statutes have promoted price stability, but dependence on

a fixed exchange rate still limits monetary efficiency. The transition to a more flexible exchange rate regime is therefore crucial to increasing BAM's autonomy, improving external competitiveness, and effectively managing economic shocks.

Between 2000 and 2023, Moroccan GDP growth fluctuated significantly, reflecting the economy's sensitivity to external shocks, climatic conditions, and structural reforms. After a strong expansion in 2001 (7.72%), driven by agriculture, growth fell to 3.73% in 2002. The 2009 global financial crisis reduced GDP to 3.74%, before a rebound in 2011 (5.52%) thanks to public investment and economic reforms. Between 2016 and 2020, growth remained unstable, marked by an agricultural slowdown in 2016 (0.52%) and a collapse in 2020 (-7.18%) due to the COVID-19 pandemic. The recovery in 2021 (8.02%) was followed by a slowdown in 2022 (1.26%) in the face of inflation and tensions on supply chains, illustrating the persistent vulnerability of the Moroccan economy.

Between 2014 and 2019, inflation in Morocco remained low and under control thanks to Bank Al-Maghrib's prudent policy. The pandemic initially caused prices to virtually stagnate in 2020, before a sharp inflationary surge in 2022 (up to 9% in 2023), linked to raw materials and global tensions.

Bank Al-Maghrib practices inflation targeting, which is effective in an interim exchange rate regime where its interventions stabilize expectations. But the recent surge demonstrates the limitations of this framework and underscores the increased risks that a more volatile floating regime would entail.

From 2014 to 2019, Morocco's GDP grew steadily thanks to macroeconomic stability, before falling sharply in 2020 due to the pandemic. It then recovered, reaching a record high in 2023. Meanwhile, the interest rate remained stable at around 2.25% until the health crisis, then was lowered to 1.5% to support the economy. Starting in 2022, in the face of recovery and inflation, the Central Bank gradually raised it to 3% in 2023.

Between 2014 and 2023, Morocco's nominal and real exchange rates remained broadly stable, with slight volatility in 2020 linked to the pandemic. This stability reflects Bank Al-Maghrib's interventions to limit fluctuations and contain inflation.

The interim exchange rate regime, based on active intervention by the Central Bank, allows for better anchoring of inflation expectations and more reliable economic planning. Conversely, a floating regime would lead to greater volatility and less controlled inflation expectations.

4. Conclusion

Ultimately, this work highlighted the dynamics that structure the Moroccan economy and the foundations of its move towards a more flexible exchange rate regime, a preliminary step to the adoption of inflation targeting. The analysis showed that Morocco's monetary choices are part of a logic of progressive modernization, driven by the historical evolution of the exchange rate regime, the consolidation of foreign exchange reserves, the improvement of external competitiveness and the implementation of appropriate monetary reforms.

This approach reflects the desire to establish a more autonomous macroeconomic policy that is better aligned with the demands of the global economy. The shift to greater exchange rate flexibility is not only a technical adaptation, but also a structural transformation aimed at strengthening the country's resilience to external shocks, preserving price stability, and supporting sustainable growth. As such, Morocco is positioning itself on a trajectory where monetary transition becomes a strategic lever for stability and competitiveness, an essential condition for successful international economic integration.

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