

Exchange rates and their effect on morocco report essay sample



Most markets operate by trading goods or service in exchange for money. That is to say today I could go to local farmers market and buy x amount of apples for one euro. I thereby get the goods and the seller receives money which he can then in turn exchange for other goods. The one euro in this transaction is a medium of exchange.

Without a currency, markets would revert back to a barter system.

Participants in markets would have to exchange goods and services for other goods and services.

Currency markets are different because rather than trading currencies for goods or services, currencies markets trade one currency for another currency.

The two basic choices a country has over its exchange rate regime is whether to fix the value of its currency to other currencies or to let it float and let the market decide what the value of its currency should be.

In a free floating exchange rate regime the price of a currency is determined by supply and demand. A shift upwards in the demand curve and downwards in the supply for the home currency will lead that currency to appreciate in value. These movements in supply and demand would results in more importing and less exporting.

In free floating exchange rate regimes it is purely economic performance factors that the effect long-term movement in exchange rates. Monetary policy will be used to control inflation. For example, this is shown in the

graph as a rise in currency supply means that there will be a subsequent depreciation in the market value of the currency (Moroccan dirham).

In a managed float the country does not completely ignore what is happening in the currency market. It will from time to time exert some pressure on currency markets by taking steps such as adjusting interest rates. This happened recently in Switzerland when the Swiss central bank announced it was setting a minimum exchange rate of 1.2 Swiss francs to the euro as it felt its own currency was becoming too strong against the euro. (BBC news 6/9/2011).

A fixed exchange rate or a pegged exchange rate is an exchange rate regime where a country's currency value is set against another asset. This can be another currency, a basket of currencies or a commodity such as gold or silver.

This can be a specific target as was the case before euro notes came into circulation when a punt would buy you 1.27 euro. Or countries might set up and lower limits which they will not let the currency go.

In fixed exchange rate regimes maintaining the exchange rate is the primary target of monetary policy. This is achieved by increasing money supply when its own currency is appreciating and limiting money supply when its currency is depreciating.

History of exchange rate regimes

Britain adopted the classic gold standard in 1821 whereby any one holding a

British banknote or coin could convert it into gold. In the 1870s Germany,
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USA and France also adopted a gold standard. This meant that exchange rates were fixed to each other. If £20 pounds could be converted into two ounces and \$40 could be converted into 2 ounces. The £/\$ exchange rate was fixed at £1 to \$2. This meant that exchange rates between all countries on the gold standard were fixed. School children would have learned exchange rate the same way that they would learn that there are 14 pound in a stone or 8 furlongs in a mile.

It was during this time that the agricultural and industrial revolutions took place first in Britain and then in mainland Europe. The European and American economies grew and the gold standard was seen as a success.

At the break out of the Great War the gold standard was abandoned and reinstated after the war in 1926. The interwar period unlike the period before the war saw declines in economic growth. This led to pressure on the gold standard and countries began to abandon it in 1931(The economic history association).

After World War 2, Morocco saw the American's implementation of the Bretton Woods agreement. By which the US dollar was linked to gold at \$1 to 35oz of gold bullion and in turn other countries agreed to fix their exchange rate to the US Dollar. (Times, 2008)

In 1971, President Richard Nixon ended dollar convertibility to gold fearing a run on fort Knox which did not hold sufficient gold. After this other currencies were allowed to freely float against the dollar.

Consequences of exchange rate regime

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Developing countries tend to use a fixed exchange regime while developed countries tend to let their currencies float. This is not always what happens. China has a fixed exchange rate as does Denmark and Brazil uses a floating currency as from 1999. But in the main it is true.

So why do some countries fix and others float? It can be useful for a country to fix its currency as it helps deliver certainty to exporters who don't have to worry about changes in floating exchange rates. For developing countries where exports make up a large part of their GDP this is a desirable effect

Countries that fix their exchange rate regime cannot use monetary policy for any other reason than maintaining the pegged currency rate unless they put in place capital controls to stop capital leaving the country when interest rates are low and entering when interest rates are high.

This is known as the impossible trinity. A country can only achieve two outcomes of stable exchange rate, capital mobility and independent monetary policy

Economic history of Morocco

The Kingdom of Morocco is a predominantly Muslim country in the north east of Africa. It has gone through many political changes, the most recent of which being French occupancy from 1912 to 1956. It was during this time that the Casablanca stock exchange was established.

Morocco is headed by King Mohammad VI, who, in his recent economic plans has sought to eliminate poverty and homelessness from the country in the

coming years. The language spoken in day to day business is French. It is also the most common language spoken on the Stock Exchange.

Morocco's largest trading partners consist of the 27 countries within the E. U., China and the United States. These accumulate to 57. 9%, 6. 4% and 5. 7% of Morocco's trade, respectively. On the 15th June 2004 both Morocco and the United States signed an agreement, the FTA (Free Trade Agreement) making Morocco the 62nd largest export market for American goods. One of Morocco's main imports is oil from Saudi Arabia, which consists of 5. 7% of Morocco's imports.

Morocco's export market is made up primarily of goods from the primary sector, as Morocco's arable land and sea side location make farming and fishing there most sustainable source of income. Morocco also contains many natural resources like manganese, iron ore, fish and salt. Morocco is also the world's leading supplier of phosphate. Morocco has also become a major tourist destination, mainly popular among Europeans. In 2008, at the beginning of the economic crises, Morocco had 8 million visitors to the country and they have also developed a very ambitious strategy to try and overcome the recession through tourism. This involves building new hotels in sea side resorts and providing 600, 000 jobs in the process, this development has been dubbed ' Vision 2010'.

Morocco's market economy has benefited from the country's low cost of labour and also its proximity to Europe. Transport of goods to European cities is made easy through the Mediterranean Sea. The estimated Gross Domestic Product (GDP) of Morocco in 2010 was \$103. 5 billion. The currency of

Morocco is the Moroccan Dirham (MAD) and can be exchanged for the American dollar at 1MAD= 0. 119837USD (exchange rate is approximate, taken as at 7/10/11).

The unemployment rate has increased during the recession however, which shows that it has not escaped the recession. In 2009 the unemployment rate was 9%; the 2010 figures released show an increase of . 8% (9. 8%). The CIA world fact book placed it at the 103rd lowest in the world.

Overall Morocco has enjoyed stable growth over the last few years and has maintained low inflation during the recession. Inflation on goods and services remained at 1% from 2009 to 2010 figures. Also, the Real Growth rate decreased slightly from the previous year, but not substantially. Morocco still enjoys a 3. 2% growth rate.

In March 2010, Standard and Poor raised Morocco's foreign and local currency ratings by one notch twice, from BB+ to BBB then from BBB to BBB+. However Morocco has experienced some economic setbacks due to the recession. For example in 2010 Morocco's trade and budget deficits widened and Government spending was forced to be reduced in order to adapt to the sluggish economic growth in Europe.

Also, in the past, it was a common practice for Moroccans to immigrate to Europe in order to find work. Now, however, many migrants are starting to return to Morocco to try and escape the global economic crises. This in turn has had a knock on effect as the surge of remittance that used to travel through the country has started to decrease.

Exchange rate policy of Morocco

The Moroccan Dirham (reintroduced in 1960 after replacing the Franc as a major currency) is the official currency of the country of Morocco with currency code MAD (according to the ISO 4217). The dirham is issued by the central bank of Morocco, known as Bank Al-Maghrib (founded in 1959). It is also the de facto currency in Western Sahara. In addition to the supervision of numerous privatized banks supplying retail services, the central bank of the Kingdom of Morocco fundamentally assures the stability of its currency and convertibility implementing appropriate monetary policy measures.

Since the beginning of the 1990's Morocco has pursued an exchange rate policy of pegging the dirham (MDH) to a basket of currencies dominated by the Euro, but it also included the US dollar and other currencies, weighted according to Morocco's trade pattern. However, by the end of the first quarter of 2001, " the weight of the basket of currencies was changed in favour of the euro" to reflect Morocco's financial and commercial links with the EU optimistically, " resulting in a slight depreciation". (Source: Commission of the European Communities; European Neighbourhood Policy; Morocco)

The adoption of a fixed exchange rate regimes policy has contributed Morocco to macroeconomic stability and particularly fostered price stability. Morocco could better adapt to changes in the international environment through increased flexibility in monetary and exchange rate policies. In particular, " implementing an explicit inflation targeting framework combined with increased flexibility in the exchange rate could be beneficial,

particularly in a context where inflationary pressures are low.” (Source: IMF – International Monetary Fund; Preliminary Findings of the 2009 Article IV Consultation)

With respect to the exchange rate regime, numerous factors over the past have emerged to point out the benefits of increased liberalization. The account position is less favourable currently over the medium term than previously anticipated. In the current international context, the risks of imported inflation are low. Moreover, the financial statements (such as the balance sheet) of businesses, banks and households experience limited negative implications, as the degree of their foreign currency exposure are below the standard.

Numerous factors have determined the Moroccan exchange rate, and all are related to the trading relationship between two countries. Exchange rates are relative and are expressed as a comparison of the currencies of two countries. Differentials in inflation rates, public debt and current-account deficits are the most important determinants of exchange rates.

Since 1997 the inflation rate has been below 3%. In 2003 the government succeeded in meeting its target average inflation of 2%, supported by favourable domestic and international developments. Foodstuff prices were reduced through improved agricultural production and weak international demand contained inflationary pressures.

Morocco’s external accounts are traditionally characterized by a trade deficit, which is to a large extent financed by private transfers and a service balance surplus. High fuel, agricultural, and consumer goods imports account for half
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of Morocco's imports and appear to be responsible for trade deficits that averaged around 7% of the GDP in the 1990's and recently reached about 12%. Net tourism inflows have increased from 1.9% of GDP in 1980 to 6.5% of GDP in 2011, while private transfers of Moroccan residents living abroad have grown steadily to 7.3% of GDP during 1993-2011.

In conclusion, Morocco is a country which is growing steadily even in the current recession due to its low rate of inflation and its adaptability to change. It has grown as a well respected tourism centre and has many attractions for worldwide travelers. Morocco also has a good trading reputation being the leading producer of phosphate and trading a considerable amount of other goods, a lot of which are primary resources. The Moroccan Dirham is pegged to a basket of currencies which means that the exchange rate can adapt to changes in the market to a certain extent. After studying Morocco's past and present economic state we have come to the conclusion that if the primary resources are sustainable and there are a large number of tourists each year then Morocco looks like it has a bright economic future ahead.