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OPINION

North Africa in the Global Economy

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With the proliferation of air transport links between cities around the world, and the massive expansion of telecommunications, the Internet, and banking, globalization is here to stay. It is not only a potential source of wealth creation, if planned intelligently, but it is now also an accepted reality among North Africans.

In the 20 years past, the debate in North Africa over the benefits and risks of globalization used to be intense. It was a passionate debate in that it led to the confrontation of various ideologies and competing visions, from labor unions to businesses, from political parties to central governments. The debate was also passionate because the region was negotiating the anchoring of its economy into that of the European Union, all while the World Trade Organization rules began to impact domestic policies.

Today, the issue is seemingly settled and the press, which usually carries the concerns of the population, has put the subject behind and is focusing on other issues. But is the topic of globalization a thing of the past? Recent events could bring back with a vengeance the globalization battle into the boxing ring. This time, though, North Africans may not be alone to challenge the virtues of intricately tangled economies. The Americans, to begin with, are looking at the Chinese, the Indians, the Brazilians, the sovereign funds, and others with a certain fear and the feeling of declining competitiveness. Two of the three current presidential candidates have pledged to revisit the North American Free Trade Agreement (NAFTA) given the growing perception that U.S. workers have gained nothing and lost a lot. The sorry state of the city of Detroit and the State of Michigan, once the world's capital of the automobile industry is what Americans are working to avoid a repeat of. Representing a certain portion of the blue collar conservatives, John McCain will have to make similar pledges at some point in his campaign, if he wishes to compete.

While the Americans should blame their financial institutions for their sloppy work leading up to the subprime mortgage meltdown, and the subsequent credit crisis, they occasionally (some often) point their fingers to foreigners, in particular as their energy cost rises (OPEC is the villain), their trade deficit expands (China exports more), and their debt mushrooms (China lends more).

North Africans are not so different as well. Their issues are similar in some ways, and many of the economic problems have gotten out of control. Despite efforts to liberalize the region’s economies, they still remain highly centralized as of today. The role of central governments and state-controlled businesses and entities is instrumental, almost vital. In contrast, the role of individuals and the private sectors is almost inconsequential. Of course, progress has been made, but a liberal economy is still in its infancy.

North Africans are facing important problems, many of which are structural and will require changes in rules, but also in mentality, which is a hard thing to change. One of the most impactful problems today, in relation to the globalization debate is the region’s heavy reliance on food imports. In this issue, we address some the very challenges facing North Africans as they face one of the most unstable global agricultural markets to date. The reliance on imports during a period characterized by a weak US dollar and expensive agricultural commodities is forcing North African households to make changes in their own eating habits. In Algeria, for example, the bread industry is pushing consumers to move away from the traditional baguette and white bread to whole-wheat flour and related breads, pastas and couscous. This is because it is cheaper to market whole wheat products. Although this is apparently a good move, given the fact that whole wheat products are better for one’s health, the old habit of eating white bread will be difficult to abandon. I personally tried it and three years into it, I still find white bread tastier and tempting.

Changing habits is not the only problem North Africans are facing. That may be the easiest thing to do. Perhaps more worrisome is the amount of money they have been pouring on importing their oil and food. By spending billions on food and other commodity imports, Algeria is quickly nullifying the gains it made through its oil revenues. By selling its oil in the weak US dollar and buying expansive food, Algeria is steadily chipping away the $72 billion it made selling oil and gas in 2007.

In Tunisia, the subsidy fund saw its payouts to cover the country's deficit of just hard wheat and soybean oil explode from an average of 250 million dinars per year between 2002 to 2006, to 600 million dinars in 2007, and 960 million in 2008 on the same products without increasing volumes. The state uses a full 1% of GDP on subsidizing imports.

In Morocco, the situation is no better. The government has to deal with the potential insolvency of the state subsidy fund, the "Caisse de Compensation." In the 2007 budget, the government allocated 13.6 billion dirhams to the fund, but the latest spending assessment shows the fund committed a whopping MAD 22 billion to cover the rising prices of oil and food on the international market.

So what should North Africans do? Well, just like the Americans, they will first feel the pain, then hopefully learn something, then may be more hopefully, they'll end up taking a hard look at their problems and work to identify a strategic path to economic growth that does not rely on simple global economic integration. They must realize that linking their economies to the EU or joining the WTO are no magical solutions in themselves.

In the US, the debate over overhauling the nation's financial regulatory system has already begun. I bet a few short years from now, we will see a completely transformed and more robust financial and banking industry. Learning their lesson and looking at solutions within their own systems are what the Americans are using to rectify the problem. Successful economies such as South Korea, China, the US, Western Europe, and Japan are economies that actually have serious domestic growth expansion policies that almost exclusively depend on their own people's talents, while North Africans have long been calling for foreign investors to come in, almost as the single most favored solution to the region's economic woes. There is nothing wrong with attracting foreign investors as it shows confidence in the nation's economy and its institutions. But countries must first harness their own energy, talents and resources to forge ahead. Foreign investors are necessary as they bring funds and know-how, but they have very little tolerance to risk and can leave as quickly as they came in. We've seen that already happen some years ago, when a famous American investor decided to pull all his money from the Casablanca Stock Exchange to move it to the another market in the Middle East. The Casablanca Bourse took an unprecedented beating and required some time before it recovered.

In concrete terms North Africans should realize that agriculture, energy, basic infrastructure, information technology, telecommunications, education and health must be strategic priorities, if the region's countries want to be competitive without having to ask for foreign investors' attention. Scrapping the current industrial and economic policies of the region's countries should probably be the first action item on the agenda. It sounds rather severe as an action item, but if the US is embarking on the most revolutionary revision of its financial sector since the 1930s, why can't North Africans challenge their current practices? Then employing new schools of thoughts and using ideas that are also revolutionary and make sense should follow as well. Part of the revolution in ideas is to revisit what the IMF and other such institutions have mandated to developing economies to follow. These institutions that were born in another era and another century themselves need to be challenged to their core. Short of an economic revolution, the current single step forward the region is making, will follow with two steps back.

Arezki Daoud

ENERGY AND MINING

North Africa Petroleum Round Up

Algeria's Sonatrach acquired a 20% stake in of France's Total Taoudeni Permit in Mauritania. Total had a 100% control over the Mauritania permit, and has now added a partner in its venture in the country, the first time since it was awarded the permit in January 2005.

Still in Mauritania, Winfield Resources Limited says it has received a license to refine oil in the northwest African nation. This license is a result of Winfield's application for its own account to build, own and operate a new 300,000 bbl/day oil refinery at the Port of Nouakchott, in the Mauritanian capital. The license is subject to a number of conditions, including:

- giving priority to acquiring feedstock from sources within Mauritania;
- abiding by all applicable environmental laws;
- giving priority to selling refined petroleum products to consumers in Mauritania; and;
- paying royalties in favor of the National Oil Commission.

Based on this license, the Company intends to move forward with its proposal to construct, engineer and operate a new stand-alone oil refinery at Nouakchott and has hired UK-based engineering firm KBC Process Technology to conduct a feasibility study that will include the design of the facility. Meanwhile, Winfield has begun the process of securing all relevant studies and licenses for the proposed site in Nouakchott. It is not looking to select a contractor to prepare a study as to the nature and source of crude oil feedstock.

The Company wishes to confirm that the grant of the license from the Mauritanian authorities is conditional, and subject to a number of logistical matters including sourcing crude oil feedstock, financing and site location.

Winfield warns that there is no assurance it will be able to construct and operate a refinery at the Port of Nouakchott on terms acceptable to the Company, or at all. There is also no assurance the Company will be able to source crude oil feedstock or financing for such refinery project.

Meanwhile, in a short statement, Australian oil company ROC said on March 24, 2008 it decided to abandon its Khop-1 exploration well in Mauritania after drilling showed poor results. The Khop-1 exploration well is located approximately 70 kilometers from the Mauritanian coast.

In Tunisia, Candax Energy and PA Resources say production from a well on the El Bibane field offshore has began production.

The partners reported that the production rates from EBB-4 have varied because of the onshore plant commissioning and offshore tie-in delays due to bad weather. The peak daily production rates are hitting 1,400 bpd; however, production is expected to rise as production from EBB-4 is optimized and the EBB-3 well is tied in and brought on stream.

The EBB-3 well was also completed and the West Titania drilling rig's demobilization has started. The installation of the EBB-3 platform and pipeline hook-ups with the other wells is ongoing. The onshore SEEB gas power station is also being commissioned and will be ready to commence power generation operations once gas production from El Bibane has been stabilized in April 2008.

The gas injection well EBB-5 was tested in the beginning of March and flowed gas and condensate to the onshore Central Processing Facility to clean up the well and enable the onshore plant commissioning to be initiated.

In Libya, the focus has been on the drafting and inking of contracts with some of the world's largest oil companies. Among the companies that have recently ratified agreements with Libya are Gazprom, Shell, BP and Occidental. The Gazprom contract deals with a $100 million for an exploration license. Shell will spend about $200 in form of exploration investment and license payment. Occidental and its exploration partner will invest some $80 million, including a $10 million permit rights. More recently, ExxonMobil was granted access to an offshore exploration area to drill one or more exploration wells and run seismic operations on a vast offshore territory. ExxonMobil had to pay a price tag of more than $70 million for the right to explore for hydrocarbons, an operation that will require an investment of almost $100 million. Exxon also agreed to spend some $25 million on social programs to benefit Libyan citizens.

StatoilHydro Gives Sonatrach Access to US LNG Market, Makes Discovery in Algeria

The Algerian petroleum firm Sonatrach has made a significant entry into the US liquefied natural gas (LNG) market, reinforcing its partnership with Norway's StatoilHydro.

Sonatrach signed an agreement with Norwegian peer StatoilHydro for the use of 2 billion cubic meters per year of regas capacity at the Cove Point terminal on the Chesapeake Bay, in the state of Maryland. The capacity is owned by StateOilHydro, which will make it available to Sonatrach in early 2009 to expand into the US market. The contract is valid for 15 years. StateOilHydro also agreed to purchase 1 billion cubic meters of LNG from Sonatrach from 2009 to 2014.

For Sonatrach, this is an important strategic entry into the American market, after consolidating its presence in its traditional, but high-growth markets, including Southern Europe and the United Kingdom.

With this agreement, the two companies are further reinforcing their partnership, in particular following their joint venture in exploration off the coast of Egypt. The two firms operate two blocks there. StateOilHydro for its part has been active within Algeria proper with two gas fields that it operates with Sonatrach and BP. The Norwegian firm operates in the Hassi Mouina perimeter in the southwest Algerian desert.

In Hassi Mouina, the two companies have completed the drilling and testing of exploration well number four, with the fifth now being drilled.

"This is the fourth discovery in the Hassi Mouina license, and the encouraging results from the first four wells have given us valuable information about the resource potential in the block," says Statoil Hydro's Bill Maloney, senior vice president for Global exploration (GEX).

The rig has been moved to the next location also situated in the southern part of the Hassi Mouina license, where the fifth well – TNKW-1 – is being drilled.

Further exploration drilling is needed in order to confirm the full potential in the license.

Awarded in 2004, the Hassi Mouina license comprises four blocks within a 23,000 square-kilometer area in the Gourara basin. The area is located in the Western Sahara in Algeria, north-west of the In Salah gas field.

StatoilHydro has a 75% interest in Hassi Mouina. Partner Sonatrach has 25%.

Record Revenues for Sonatrach

The year 2008 promises to be a good one for Sonatrach. Just for the months of January and February, it managed to generate $12 billion, a record figure for the Algerian company. The company's CEO, Mohamed Meziane predicts that if the current oil pricing environment sustains, Sonatrach could earn another record, above last year's $72 billion.

SPECIAL REPORT:

NORTH AFRICA COPING WITH RISING COMMODITY PRICES

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When the Basic Staples are out of Reach

Blaming the Global Markets or the Failed Domestic Policies?

Wheat is one of the most consumed cereals in the world. With an explosion in global consumption, estimated at 100 kilograms per year per capita, equivalent to 220 LBS, combined with stagnation in production, wheat prices exploded as a result, creating tension in the market.

With the prices of soft wheat at around US$460 per ton and hard wheat at US$640, importing countries are forced to spend more of their import budgets to meet domestic demand. One of the world's largest importers is Algeria, where per capita consumption is 230 kilos a year, more than double the world's average.

With high oil prices, Algeria may have the financial resources to deal with high commodity prices, but in the longer term, new policies dealing with agriculture, import, and subsidies must be considered so as to avoid looking at expansive foreign suppliers. Algerian diets depend heavily on wheat-based products such as bread, pasta and couscous, and with wheat prices up 60% in 2007; the state budget earmarked for wheat import had to be revisited several times.

As prices of wheat worsen for buyers, Algerian officials have taken a reassuring stance, calming fear that the prices of bread and other such staples will have to go up as a result. Acknowledging the weakness of the Algerian agricultural system, the 2008 state budget allocated some $450 million to the nation's cereal market regulator and supplier, OAIC, with the purpose of stabilizing prices in the domestic market. In the first half of 2007, Algeria imported 2.53 million tons of cereal, down slightly from 2.67 million the same period in 2006. It paid $590 million for the cereal it purchased in 1H07. For the entire 2007, early estimates call for an annual import volume of 5.1 million tons, or more than the 4.3 million tons the country harvested.

Yet, the agriculture minister, Said Berkat, recently estimated domestic consumption to be around 7 million tons. Covering 60% of domestic demand, Algerian agriculture is expected to push its contribution further to reduce imports, according to Berkat. However, in a stunning contradictory statement during a speech to the farmers association UNPA, Berkat stated that domestic production will cover 60% of national needs in the 2013 horizons, contradicting his earlier statement that such goal has already been met. Berkat's shifting positions show how unreliable government data are and how official statements are full of contradictions.

Algeria's wheat import frenzy is related to its agricultural policy, or lack of it. Moving from the 1970s, when the main slogans focused on agricultural self sufficiency, the government disengaged and withdrew its support to farming in the 1990s as it focused on battling the Islamic insurgency and comply with IMF demands for more market openness. The sector also underwent what some Algerian planners considered a liberalization phase, by forcing farm cooperatives and associations to act as corporate entities competing in an open market, with very little or no knowledge on how liberlized markets worked. These institutions used by farmers and peasants shifted to an autonomous corporate status and had to cope with new rules of free-market nature that was so foreign to them. Of all the key agricultural institutions, such as Eriad and Enial, only the cereal entity OAIC maintained its status of state-owned organization. Politics prevailed in the fate of OAIC. In addition, the government began to withdraw its support for food prices by scaling back its subsidy program. One of the most poorly managed price liberalization initiatives was that of the price of semolina. Allowing the market to dictate prices has led to massive disruptions amid growing speculation. Today millions of households are unable to afford semolina, a product that used to be so basic to the Algerian kitchen. The same story applies for other basic staples, such as pastas and couscous, which are now inaccessible for so many in the low-income segments of the population.

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How Rising Prices Lead to Shifting Habits

When prices of a crop increase and consumers cannot afford it, they shift to another one, with all the challenges to their culinary heritage. A historical example of such event occurred in the 1980s when the Algerian government favored heavily the planting of potatoes instead of wheat. The results took less than a year to be felt. Local markets were flooded with potatoes, a less desirable product in Algeria kitchen, which saw their prices drop. In contrast, wheat-based products, from couscous to pasta, which were then the primary products in the Algerian kitchen, became scarce and expensive, forcing individuals to shift their eating habits and diets to potato-based meals.

In 2008, this is happening again. Algerian bakers and their wheat suppliers are refocusing their marketing efforts on whole-wheat based products. Anticipating further price increases of white flour this year, bakers and their partners have begun to publicize the virtues of whole-wheat flour as a better alternative.

This move is the result of a simple cost analysis exercise. Whole wheat flour requires lot less processing than white flour. It is cheaper. It comes from the grinding of the wheat's whole grain without further treatment such as bleaching to removing specific elements of the grain. This is while the most consumed type of flour in Algeria, the white flour, requires further processing of the grain, removing all the brownish appearance, before it is distributed to markets. The life of white flour is also longer than that of the brownish whole wheat, yet, at the end of the day, whole wheat is cheaper to bring to consumers.

Apart from the economic and cost considerations, the bakers' current campaign to sell their less expensive whole wheat bread focuses also on the health benefits of the product. However, they have hinted that consumers should expect higher prices even for whole wheat bread. They argue that the pending price increase should not deter consumers to shift to whole wheat considering the nutritional and health value of whole-wheat based products. White flour products, they insist, are of poor quality, with as much as 40% to 45% of the nutritious value of whole wheat, from vitamins to fiber, eventually disappearing during bleaching and other processes.

The bakers are aggressively marketing the positive health value of whole-wheat and economic calculus in the production of their bread to justify their support for a shift to whole wheat-based products. Their argument centers on the reduction of the import bill, when moving to a whole wheat world. Helping in their campaign, flour mill companies confirm that they tend to sustain greater losses in their forex transactions when importing wheat for white flour purposes. They estimate the loss to amount to 25% of each dollar they spend when the output is white flour. The figure is reduced nearly in its entirety if the output is whole wheat flour, instead. An industry player calculates that Algeria loses $250 million on its $1 billion wheat import bill, with the difference turning into livestock feed instead of bread, for example. The cost of producing white bread is further expanded beyond and above the nutritional elements such as the bran and germ that are discarded. Additives such as potassium bromate or chlorine dioxide gas are generally applied to bleach the wheat for discoloration purposes. Other additives are added for taste and increase the nutritional value, which boost the cost of processing.

Algerian bakers add that consumers in Algeria should not be so different than their Moroccan neighbors. The latter are more reliant on local bread based on whole wheat, while the Algerian consumer has gotten used to the French baguette. Bread consumption in Algeria is estimated to exceed 500 grams per day per person, a market covered by 14,000 bakers and 300 mills. The market consumes 5 million tons of soft wheat per year.

Algerian households in general are not acclimated to consuming whole-wheat cereals, although its consumption is relatively widespread in the Kabylie region and other rural areas

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Agriculture: Shielding Consumers with Self Reliance

Algeria has nearly doubled its milk import, growing spending from US$700 million in 2006 to $1.3 billion in 2007. Rising commodity prices also are affecting the milk market, which has not only affected consumers in source countries but also in importing countries. The rise in milk prices is also in line with increases in other agricultural commodities, such as wheat, which have affected the Algerian import budget in substantial ways. This added spending is undoubtedly negatively offsetting the gains made in oil and gas exports, which in dollar value are reaching all time record highs, only to be re-sent back abroad to cover food imports.

For the Algerian government, there is a tightrope to walk. The choices before officials include how to support consumption and avoid a social cost from the high rises in commodity prices, and in the same time, not undermine the potential growth of the agricultural sector by dumping subsidized products from import into the domestic market. The government's answer is to create another bureaucracy called the National Office for Vegetables (Office National pour les Légumes), which will look at new agricultural policies that would enhance the concept of self sufficiency. The problem is that such initiatives have been undertaken in the past but never seriously implemented or successfully delivered.

For the potato crop, a product that face tight supply in the Algerian market, the government has decided to earmark each year 50,000 hectares of land (more than 123,000 acres) to produce what planners are targeting as 40,000 tons per hectare. The expected yield is 2 million tons of potatoes. The government's biggest challenge is to insure certain stability in prices so as to create a positive momentum for domestically produced crops. In case of surpluses, the government would buy the excess production and in case of deficit, imports will compensate.

This is sound theory, except that putting such strategy into practice is likely to face enormous challenges. Algeria never managed to cover domestic consumption for agricultural products with domestic crops. It always turn to foreign markets to fill the gap. Self sufficiency was never reached due to weak policies and poor execution. Lack of focus during hard times, such as in the 1990s, a decade dominated by terrorism, only led to more neglect of the sector. Yet, something has to be done, and another strategy must be in place.

In addition to the office, the ministry of commerce is proposing to establish a national price subsidy fund. The fund is to act as a price stabilization mechanism to control fluctuations in the market. Prices tend to expand substantially, in particular during peak time. In the case of the potato, demand fluctuates between 90,000 and 100,000 tons per month, and the latest survey of stocks shows that some 148,000 tons are currently stored in various facilities across the countries. With this quantity, authorities ordered the import of another 100,000 tons to expand the safety cushion in the domestic potato stocks. To lower the cost of the imported potato, the finance minister agreed to remove the import duties and value added taxes.

For another critical product, milk, Algeria has been on import frenzy, spending last year $1.3 billion on 100,000 tons of powdered milk, almost twice the amount it spent in 2006. With money spent on imports, agricultural officials are now looking at alternative solutions such as importing up to 300,000 dairy cows, capable of producing 4,000 liters of milk per year per cow. The idea is not new and has positive value in that it would create employment and boost a dormant industry, but there is no certainty in the outcome. Yet the Algeria dairy market is relatively vast. Annual consumption of milk is 3 billion liters or almost 700 million gallons. Officials are upbeat by the prospect of self sufficiency within 3 years.

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Tunisia: Revisiting the Role of the Subsidy Fund and Realignment of Domestic Prices

Subsidies as applied to consumer products have helped maintain some degree of social stability in Tunisia. But the government has been under pressure to lessen the subsidy system, a move that could bring a great deal of pain and social disruption, in particular as global food and energy prices continue to climb. Pressure to reduce subsidies comes from various sources, including Tunisia's obligations vis-à-vis its international agreements.

The government is apparently planning a comprehensive reform of the nation's subsidy program, managed by the Caisse Générale de Compensation (CGC). The details of the planned reform are sketchy, but its authors argue that for instance, the country spent an average of TND 250 million per year from 2002 to 2006, just to cover the deficits in hard wheat and soybean oil. To illustrate how important the rise in commodity prices have affected budgets, Tunisia had to spend TND 600 million in 2007 and TND 960 million in 2008 on the same products without increasing volumes. In all, state subsidies account for 1% of GDP, representing an important problem for the country to solve.

This year, the state budget has earmarked TND 350 million to subsidize hard wheat, TND 450 million for soft wheat, and TND 150 million for vegetable oil. Officials fear however that prices may continue to climb, and those earmarks may not be sufficient.

Long-Term Solution:

The Tunisians are increasingly acknowledging the need to revisit the country's agricultural strategy to focus on domestic production as opposed to import. But the biggest obstacle to a successful agriculture remains the state's involvement in price fixing, a strategy that always undermines local producers.

The Middle Eastern country of Syria is taken as an example to follow. Syria faced an important deficit in the cereal sector in the 1980s and 1990s. The deficit was essentially the result of an embargo and economic blockade imposed on the Hafed Assad regime, with devastating economic consequences. A change in pricing strategy, focusing on aligning domestic prices to international prices has apparently worked in favor of Syria and pushed the country from cereal importer to exporter in just three years. In fact, Syria today is one of Tunisia's suppliers.

While this agricultural reform based on new pricing policy could help, the CGC will have to be reformed fairly quickly if Tunisia must control the impact of rising commodity prices and help reduce the impact on consumers. Short of a comprehensive subsidy reform, the country could face a serious economic slowdown.

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Morocco: Out-of-Control Subsidy Spending

The end of Prime Minister Driss Jettou's reign in the Moroccan cabinet ended with mushrooming government spending. The deteriorating finances are not just a Morocco-specific problem, but many countries of the same economic level faced growing troubles to cover the ever rising cost of commodities in the global markets.

Trying to find ways to resolve the issue of price increases, the government also had to deal with the solvency of the state subsidy fund, the "Caisse de Compensation." The problem of the subsidy fund is enormous. In the 2007 budget, the government allocated MAD 13.6 billion for fiscal 2007 specifically to be used by the fund. But the latest spending assessment shows the fund committed a whopping MAD 22 billion.

The rise in the fund's spending is not surprising at all, but it highlights the inability of Moroccan planners to forecast efficiently. First is the price of oil, with the oil-related spending up to MAD 15 billion, compared to a budget MAD 9 billion. The continuous rise in crude oil prices is the obvious culprit. Where the government missed the target again is in the way it planned its budget based on a $65 per barrel of oil, when many analyst already forecasted a $100 barrel. The barrel in fact exceeded the $80 in 2007 and is now over $110. And for each additional dollar added over the budgeted $65, the state will have to spend another MAD 30 million per month.

Secondly is the price of sugar. Initially budgeted to consume a subsidy amount of MAD 2.5 billion, the government is now looking at 3.6 billion, as it finalizes its 2007 books. Two factors have led to the over-budget spending. As in the oil sector, the first is related to the rise of commodity prices, also affecting sugar. But equally costly was the government's agreement to reimburse soda and drink makers MAD 2 for every kilo of sugar they bought over a period of time. The reimbursement came in directly from the subsidy fund.

Similarly, the state exceeded its subsidy budget allocated to wheat, in particular flour, which alone consumed MAD 3.5 billion, compared to the budgeted MAD 2 billion. With rising prices, the state was forced to guarantee MAD 250 per quintal of processed flour to arrive at the bakeries at the controlled price of MAD 3.63 a kilo.

In addition, Morocco has been upping its spending in the southern provinces as part of its political efforts to rally the populations of the south to its call for the annexation of the Western Sahara region. The necessary base products alone required a government subsidy of MAD 500 million in 2007.

In the end, Morocco spent an unprecedented MAD 22 billion on subsidizing the consumption of petroleum and food, and its troubles are far from ending as prices globally continue to rise.

INDUSTRIES AND MARKETS

Delays in the Implementation of Drug Reimbursement Program in Algeria Lead to Higher Out of Pocket Cost

The cost of medicines is up on the Algerian market and households are increasingly facing difficulties to squeeze more out of their budgets for their drugs. Structural problems, inter-department feuds, and an expensive Euro are destabilizing the nation's drugs subsidy program and delaying its official implementation.

The government has recently released a list of drugs that are subject of reimbursement. With this list, Algerians will receive subsidy reimbursement for 375 of the 1,073 drugs marketed in the country's pharmacies and hospitals, as soon as they are published in the official journal over the next weeks. But today, the list is not officially implemented, leaving patients to pay out of their own pockets.

Drug reimbursement policy is the domain of the Comité National du Remboursement (CNR), which is affiliated to the ministry of labor and social security. The list has taken two years to establish after the enactment of a law that instituted the rules of drug subsidies. Disagreements have led to delays as the list was scheduled to be released in April 2007. The law requires a quarterly update of the list, once the official base list is determined.

Drug subsidies are not new in Algeria. In fact Algerians have long enjoyed their medicines without paying for them and for many low income households; the program is literally a life saving initiative. But the system has been facing problems in the way it is administered. Currently, a number of patients have paid for the medicines months ago and are waiting for reimbursements given the delays in establishing the most recent list. More recently, the delays have forced the social security administration to reject reimbursement requests for prescriptions that contain drugs waiting to be officially listed. While everyone is aware of their subsidy status, the delays in making the list official have created a backlog. This bureaucratic hurdle is also affecting the health of many patients with serious illnesses and no money to pay for medicines. Worse, a great number of these patients are not informed of the reasons why their drugs have not been reimbursed. CNR is also grappling with technical issues related to the proposed list, and that includes the proper dosages of specific drugs that would be subject of full subsidy. Technical issues extend to financial ones. The list was based on a euro currency valued at DZD 93, a parity established in early 2007. Today, the euro exceeds DZD 100 in value, with the expectation of further deficits if corrective measures are not taken. This currency exchange miscalculation means that patients are expected to cover the difference and for many products imported from the Euro zone, a 10% difference can be very costly.

Generic drugs are also part of this initiative, although there appears to be some resistance to making them more broadly available. The push for higher consumption of generic drugs has been mandated by president Bouteflika himself as a political position. However, the laws that have been drafted dealing with the manufacturing, packaging, marketing and distribution of such lower-cost drugs have stalled as the prime minister's office. They have been revised twice in a long process and are now moving nowhere. Other issues are leading to unwanted delays and some of them relate to the lack of clarity on who is responsible about the specifics. Feuds have been a constant factor between various ministries as to the decision process, in particular between the ministries of health and social security.

All these issues are leading Algerian consumers in need of medicines to dig deeper into their pockets.

BANKING AND FINANCE

CNEP to Sell Cardif Insurance Products in Algeria: The Beginning of Bancassurance

The Algerian bank and former savings institution CNEP (Caisse Nationale d'Epargne et de Prévoyance) has inked a partnership agreement with the French insurance firm Cardif. The agreement will allow Cardif to use CNEP's network to distribute its products and services on the Algerian market. Cardif is a subsidiary of French financial group BNP Paribas.

The deal, which could turn into a full-scope joint venture in the mid-term, is expected to close in the next weeks and Cardif insurance products will be available to Algerian consumers before June 2008.

CNEP will make available its 206 branch network to Cardif long after the French company received official authorization from the Central Bank to sell its services in Algeria. The authorization was granted in 2006.

In strategic terms, the agreement opens up the door for a new sector, the bancassurance into the North African country. This would enable the distribution of insurance products through the banking network, a practice that has been widespread in Europe and even in neighboring Morocco and Tunisia but not in Algeria.

The Algerian banking and insurance legislation was updated last year to speed up the launch of a bancassurance industry. However the prospects of an immediate success for the launch of this new industry are remote. The penetration of insurance products into the Algerian market remains low, while the banking sector itself needs a wider penetration. The banking sector is seen as the primary vehicle for the distribution of insurance products. Official data, however, shows that there is one bank branch for every 28,000 people (or 14,000 branches) and electronic and online banking is non existent. The challenges of establishing a successful bancassurance sector, therefore, hinges on a much more efficient banking sector reform, which has stalled to a certain extent, in particular as the privatization of CPA bank has been postponed.

Islamic Banking Instruments Make a Timid Debut in the Maghreb

Islamic financial instruments continue to attract consumer attention, with the central element of being interest-free products in compliance with Islamic Sharia law. According to financial sources, the value of funds involved in Islamic banking worldwide grew by an average of 15% annually over the past three years. Some analysts estimate Islamic banking to be worth some $500 billion, with the Middle East controlling a quarter of those assets. Kuwait is reportedly the biggest contributor, accounting for almost 29% of the sector's value in the Gulf region. It is followed by Saudi Arabia with about 27%, and the UAE with 15.2%.

The growth in Islamic banking is largely attributed to the immense wealth accumulated in Gulf nations, generated by strong oil and gas sales, but also to the religious influence in Middle Eastern societies. These nations are said to have imposed Islamic banking practices on many global banking institutions. Without such instruments, international banks would risk the loss of an important source of funds and therefore they found ways to accommodate their Middle Eastern clients.

These so-called "halal" banking products have not made significant inroads in North Africa yet, excluding Egypt. However, some financial institutions felt it was necessary to offer financial services that follow the Sharia law. We are seeing some growing interest in the region, in particular in Morocco where the Central Bank, Bank Al Maghrib (BAM) authorized the offering of Halal services as recently as 2007. In its authorization, BAM did not focus on the difficult tax and fiscal issues, but left it up to the tax authority, the *Direction Générale des Impôts*, affiliated to the finance ministry to figure out how to solve the tax problem. This includes the value-added tax (VAT) required for the commercialization of such instruments.

In Morocco, Islamic banking has introduced three products refer to as Ejara, Murabaha and Mucharaka. The first is essentially the equivalent of a leasing product, which typical is subject of a 20% VAT. But in the Ejara case, the financing does not originate from a bank per se, meaning that it is not considered a credit with the classic interest rates that apply to credit. Ejara is said to be financed by the own funds of the consumer credit company, that is its own resources and not what it labels as credit. What the financing firm gets is a sort of profit margin generated during the lease period through monthly installments, instead of an interest on financing. Nevertheless, the Moroccan tax authorities have decided to impose a 20% VAT on Ejara.

In contrast, Murabaha was defined by the tax authorities as bank loans and imposed a 10% VAT. They consider it as a form of credit, just as it is defined in mainstream banking. Where the difference occurs is in the way the transactions are defined. In mainstream banking, credits are subject to interest on the money loaned. In the Murabaha case, the creditor actually sells the "product" in question and earns a "legitimate" profit on that product. Even if the creditor never saw or took possession of the product, the money it gave its client means that implicitly it (the creditor) purchased that product and resold to its customers in exchange for a profit margin. The problem with the financing institution is that it will actually pay a 20% VAT to acquire the product upstream but then recoup only 10% when it sells it to its customer downstream.

This problem has affected the lease-with-purchase option offerings (*location avec option d'achat*) in similar ways back in 2007, which put some key players in difficult position regarding the recovery of the VAT tax. The 2008 finance law readjusted the discrepancy and balanced the two ends of the lease-with-purchase option offerings.

The fiscal and tax issues surrounding Islamic banking instruments are thorny problems for the credit sector in Morocco. Lobby groups in the sector have been putting pressure on the tax authorities to bring solutions to what they consider a source of loss in VAT imbalance. They threaten to delay the launch of such alternative financing options if a solution is not implemented.

An exception to this is credit financing firm Wafasalaf, which has made its own interpretation of the rules when it launched a Murabaha-based auto loan package called Taksit, involving VATs of 10% on both ends of the spectrum. Wafasalaf uses a VAT grid released by the central bank as a reference, as opposed to a directive from the fiscal authorities, which uses a different grid structure. Although Wafasalaf's decision is seen as an important precedent, it also highlights how difficult the implementation of Islamic banking has been thus far. While Wafasalaf is moving ahead with its offerings, all other credit firms are taking a wait and see position, seeking clear signals from the authorities.

Unclear Value Proposition of Islamic Banking in Morocco

The first financial institution to offering Halal-class products in Morocco was Attijariwafa bank (AWB). Its products were made available as early as October 2007, and other competitors followed its path, yet with prudent steps. Six months later and very little progress has been made. With the exception of AWB, all other banks have been rather cautious about the performance of their Halal products. They include BMCE Bank, Banques Populaires, BMCI, and others, who remain discreet about their Islamic banking activities.

After AWB, BMCI entered the field with the launch of mortgage loan package it called *Ejara wa Iqtinaa* and a Murabaha product for the general consumer and auto financing. Months later the bank has not fully materialized its own marketing campaign to inform customers how these products actually work. In fact, the bank has been rather silent about how its products have been doing, a sign that no significant amounts of loans have been released.

In contrast, Wafasalaf, the consumer and auto financing unit of Attijariwafa bank, has been offering Taksit and Ejar in what the company's executives consider a successful launch.

In October 2007, BMCE Bank also entered the Halal banking space with an Ejara offering in form of home mortgages. The offering, which is actually a lease-to-purchase deal, is the only such product available in Morocco's Islamic banking today. But sources close to the company say the bank failed to sign up a single customer. The bank has taken a wait-and-see position given the lack of clarity in the country tax regime affecting this emerging financial sector, and has virtually stalled its own efforts to market its products, as one would expect. The bank has limited itself to printing brochures and flyers explaining its offerings in very broad terms, but these papers have not been widely circulated to inform and educate potential customers.

While the VAT issue remains a significant hurdle, the basic economics of these offerings make no sense and cannot compete with the classic services yet. Bank sources say that among the potential customers who inquired about the offering, all of them decided that the cost of using Islamic banking instruments as they stand is much higher than in the case of standard interest-bearing loans. For example a 100%-financed apartment worth MAD 1 million, would cost its owner MAD 8,433 per month for a period of 25 years under the Halal procedures currently in place in Morocco. However, financing it with a 5.07% interest loan, the same apartment would require MAD 6,187. Given the difference in monthly payment levels, the Halal package would be offered to individuals who earn at least MAD 19,000 per month. In the second case, that level is dropped to MAD 18,000.

First Islamic Bank to Open in Mauritania

Mauritania has a new bank and it will offer exclusively Islamic financial instruments. The bank, Al-Wataniya, is owned by Mauritanian businessman Mohamed Ould Noueigue. The bank will compete with the existing dozen banks, including the two foreign financial institutions, France's Societe Generale and Paribas.

The bank's strategy is to convince the Mauritanians to open accounts and reduce the amount of cash circulating in the country and which escapes the financial system. Sources estimate that nearly half of the money in Mauritania is not captured by the banking system. These same sources say that a great number of merchants and businessmen believe using classic banking goes against their religious beliefs. Transactions involving interests are considered a sin and therefore opening a bank using religious financial rules could reignite interest in the sector.

ECONOMY AND TRADE

GFH to Set Up $3 billion Economic Development Zone in Algiers

Manama, Bahrain-based Gulf Finance House announced in mid-February a project to establish an economic development zone on the outskirts of Algiers, Algeria. The Zone will be the primary commercial development within the new master planned city of Bouinan and is expected to have an end value of more than US$3 billion once completed on a site extending to at least 2.8 square kilometers.

The Algerian zone is the second GFH Economic Development Zone, following the launch of the first, the GFH Mumbai Economic Development Zone in India, in the autumn of 2007.

The GFH special projects team is currently working with international industry experts to finalize the business districts of the zone and the business clusters within each business district. It is expected that the zone would include energy, financial, telecommunications, and IT business districts as well as residential development and leisure facilities.

SECURITY, POLITICS AND DIPLOMACY

Libya without a Government?

Muamar Kaddafi has taken an extreme harsh stance against the Libyan government cabinet. If his plan goes as proposed, Libya would be the envy of many around the world who believe in a minimalist government, including within many US circles.

During the holding of the Libyan General Popular Congress (equivalent of a parliament) in Syrte in early

March to debate the $35 billion-2008 budget, the Libyan leader did not hesitate to call for the dismantling of most of the nation's ministries and administrations. He argued that none of them met the goals assigned to them in the previous congress and "failed to meet the needs of the Libyan people."

To further push his anti-administration agenda, Kaddafi announced the distribution of the oil revenues to go directly to the population, to "enable them to run their own affairs." It is unclear how this will be done, but the Libyan parliament will have to figure out a wealth redistribution mechanism, if Kaddafi imposes his plan. Kaddafi stated that "ordinary people should participate to the construction of their country without the existence of a bloated government." Addressing the people, he added "you all must be wealthy. The price of oil is high and it belongs to you." Kaddafi insisted that each year the government spends billions but the population always complains about the shortage of school and health services, housing and underperforming agriculture. While it is possible his views are populist rhetoric aimed at grabbing positive attention and new momentum, it is also clear that the Libyan leader appears to be feeling a certain degree of competition with the growing roles of the administration as the country re-engages with the world.

Focusing his attention of reducing the size and scope of the government, Kaddafi urged the congress to leave only three ministries: defense, public safety and foreign affairs. Everything else, he argued, must go. This is indeed a rather severe approach to "cutting government waste."

Libya to Release LIFG Members from Jail

The Kaddafi Foundation, a Libyan national organization led by Muamar Kaddafi's son Seif Al-Islam, announced in late February the imminent release from jail of one third of the members of the Islamist insurgency group, the Islamic Fighting Group of Libya (LIFG) from jail. The release is expected to occur despite the alleged plots by LIFG to kill Kaddafi.

In September 2007, Abu Laith El-Libi, the LIFG leader in exile announced the realignment of his organization to Al Qaeda. But his death on January 28, 2008 during an American raid in North Waziristan in Pakistan has led to a cooling of the radical position of the LIFG and the removal of the last obstacle in the opening of negotiations with the Libyan regime. Talks between Seif El Islam, Libya's heads of intelligence services with the leaders of LIFG, Abdullah el-Sadek and Abu el-Monder el-Saidi have been taking place for several months. The two men have already been under arrest. El-Sadek was arrested in Thailand in 2004 and extradited to Tripoli. And El-Saidi was captured in Hong Kong. The talks were facilitated by the moderate Islamist figure Ali Mohamed el-Salabi and a former Jihadist Noaman Ben Othmane.

The terms of the deal are fairly simple. In exchange for their release and reintegration into the Libyan society, some 90 LIFG members must pledge to renounce violence and denounce the Jihadist ideology. Until early February, the talks faced some obstacles, as the Islamist negotiators took longer than expected to broker a deal. They argued that they could not make a decision without the organization's other leaders agreeing with the terms. The problem was that most of them were based in Afghanistan, Pakistan and Iran. The death of Abu Laith el-Libi has had a significant impact in speeding up the process. LIFG is also a U.S.-designated terrorist organization.

Oil for Detainees

Oil giant BP is said to have concluded a contract with Libya with rather disturbing terms. Paris-based Jeune Afrique magazine says BP won a $900 million exploration contract, which was made possible only after Britain agreed to transfer to Tripoli all Libyan nationals detained in British jails.

The magazine, which states the Financial Times as the source, says an agreement between Tony Blair, then the prime minister and Muamar Kaddafi was reached in 2007 during a short visit of Blair to Tripoli. The information is reported to have been confirmed by BP. The deal seems to pose a certain problem and that is what to do with Abdelbasset Ali El-Megrahi, the Libyan intelligence agent who was found guilty in the Lockerby case, sentenced in 2001 and detained at Scotland's Greenock jail. Apparently it is unclear what the fate of El-Magrahi is at this stage.

SOCIAL, LABOR AND HUMAN AFFAIRS

Assessing Morocco's Most Vulnerable Population

Poverty remains a visible phenomenon in Moroccan streets and the number of people defined as beggars is relatively large, yet subject of controversy. A study conducted by the Moroccan ministry of social development, in partnership with the NGO called the Moroccan Association of the Support and Promotion of Small Enterprises concluded that Morocco is home for nearly 200,000 beggars. This number means that one out every 150 Moroccan is part of this severely excluded social category. Slightly more than half of this vulnerable population (51%) is women, but a striking 62% of all, regardless of gender, are professional beggars. This means they have selected this practice as a way to earn a living, while they may have opportunities to hold normal jobs.

Assessing the beggar population is no trivial exercise. It is subject of a controversy with political implications. For example, this latest figure stood in stark contradiction with earlier estimates of 500,000 beggars reported in a study released in 2004 by a children advocacy group, funded by the health ministry. It is also in contradiction with another report released in 2006 that cited 18,000 people in this category, highlighting the extreme difficulty in generating reliable statistics.

Despite the uncertainty in the figures, they are a good start in profiling the lower economic classes of the Moroccan society. From an age perspective, beggars are overwhelmingly older adults with nearly 35% between 40 and 59 years old and nearly 30% over the age of 60. Children account for 11.5% of those found begging. So as the bulk of the beggars being over the age of 40 (64.2%), officials believe the solutions can be found in the establishment of sound institutional and family reinsertion policies that take into account government aid and new support programs. New programs have been put in place since early 2007 with the collaboration of several ministries and NGOs and are currently in test phase in Rabat and Casablanca, cities where poverty is more magnified than in other regions given the size of these urban centers. Combined, Casablanca and Rabat are home for nearly 80,000 beggars, according to the study, who are targeted by these government programs.

The study indicates that the Casablanca-Rabat-Salé urban axis is where there is the highest concentration of beggars in the country. The nation's capital Rabat and its surrounding areas account for 21.8% of the total beggar community in Morocco, followed by the business capital Casablanca with 17.8%. In all, urban centers account for 87% of the problem, as most of the beggars moved from rural areas to escape extreme poverty as a result of drought and lack of economic opportunities. Headed to cities in search of jobs, 52% of the new "immigrants" fell into poverty and resorted to begging after they failed to find a job. While most are victims of economic hardship, some 13% are also victims of some sort of physical or mental handicap, forcing them to ask for money, instead of earning it.

The study also reveals that 75% of the beggars are actually heads of households. Of the 200,000 beggars counted, 35.2% are married and begging helps in balancing the household budget. 24.1% have lost their spouse to death and became widows, and most of them are females. 12% are divorced, with 9% of them being women. These figures highlight a certain break up in the family structure as a root cause of poverty. Lack of family cohesion creates a great deal of vulnerability and leads to these kinds of social problems.

Interestingly, most are literate with 65% knowing how to read and write. Yet, most of them were forced to discontinue their schooling at the primary-school level due to economic hardship or family problems. Some 2.3% received their high-school diploma, and few (less than 900) even pursued higher-education degrees.

Ironically, nearly 70% have held jobs in the past, before drifting into utter poverty. Some 10% were even considered white-collar professionals, and only a minority worked in the public administration (less than 2%). Others (19%) worked in domestic help, and more than 10% reported to be able to work in a legitimate environment, yet prefer not to. Almost all recognize that it is more profitable to beg than to work. Begging can generate up to MAD 200 per day. That is not a lot money, but it is more than what most entry-level jobs would pay. Despite the lower income one would receive in the legitimate labor market, 42% say they would give up begging in the streets if a job opportunity arises.

In terms of timing, 58% have been on the streets begging for more than five years, and 14% joined their ranks in the past few months. Most have never faced negative reaction from the general population and never been subject of violence. Yet, 37% have been mistreated at some point in the form of beatings, insults and sexual harassment.

The challenges of eliminating poverty are enormous but the urgency is equally important. Poverty is not just source of beggars but also a source of disgruntled youth from the slumps of Casablanca and elsewhere that fuel the radical movement with implications on national security. The Moroccan government has put in place an ambitious program to reduce poverty based on three areas: job placements with the use of education and training; severe punishment for the so-called professional beggars with up to one year jail terms; and educating the population to not respond to beggars on the streets. These areas are often contradictory to the practices in Moroccan society, where charity is seen as a religious requirement. The government will have to come up with a much better and a less subjective approach to dealing with the issue, an approach that includes more economic opportunity through new job creation.

Morocco to Lower Income Tax, as Debate over Minimum Wage Continues

Morocco is preparing to reduce the income tax for the second time, after the reduction that occurred in 2007. The next income tax reduction will be implemented in two phases, one in 2009 and the second in 2010. In 2009, wage earners will benefit from a 2% reduction affecting all wage levels. The upping of the ceiling of the wages that will be fully exonerated from the income tax will also be introduced in 2009, moving from the current ceiling of MAD 24,000 per year to MAD 27,000. This is equivalent to those who will receive an income of MAD 2,250 per month (up from MAD 2,000).

The changes will be introduced in the 2009 budget and finance law, followed by another 2% across-the-board cut in income tax in 2010, and a second upping of the non-taxable income to MAD 30,000. In practical terms, the marginal tax rate, currently at 42% will drop to 40% in 2009 and then to 38% in 2010.

From the perspective of the state finances, severe losses are expected, in particular since the tax on wages and workers' incomes account to 75% of the global revenue contribution to the state budget. As a result of the January 2007 income tax cut, the state sustained a MAD 3 billion loss, following a cut that was less aggressive than what is planned for the next two years.

Yet, analysts question the move in that several issues remain to be solved, in particular affecting the intermediate income levels, or the so-called middle classes. The definition of a middle income in Morocco essentially focuses on those who earn MAD 5,000 per month and most analysts say that middle income is not good enough to earn a decent living. They argue that a 4% reduction in the income tax will bring no relief and a new mechanism of calculating the tax reduction should be introduced. But in the same token, isn't this also the case for lower income earners? Observers say that the biggest beneficiaries are obviously high-wage earners.

The 2007 tax reform benefited some 2 million workers, who saw their wages rise by an average of 5%, as a result. Even better improvements on wages are expected to benefit the wider population as the cuts are rolled out in 2009 and 2010.

The government plan has not received full feedback from labor unions. Discussions are apparently underway, which would help unions formulate their position. Unions, for their part, have been looking for others aspects of the workers' compensation package, beyond the income tax reduction. Such package of concessions sought after include the raising of the minimum wage to MAD 3,000 according to the demands of the unions. In this context, government representatives say the request makes no sense as the minimum wage is currently set at MAD 1,800. An increase to MAD 3,000 would amount to "economic suicide," an finance official noted. The results, the government argues, would be mass layoffs as companies will not be able to pay for the new wages. But the topic of the minimum wage increase is still on the government agenda, though observers are noticing reluctance from authorities to enact an increase. "Some companies, which produce value and good earnings could eventually afford to raise their wages, but with 90% of the social security contributors declaring less than 10 employees, most companies will resist strongly," an official added.

Another issue under consideration is the potential increase in the so-called "Allocations Familiales" (AF) or family allowances. These allocations added to the monthly paychecks help households in balancing their budgets, in particular those in the lower-income categories. The current ideas being debated call for an increase of the AF in the magnitude of MAD 150 to MAD 200 per month. Such increase would up the payroll of the state administration, the country's biggest employer, by MAD 700 million per year. In the ongoing talks over retirements, the focus is on bringing the minimum pension to MAD 600 per month.

In the end, the government feels it is sandwiched between the need to protect the population and households from further deterioration of their budgets, as the cost of living continues to spiral out of control, and the need to help companies improve their productivity and competitiveness as they continue to face foreign competition in their own territory. Raising household incomes would also mean increasing spending in the state budget, with consequences on the already troubled state finances.

This analysis makes finance officials nervous and many predict nothing will happen until broader and more comprehensive agreements involving all parties, from businesses, to unions and politicians are reached.

A first list of broad propositions with implementation steps is being drafted and will be submitted to the negotiators in early April as part of the country's social dialogue. Then perhaps solutions to a deteriorating cost of living while helping companies compete will be found. But we also expect the battle to go on for a while before agreements are finalized.

SPECIAL REPORT: THE BUSINESS OF NARCOTICS

North Africa's New Drug Route

More than 2,000 pounds of cannabis (20 quintals) were seized recently by Algerian customs stationed at the Bechar borders. The seizure is another record broken in less than one week, providing new indications of accelerated activity in drug trafficking in the region. Official sources believe drug traffickers have been working to open up a new route to distribute their products in Tunisian and Libya transiting via the Algerian southern provinces of Ouargla, El Oued and Illizi. The new routes toward the eastern Maghreb are believed to be the result of a redeployment of traffickers as seaport authorities in southern Europe and in the northern Algerian cities like Oran, Algiers, Skikda and Annaba have imposed stricter controls and disrupted the long-established channels.

It was during a routine inspection that customs officers discovered the cannabis hidden in the trunks of two Toyota SUVs as they were attempting to cross the border post of Hassi Khebbi, in Bechar coming from Morocco. The drivers of the vehicles managed to escape after the police issued warning shots. The operation occurred a few days after a similar event that occurred at another border crossing known as Delaat Djenaib, in the same province of Bechar. The same amount of cannabis was seized as a result.

The two operations highlight growing narcotic activity in the area. Official data suggest that drug seizures in Algeria have been growing at a phenomenal rate from 7 tons in 2005 to 10.5 tons in 2006, before jumping again to 16.5 tons in 2007. More worrisome are the 2008 trends showing some 3 tons already captured just during the first two months of the year, most of which occurred along Algeria's southwest border. Before the southwest took the lead in the Cannabis route, the north-western region of Oran was a hot transit point for narcotics moving into Tunisia. But today, narco-traffickers are refocusing their attention to the Western Erg region, known as Erg El-Gharbi, stretching from Bechar to the Tunisian and Libyan borders with Algeria. The route includes the sub-routes of Ouargla to El Oued and Ouargla to Illizi, Algeria's southern most province along the Libyan border.

The changes in the logistics routes used by the traffickers come from the expanded crackdown that essentially affected the traditional southern European ports of entry, including Spain, France, Portugal and Belgium, from which cannabis grown in Morocco would move into the consuming markets of Europe. An estimated 1,200 tons of cannabis produced in Moroccan fields enter the European markets each year. According to 2004 data from the United Nations, Morocco grown cannabis accounts for 60% of global production. With growing enforcement in Europe, narco-traffickers have been forced to redraw their logistics, by including Algeria as a new transit route. As a transit platform, Algeria has provided a de-facto unique opportunity for drug criminals, leveraging the security vacuum originating from the conflict facing the government with the Islamist insurgents. With growing social discontent, Algeria also became a significant consumer of cannabis. Although no major investigation has been conducted on the full scale of drug consumption in Algeria, the state says it has some 5,000 addicts it fully supported in 2006, before expanding to 5,600 in 2007. Thousands of drug addicts have been treated over the past years, but the issue is likely far bigger than what is publicized given the lack of clear policy on drug treatment and prevention. More alarmingly, a number of surveys conducted in high schools indicate a sharp rise in cannabis consumption among Algeria's youth, as the sources of drugs appear to be readily available and at low cost.

The Casablanca Stock Exchange in 2007 and Outlook for 2008

By Sophia Hakam and Hanane Rahali
Casablanca Finance Group

The Moroccan equity market continued on its upward trend in 2007. The CFG25, an index established by the Casablanca Finance Group to measure the stock exchange performance, rose 26.0%, or close to the average market increase of the past five years (27.3%). The CFG25 rose by an exceptional 57.4% in 2006. Most of the market gain in 2007 took place in the first four months of the year (31.6% up by May 8, 2007), driven by the anticipation of strong corporate annual results for the previous fiscal year, combined with an upbeat outlook for 2007.

Performance by sector ranged from +92.4% for capital goods to -20.5% for utilities. Some small caps performed well and were among the year's biggest gainers. At the top of chart wereTaslif (+218.5%), Acred (+159.2%) and Zellidja (+128.1%). Among the large caps, triple-digit gains were recorded by the newly listed CGI (+155.3%), and financial firm BMCE (+125.2%).

Total equities volumes traded soared in 2007 to MAD 167.5 billion, compared with MAD71.7 bn in 2006. This can be attributed to a combination of:

- An abundance of liquidity,
- A major boost to volumes on the primary market (with 10 new listings raising MAD6.8bn), and
- Round-trip trades at the end of the year, boosted by the increase in the Tax on Profits from Securities Disposals (TPCVM) and the abolition of rebates for insurance companies (in December alone MAD56.6bn were raised, or nearly 30% of total annual volumes).

This boom in trading volumes led to a marked improvement in market liquidity. The liquidity ratio, stripping out strategic transactions, was 25.4% in 2007, compared with a ratio of 16.8% in 2006 and 8.8% in 2005. In view of the strong fundamentals of the listed companies (total earning power rose by 31.6% in the 1st half 2007), profit growth estimates for the full-year 2007 are substantially higher (estimated increase of 28.8%). The downwards revision to the corporation tax (2008 Budget Bill) also led to an increase of 4 basis points in estimates for 2008 (from 14% to 18.3%).

Total dividends (ordinary dividends) continued to increase in 2007 as well, reaching MAD14.2bn compared with MAD12.5bn in 2006. This rise was due to additional dividends of MAD379.4m generated by the 10 new listings and because the dividend pay-out remained at about 70%.

The upward trend in the market led to an expansion of valuation ratios. Stripping out loss making companies, the market is trading at 22.2x earnings estimates for 2007. After the upwards revision of 2008 results, the P/E for 2008 is 18.7. Meanwhile, the dividend yield declined from 3.15% in 2006 to 2.45% in 2007.

We believe the stock market will continue to rise in 2008, with the share prices having upside potential of 15% to 20% this year.

ANALYSIS

With an annual rise of 26.0%, close to the average market growth in the past five years (+27.3%), the Casablanca Stock Exchange marked its fifth straight year of gains, fuelled by growing interest from both institutional and individual investors. Although share prices followed an ascending curve over the year as a whole, this rise slowed in some periods. There were four phases in price movements:

- The stock market had a positive start in 2007, pursuing the exceptional performance of 2006 (+57.4%). It was mainly sustained by anticipation of good annual results in 2006 and the results outlook for 2007. The CFG25 index hit a high of 26,786 points on May 8, 2007, up 31.6%.

- This sustained rise in prices led to a strong rise in valuation ratios (P/E of 22.6 and P/B of 4.7 on 08/05/07) and a correction in excessive ratios in some sectors (particularly banking, with a P/E of 25.2) was necessary. From this point and on substantial trading volumes, the downward spiral began, cancelling the majority of previous gains. In five straight sessions, the index lost 17.6%, reducing the market's annual gain to 13.9%. Analysis of the index by sector shows that the first stocks to be affected by the downturn were the most liquid, particularly conglomerates and stocks in the construction and financial sectors.

- From mid-July, the market rallied, in a context of new listings: Promopharm and CGI were floated in June and August, respectively. CGI's listing attracted a lot of interest and gave fresh momentum to the market, which topped 27,000 points to reach an all-time high of 27,102 on September 5, 2007, representing a rise of 33.1% since the start of the year.

- This trend dwindled rapidly when the stock market entered a phase of indecisive fluctuations in the final three months of the year, which brought the index down to 25,658. The CFG25 finally registered a gain of 26.0% in 2007, compared with a rise of 57.4% in 2006. In US dollar terms, the index grew by 36.8%. The CFG25f index, based on the free float of the stocks in the sample, rose by 34.8% in the course of the year, compared with 73.8% in 2006. In US dollars, the CFG25f rose by 46.4%.

The sustained growth of the market capitalization resulted essentially from the continuous growth of the equity prices during this last five years corresponding to an accumulated growth of 247.8% of the CFG25. This is in addition to the succession of IPOs accelerating over the last two years (the total listed companies has moved from 48 in 2002 to 73 in 2007). In the wake of big capitalizations (Maroc Telecom, Addoha, CGI…) the Stock Market attracts more SME.

The capitalization of the Moroccan market is at the same level as international standards at about 100%. This shows that the Stock exchange starts to weigh significantly in the national economy in terms of representativeness compared to the GDP. In contrast, Jordan with market cap/GDP ratio of 304% has been raising fears of a stock market bubble. As for emergent countries, the BRIC region (Brasilia, Russia, India and China) posts an average ratio of 46%.

Net assets managed by mutual funds rose by 3.3% in 2007, from MAD129.1bn in 2006 to MAD133.3bn. Continuing the trend seen in 2006, net assets managed by equity funds continued to attract investor attention during the year 2007, rising 55.5% to MAD 24.4bn from MAD 15.7bn.

Net assets managed by equity funds as a proportion of total assets managed by mutual funds increased from 12.2% to 18.3%, approaching the 20% mark reached in 1999 but below the all-time high reached in 1998 (37%).

Net assets managed by money market funds increased by 27.4% to MAD33.2bn. These constituted 25% of total net assets, compared with 20% in 2006. Furthermore, upward pressure on the yield curve caused a 13.3% decline in net assets managed by bond funds, from MAD87.3bn in 2006 to MAD75.7bn in 2007. Bond funds therefore constituted 57% of total net assets, down 11 basis points.

Net earnings growth CFG25 Index Performance

The analysis of the earnings growth compared with the CFG25 index progression over the period between 1995 and 2007 shows that the performances of the market are globally correlated to the good performance of the listed companies' fundamentals. A part from the speculative movements boosted by exceptional events (announcements, floatations…), the investors investments mainly institutional are oriented by the good fundamentals of listed companies.

The capital goods sector was the year's best performer, gaining 92.4%. This reflects the positive climate in the automobile market. This sector, which has been given second priority in the country's industrial strategy, has great potential both at national level and in terms of the expansion of supply internationally.

Financial stocks were the second-best performers (+43.5%), boosted mainly by strong performances by the insurance (+85.4%) and banking (+42.4%) sectors. The leasing sector, comprising Maghrebail and Maroc Leasing, lagged behind the market despite the sound fundamentals of both companies and their attractive valuations.

Continuing the trend seen in 2007, basic industries stocks rose by 39.0% driven by the strong performance in building and public works, which benefited from the property boom, the increase in infrastructure projects and social housing requirements. The sector also benefited from the second half year from the listing of CGI. This listing, like that of CGI's rival Addoha, attracted strong interest and the stock closed the year 155.3% higher.

The cyclical consumer goods sector was also among the five best performances in 2007, outperforming the market for the fourth consecutive year and rising 37.3%. Similarly, the transport sector rose by 29.9%, wiping out a decline last year and returning to an upward trend. Investors reacted favorably to an improvement in the fundamentals of CTM.

The telecoms sector, with IAM, also rose but by less than the market average. It is worth noting that the stock has risen by an annual average of nearly 20% since it was listed in 2004, confirming itself as the model fundamental portfolio stock. Meanwhile, conglomerates profited from the market increase only partially, rising 9.4%. They were affected by a modest performance by ONA (+3.9%). We believe that they can be expected to catch up this ground in 2008.

Consumer staples and tourism were also lackluster and almost unchanged at +2.1% and +1.2% respectively. Consumer staples were affected by a timid performance by agrofood stocks, which are struggling to compensate for a weak performance by nearly all companies in the sector.

Two sectors bucked the overall trend on the stock market and closed in negative territory. The biggest losers were utilities, represented by Lydec (-20.5%). The stock has not yet been able to rally. After a high of MAD465.85 on 15 February 2007, the stock fluctuated due to the dispute between Lydec and local politicians in Casablanca over the renewal of the city's utilities contract. The international climate, with upward volatility in oil prices, had a negative effect on Samir, which ended 2007 down 3.3%.

Despite their relatively high-risk profile due to a modest floating capital that reduces their liquidity, some small capitalizations fared well in 2007 and registered some of the strongest stock market performances. These included Taslif, which ended the year an exceptional 218.5% higher, Acred (+159.2%), Zellidja (+128.1%), IB Maroc (+80.8%) and many other small caps. The consumer credit stock Taslif registered startling growth, hitting a record high of MAD 1,160 on 26/04/07. This was initially due to a favorable market reaction to the marked improvement in the company's earning power (net profit increased by 108% in 2006) and then to expectations of positive side-effects from intra-group synergies after Taslif's takeover by the Saham group, as well as an external growth operation in the form of the acquisition of the consumer credit company Salaf.

Among the large capitalizations, it was the property company CGI, listed on August 10, 2007, which took the leading position. The listing, which followed the flotation of the company's rival Addoha, received a great deal of investor attention, and the shares had risen 183.2% less than a month after they were introduced.

The banking stock BMCE also put in a remarkable performance and stood out in 2007 with a gain of 125.2% on high trading volumes. In the first half, the stock was initially boosted by strong speculation on 2006 earnings and was later driven up by a series of announcements made by the group. In the second half, the uptrend in the stock faltered when the market corrected in May before rallying after the publication of a strong interim results for 2007 (profits rose by 70.1%). The stock thus registered a record high of MAD 3,175 on 10/09/07.

Performances of individual stocks

The uptrend continued in 2007 at a relatively sustained rate. Of the 69 stocks covered, 56 rose and only 13 fell. This performance can be attributed to sound fundamentals in nearly all sectors and enthusiasm following stock market listings. Investors, and particularly institutional investors, that were not very satisfied (there was an average satisfaction rate among institutional investors in 2007 of about 1.35%) on the primary market went to the secondary market, boosting stock market share prices.

Share price performance of companies floated in 2007

After having outperformed the index in 2006 with a gain of 91.9% compared with a 57.4% rise in the market, Wafa Assurance continued this trend in 2007, rising 90.0%. This performance was initially driven by the publication of annual results for 2006 that were substantially higher than analyst estimates, later accelerating when strong interim results were announced for 2007.

Furthermore, Addoha, which was the flagship stock in 2006 when it rose by an exceptional 387.2%, ended the year with an increase of 18.2% compared with a 26% rise in the market. The volume weighed average share price in the period was MAD 2,855, with maximum upper and lower closing levels of MAD 3,471 and MAD 2,400. The stock has strong upside potential, particularly in view of recent developments and is now more of a fundamental portfolio stock, moving away from the speculative fervor that followed its flotation.

Similarly, Maroc Telecom ended the year with modest growth of 13.1% compared with a rise of 29.5% in 2006. After rising within a limited range of MAD129 and MAD148 from the start of the year, the shares regained momentum towards the end of the year. They seem well on the way to catching up on the cumulative performance gap seen in the past two years.

Ten stocks went against the general market trend and ended 2007 in negative territory. The most notable of these were Involys, Fenié Brossette, Colorado and Lydec. Involys, which was listed on 14/12/06, dropped by 32.9% from the start of the year to MAD285.

The shares listed in the 3rd compartment lost so much ground that they dropped below their IPO price of

MAD316. This decline was due to lackluster interim figures (a net loss). Furthermore, and despite sustained fundamentals (net profit grew by 250.3% in H1-07), Fenié Brossette dropped 39.5%. Listed on 04/12/06, the stock made substantial gains in early sessions due to speculation, and then began a downward trend from the start of 2007.

The situation for Colorado was similar: the stock lost 20.4% from the start of the year to MAD840, compared with an IPO price of MAD514. The shares rose 160% in the early days of listing and then started a downward trend, ending the year at MAD840.

Trading volumes and liquidity

Total trading volumes (for bonds and shares) came to MAD179.9bn in 2007, compared with MAD83.3bn in 2006, representing an increase of 116.0%. On the stock market, volumes soared in 2007 to MAD167.5bn compared with MAD71.7bn in 2006. This vigorous performance was due to abundant market liquidity as well as a strong dynamic on the primary market with volumes of MAD6.8bn compared with MAD3.6bn a year previously.

However, it should be noted that round-trip trades begun in December by institutional investors as part of the revaluation of portfolios contributed substantially to volumes this year. December alone saw volumes of MAD56.6bn, or more than 30 per cent of total annual volumes. Stripping out strategic operations and round-trip trades, annual volumes grew by 60.6 per cent to MAD104.3bn.

By compartment, the central market was the focus of the majority of trading, with 66% of total volumes and MAD105.9bn traded compared with MAD58.6bn a year previously. On the block market, transactions totaled MAD54.7bn, compared with MAD9.5bn in 2006. The main block trades included the following:

- The sale of 5% of the capital of BMCE to the Spanish bank CAM, for MAD1.48bn.

- Two operations on the capital of Maroc Telecom: (1) the sale of the State's 4% shareholding in Maroc Telecom for MAD4.57bn (unit price of MAD130) and (2) the sale by CDG of 2 per cent of the capital of Maroc Telecom to Vivendi for MAD2.5bn (unit price of MAD140.27).

Other notable strategic block trades include the transfer of 44.8% of the capital of Taslif to the two insurance subsidiaries of the Saham group, CNIA Assurance and Assurance Saada, increasing the Saham group's shareholding to 50% plus one share in the capital of the consumer credit company.

Equity trading volumes on 2007

Like last year, 10 new companies from six different business sectors were listed on the primary market. By business sector, the IPOs were as follows:

- Three new stocks joined the new technologies sector: **Matel Pc Market**, a leading IT retailer in Morocco, opened its capital to the public on 28 February 2007, in a double operation comprising the sale of 239,459 shares and a capital increase for 135,135 shares at a unit price of MAD370. The operation raised MAD138.6m in total. **M2M**, which specializes in electronic transactions, was floated on the stock market via the sale of 129,555 shares at a unit price of MAD 1,095, for MAD141.8m in total. Finally, **Microdata** was the last stock to be floated, listed at the end of December via the sale of 30% of its capital at MAD960, for MAD120.9m in total. A fourth stock was also to have been floated: the IT operator GSI, which had its authorization withdrawn by the CDVM (Moroccan Stock Exchange Watchdog) because its dossier was incomplete.

- After the flotation of Sothema in 2005, **Promopharm** joined the pharmaceuticals sector of the market on 15 June 2007. The operation involved the sale of 27% of its capital at a unit price of MAD880, from which it raised MAD237m in total.

- Similarly, there are now two transport stocks representing the sector: CTM and **Timar**, which was listed in July via a capital increase for MAD15.7m (MAD350 per share).

- The insurance sector also had new entrants. The sector gave a strong boost to its market capitalization with the IPO of **Atlanta** in October 2007, via the sale of 17% of the company's capital at a unit price of MAD 1,200, for MAD1.2bn in total.

- There were two new entrants to the basic industries sector in 2007, compared with 4 in 2006 (Addoha, Colorado, SRM and Mediaco): **CGI**, which raised MAD3.5bn in total via a double operation comprising a capital increase and the sale of shares at a unit price of MAD952. **SNEP**, a subsidiary of Ynna Holding, was floated in November 2007 via the sale of 35% of its capital at a unit price of MAD 1,250, for MAD1.05bn in total.

- In capital goods, **Stockvis Nord Afrique**, a subsidiary of Sanam Holding, floated via a capital increase for MAD108.5m (MAD590 per share).

- Finally, a sixth stock entered the consumer credit sector: **Salafin**, a subsidiary of BMCE Bank, which carried out a double operation comprising the sale of shares and a capital increase, for nearly MAD300m in total, at a unit price of MAD670. The 10 new listed stocks raised MAD6.8bn in total on the primary market and added MAD62.7bn in capitalization, increasing the total market capitalization to MAD585.2bn at the end of 2007.

Earnings growth

The earning power of the companies listed in 2007 is expected to increase substantially, with an estimated growth of 28.8%. Figures in the first half 2007 were very positive, with a 31.6% rise in earning power compared with the first half of 2006. Some stocks even substantially exceeded analyst estimates and analysts have raised their growth forecasts for the coming years as a result.

This growth is connected to strength in the national economy, which, despite a mediocre performance by the agricultural sector, continued to be driven by sustained growth in the non-agricultural sectors. By business sector, banking, telecoms, holding companies, property construction and capital goods saw the strongest profit growth.

The telecom sector, represented by the incumbent operator Maroc Telecom, which accounted for nearly 33% of total earnings, confirmed its leading position. The operator should generate alone additional earnings of MAD1.4bn in 2007, due to a good performance by all its business divisions and its foreign subsidiaries. Between 2006 and 2008, its average annual earnings growth rate is 17.6%.

Financial stocks ranked second, contributing nearly 29% to total earnings, generated mainly by banks. These are expected to post earnings CAGR of 20.2% in the period, confirming the sound health of the banking sector. This performance was due to increased revenues owing to the continuing expansion of the banking network, curbing of costs and bad debt risk, as well as the gaining strength of market activities. However, the sector's performance was altered in 2007 by non-recurring revenues, particularly the capital gains of MAD700m generated by BMCE Bank on the sale of 5% of its capital to the Spanish bank Caja Mediterraneo (CAM).

In third place came basic industries (19% of total earnings), driven particularly by property stocks. They are expected to post a CAGR of 37.2% of earnings between 2006 and 2008. This performance can be attributed to the development of the property sector and tourist and infrastructure projects.

Our universe comprises 66 non-loss-making companies including the newly floated companies. The net profits calculated take into account the downward revision in corporation tax, which increased the 2008 growth estimate by 4 points.

Earnings of companies covered by sector

The conglomerates (8% of total earnings), boosted by the good performance by their main subsidiaries, should see average earnings growth of 24.4% between 2006 and 2008. The ONA group should be the main driver of growth in the sector due to expected strong results in financial activities, an expected maturing in the supermarket retail sector, which should benefit from the economies of scale permitted by the critical mass it has now reached, as well as the recovery in mining activity and a progressive return to operating profit by the agrofood sector.

The consumer staples sector (4.3% of total earnings) should see an average increase of 27.2% in earnings between 2006 and 2008. Despite an international situation marked by rising raw materials prices, the overall performance of the companies in the sector was positive at the end of H1-07. Apart from Lesieur, which registered a 56.4% decline in net profit following a modest olive harvest, and Centrale Laitière (net profit down 2.2% at end H1-07), which suffered from increasing raw materials costs; the other players saw double-figure earnings growth.

Profiting from the country's economic development, the capital goods sector earnings should increase by 73.8% in 2007, when final results are released. Most of this growth is expected to be generated by the companies Auto Hall, SRM and Fenié Brossette, driven by the surge in demand for low-cost cars and a robust construction and public works sector, which has caused growth in sales of maintenance and construction machinery and equipment. The sector is expected to see an earnings CAGR of 40.8% between 2006 and 2008.

In a context of soaring oil prices, the energy sector, represented by Samir, saw a 22% decline in profit in the first half 2007. We expect earnings to grow by 4.8% a year on average in the sector in 2007, and to decline by 3.7% in 2008. The expected broadening of margins should initially continue to be affected by the financial costs and the depreciation and amortization costs of plans to modernize the Mohammedia refinery. This project is now 70% complete, having been launched in 2005 as part of the investment agreement signed between Samir and the government. Works are scheduled for completion by September 2008 and the refinery is to be put back into service in the first quarter of 2009.

Driven by the Vision 2010 project, the tourism sector offers considerable growth potential due to synergies generated by the launch of the new coastal resorts, the development of new areas of tourism, the penetration of new outbound markets and the growing strength of domestic tourism. Capitalizing on its position as leader of the Moroccan tourism sector with market share of 7% and a presence in about 10 towns under several trading names and brands, Risma, which is the only representative of the sector on the Casablanca stock market, is expected to post annual average net profit growth of 13.3% between 2006 and 2008.

The new technologies sector is expected to register an earnings CAGR of 40.7% in the same period. The listed companies in the sector should be driven by a strongly growing Moroccan IT and communications market. Many measures have boosted the ICT market: implementing the e-Morocco strategy in 2001, launching the E-Gov project, creating dedicated public stakeholders and signing the Progress Agreement in Skhirat in September 2006.

Representation on the Casablanca stock market continues to increase steadily. After the listings of HPS, Distrisoft and Involys in 2006, three more companies from the sector were floated in 2007: Matel PC Market, M2M and Microdata.

Dividends

For the purpose of consistency, we have not taken account in our calculations the exceptional dividends distributed in 2007 by Eqdom (MAD30), Lafarge Ciments (MAD128), Brasseries du Maroc (MAD13) and BMCI

(MAD20). Total dividends paid out by listed companies continued to increase in 2007, reaching MAD14.2bn compared with MAD12.5bn in 2006, a rise of 13.8%. This increase is partly due to the dividends generated by the 10 new listings, which represented additional total dividends of MAD379.4m, and partly to a sizeable increase in pay-out rates. The good earnings generated by the listed companies (up 15.7% in 2006) allowed them to revise their dividend payout policies upwards.

There was an increase in almost all dividends paid out for all sectors. As usual, the telecoms, finance and basic industries sectors registered the three largest dividend pay-outs, driven respectively by the shares of Maroc Telecom, Attijariwafa Bank and Lafarge Ciments.

The telecoms sector with IAM seems to be maintaining a generous dividend pay-out policy, accounting for nearly 49% of total dividends paid out in 2007. The telecoms operator has distributed more than its net earnings for the second consecutive year, for group net profit of MAD6.7bn. Maroc Telecom is profiting by its leadership position to remunerate its shareholders while pursuing its investment strategy.

Financial stocks took the second place in terms of dividend pay-outs, particularly Attijariwafa Bank, which paid out nearly MAD868.5m in 2007, a rate of 43%. Basic industries are close behind, driven by the cement group Lafarge Ciments, which distributed MAD619m in ordinary dividends, representing a pay-out rate of 65%.

In the past three years, the market dividend pay-out rate has stabilized to an average of 73%, mainly due to continuing improvements in the earning power of companies listed in the period, combined with the aim of listed companies to allow shareholders to profit from the growth of their companies.

For 2007, from total earnings of MAD20.3bn generated by listed companies in 2006, nearly MAD14.2bn in ordinary dividends (and MAD896n in exceptional dividends) were paid out, giving a pay-out rate of 71.2% compared with

73.3% in 2006. Stripping out Maroc Telecom, the rate was 53.4% in 2007 compared with 56.4% in 2006.

Shareholders' equity

The equity capital of listed companies should reach MAD124.5bn in 2007, compared with MAD103.9bn in 2006. This is due to (1) the additional equity capital of the 10 new listings for MAD6.9bn, (2) the raising of funds by some companies, for MAD2.14bn, and (3) the increase in earnings in nearly all sectors.

On like-for-like terms (excluding new listings), equity capital should reach MAD117.5bn, compared with MAD101.6bn in 2006, an increase of 15.6%. As well as the 10 IPOS, two companies made public offerings, raising MAD2.34bn in total.

- **Oulmes:** The agrofood company made a call on the market via a capital increase for MAD199.9m by issuing new shares. In the operation 330,000 shares were created (at a unit price of MAD606) at a parity of one new share for five existing shares.

- **Addoha:** To finance the growth of its business, the group made a call on the market via a capital increase for about MAD2.14bn. The terms of the operation were: (1) a price per share of MAD 3,180, (2) 675,000 new shares and (3) a parity of one new share for 20 existing shares. Cartier Saada, Lafarge Ciments and BMCI also carried out capital operations:

- **Cartier Saada:** The agrofood operator Cartier Saada carried out a capital increase for about MAD7.8m, increasing this to MAD46.8m by incorporation of the issue premium. Former shareholders were thus allocated 78,000 free shares on the basis of one new share for every five existing shares.

- **Lafarge Ciments:** The cement group carried out a capital increase by incorporation of reserves for MAD1.27bn. A total of 12,704,808 new and fully paid-up free shares, with a nominal value of MAD100, were thus allocated to current shareholders on the basis of eight new shares for every three shares held.

- **BMCI:** This subsidiary of Groupe BNP Paribas adjusted the ratio for the conversion of bonds to shares issued on the 1st September 2000. This followed the recalculation of the exchange parity due to the effect of the capital increase via the optional conversion of the dividend for the financial year 2006. The capital thus increased from MAD 1,000.27 m to MAD 1,034.92 m. The new exchange parity is five shares for every three bonds.

Expansion of valuation ratios: Three phases of development in the Moroccan stock market

The market P/E, excluding loss-making companies, reached 22.2 in 2007, up 2 percentage points on 2006. This increase was due to the continued rise in share prices in 2007 (an increase of 26%). The Moroccan stock market has undergone three distinct phases. The first phase, from 1995 to 1998, saw prices rising much faster than earnings. In this phase, the index rose by an annual average of 32.4% compared with average annual earnings growth of 19.2%. The second phase (1999-2002) was marked by a correction of the excessive rises witnessed in the first phase. The CFG25 index fell by an annual average of 15.0% over this period compared to a modest annual average rise of 3.1% in the earnings of listed companies. The third phase, in place since 2003, has been characterized by a more rapid rise in prices than in earnings. Between 2003 and 2007, the index rose by an annual average of +27.3% compared with average annual earnings growth of +22.8%.

The equities market's P/E rose from 14.3 to 19.2 between 1993 and 1998, largely due to the sharp rally in share prices over the period (+27% per year on average). Between 1998 and 2002, the market P/E fell sharply, due to a price correction on the market, to reach a record low of 8.8 at the end of 2002. Since then the market has rallied, expanding valuation ratios, which have risen steadily to reach 22.1 at the end of 2007. Since 1994, the average P/E has been 15.5. The market dividend yield fell by 22% from its 2006 level to reach 2.45%. This decline was due to a greater rise in share prices (+26% in 2007) than in total dividends (+13.8%).

The share market, buoyed by a sharp recovery in confidence, continued to rise, entailing a steady decline in the risk premium. The risk premium moved from 4.72% at 29.12.06 to 2.76% at the end of 2007, a decline of 196 basis points. This decline can be attributed to the increase in share prices (+26.0%) combined with a near-stagnation in the 10-year BdT yield (4.37% at end-2006 to 4.38% at end-2007).

We think the current valuation gap between the equities and bond markets is appropriate given that the average historical risk premium (since 2000) is 4.26%, with a low of 1.00% hit on 29/01/99 and a high of 7.16% reached on 05/07/02.

For the next six months, our bond research team has forecasted stability across the entire yield curve, mainly due to:

• The improvement in macroeconomic indicators such as agricultural GDP, which increased from -17.5% in Q3 2007 to -8% in Q4 2007, combined with the sustained growth in non-agricultural activities.

• Stabilization of money-market rates at about 3.25% due to BAM's decision to maintain rates around the benchmark (3.25%). This decision led to a reduction in the mandatory reserve level from 16.5% to 15%.

Given that we expect further share price rises between now and the end of 2008, we believe the risk premium should fall slightly over the next six months.

Since the market recovery began in July 2002, the CFG25 index has been moving within a main upward trend channel R-S. As we anticipated in our half-year technical analysis of the stock market (July 2007), the downward market fluctuations seen in June petered out. The index broke upwards through the MA100 short-term moving average to reach a peak for 2007 of 27,102 on 05/09/07, testing the major resistance R on the same occasion. There followed a consolidation phase, in which the index broke downwards through the MA100 short-term moving average and met resistance at the MA200 long-term average.

Since the start of 2008, the market has rallied substantially with sustained trading volumes, breaking through the major resistance of the upward trend channel R-S on 17/01/08. A new index record of 28,213 was thus reached. Since then, the index has been moving in a new short-term upward trend channel r'-s'. In the short term, we favor an upward trend scenario, underpinned by the movement of the index within an upward channel strengthened by continued positive signals from the technical indicators, such as the MACD which is crossing over its signal line.

Market outlook

Global economic growth is expected to drop from 2.7% in 2007 to 2.35 in 2008 (according to the growth forecasts of the OECD countries), due to an anticipated slowdown in the US economy (from 2.5% to 2.3% in 2008) as well as in the euro-zone (from 2.3% to 1.9% in 2008). This slowdown is mainly linked to the recent financial turbulence on the US subprime mortgage market and to the fall in consumption and investment following the squeeze in the credit market, added to the effects of rising oil prices and the appreciation of the euro.

Nationally, apart from a major drought, the economy saw a generalized rise in hydrocarbon prices and soaring cereal prices on the international markets in 2007. Economic growth is expected to come in at 2.3% in 2007 (compared with growth of 8.1% in 2006), mainly driven by the performance of non-agricultural sectors (5.8%), particularly the secondary sector including construction and public works and the tertiary sector, particularly tourism and telecommunications.

In 2008, GDP is expected to increase by 6.8%, driven by a simultaneous 6.1% rise in non-agricultural GDP and a 12.8% rise in agricultural added value. This increase will depend on a scenario of average cereal production of 60 million quintals, average inflation of 2.3%, an oil price of $75 a barrel and a budget deficit of less than 3% of GDP. This scenario, generally favorable for the Moroccan economy, should continue to maintain the uptrend in the stock market. In terms of fundamentals, the main indicators suggest that the upward trend will continue:

- Very promising earnings outlooks for the listed companies. Our estimates indicate growth of 28.8% in total earning power in 2007 and 18.3% in 2008.

- The positive effects from the flotations that may take place in 2008, including the two property companies Al Omrane and Chaabi Lil Iskane, Delta Holding, Finatech Group and Label Vie.

- The growing attraction of the Casablanca stock market for foreign investors. The decline seen on the international bourses due to uncertainty about US economic growth should revive investor interest in emerging market places such as Morocco.

- The average return on equity (ROE) in 2008 is expected to be 19.4%, excluding Maroc Telecom.

The 2008 Budget Bill set out a series of fiscal measures, principally:

- An overhaul of the corporation tax rate: the standard rate will be reduced from 35% to 30% and the rate for the financial sector from 39.6% to 37% (35% from 2009). According to our estimates, this reduction in corporation tax should lead to an increase of four basis points in the total earning power of the listed companies in 2008. However, we note that at the same time, the new legislation abolishes all tax-deductible provisions (provisions for investment, for housing and for deposit replenishment).

- The government has also decided to overhaul the tax incentives for social housing property developers, which until now have been exempt from all tax (pursuant to Article 19).

- These companies are expected to be subject to a 50% reduction in the corporation tax in force in 2008 and to the normal tax rate after this financial year. Programs with a selling price of MAD 140,000-MAD 200,000 will no longer be exempt from corporation tax (other exemptions, such as VAT exemption, will stay in place). The exemption will stay in place for programs with a selling price of less than MAD 140,000, in exchange for minimal production over five years of 500 residences in urban areas and 100 in rural areas. The previous legislation set this minimum at 2,500 residences.

- Furthermore, the 2008 Budget Bill does not make provision for the renewal of the tax allowance on capital gains made by insurance companies (the 2006 Budget Bill made provision for an exemption system applicable until 31 December 2007). It involved a 25% allowance on corporation tax for capital gains realized on investments of two to four years' duration and a 50% allowance for investments of over four years.

- Capital gains tax on the sale of securities (TPCVM) will increase to 15% from 10% and capital gains tax on the sale of OPCVM shares will increase to 20%.

- In terms of VAT, financial leasing operations will be taxed at the standard rate of 20%, compared with 10% previously. This final measure should cancel out the cost advantage which was the most positive aspect of the LOA formula. Promotion of the LOA product should therefore be based in future on factors that do not include cost.

- Customs duties will also change, with the maximum import duty quota reduced from 45% to 40%. The implementation of the TIC rate applied to petroleum gas and gaseous hydrocarbons will also be postponed until 1 January 2009.

Outlook for individual sectors

The outlook is promising for nearly all the sectors represented on the Casablanca stock market in the next few years. We will now try to substantiate growth outlook by business sector, focusing on the main stocks.

Basic industries

In the coming years, property construction offers a promising outlook due to the various works related to the surge in urbanization (over the next 15 years, Morocco's urbanization ratio is expected to increase to 62.1% compared with 56.2% today) which will have a corresponding
effect on housing requirements (the total deficit in urban housing is estimated at more than 1.2 million units by the housing ministry) as well as infrastructure and tourism projects, the government project to reduce substandard housing and the rise in mid- and upper range property. This dynamic has been boosted by the close involvement of the public authorities through land supply, tax incentives and loan guarantees (Fogarim).

Addoha, the biggest stock in the sector, is expected to improve its earnings substantially in the next three years (net earnings CAGR 08/06 of 120.9%), due to (1) sustained growth in the social housing segment, (2) the commercialization of new projects developed with major operators such as Fadesa5, CDG (Immolog), SOMED, CMKD and Al Qudra, and (3) property reserves of about 65 million sq. m. To finance its growth, Addoha has carried out a capital increase for MAD2.2bn. In our latest publication we recommend buying the stock up to a price of MAD 4,200. The positive dynamic in the property sector should continue to drive the **cement sector**. Evidence of this is the fact that cement makers are basing their strategies on expanding their investment capacity.

In terms of individual stocks, **Holcim** should register a net earnings CAGR 08/06 of 5.6%. Tension in production capacity in Morocco should mean that Holcim rapidly saturates its new Settat unit (completed in the 3rd quarter 2007) which has capacity of 1.7 million tons. Similarly, **Lafarge Ciments** should continue to progress in the next three years (net earnings CAGR 08/06 of 21.0%). The company is expected to continue to expand its capacity to consolidate its position.

Lafarge Ciments has therefore embarked on an investment program worth MAD2.2bn in total with the aim of doubling its production capacity in the north. The investment is expected to allow the group to expand its total capacity to 6.1 million tons, as well as creating additional milling capacity of 500,000 tons.

Ciments du Maroc (net earnings CAGR of 1.2%), instructed by the public authorities to relocate its Agadir plant to make way for tourism in the city, plans to implement a new project at Ait Baha (about 10km from Agadir), with 2 million tons of capacity. The old plant could cease production in 2011 depending on the definitive decision of the authorities. The cement group is also expected to release a financial envelope of MAD600m in the next three years to improve the productivity of its existing plants.

The outlook is also positive for the mining sector. Higher metals prices on the international market, better grades and larger reserves held by companies in the sector, as well as development projects in sub-Saharan Africa, should make it more appealing to investors. **Managem**, a subsidiary of ONA, is expected to see a major upturn in its profits in the next few years (net earnings CAGR of 226.6%). The efforts made by the mining group to restructure its hedging portfolio allows it to profit more from rising prices on the international markets. The company's exploration activities have led to discoveries of metals (including silver, gold and lead) in the Immiter, Hajar, Draa Sfar and Akka mines. Thus and also given its pursuit of developments in Africa, the multi-ore company is reducing some of its weaknesses and tackling the unfavorable coverage of its portfolio.

After completing a joint venture with Fadesa (six projects planned on 800 ha), Addoha announced the acquisition of 50% of Fadesa Maroc in December for MAD1.3bn. The Moroccan subsidiary of the Spanish group has several projects on an estimated 3 million sq. m. of building land, which are scheduled for completion in 2008-2018. This substantial acquisition completes the partnership arrangement with total estimated building land of more than 5 million sq. m., giving Addoha access to Fadesa's world-wide marketing network and its customer database.

Consumer staples

Despite an international environment marked by rising raw materials prices, the growth outlook for companies in the sector is positive. **Agrofood** stocks closed 2007 with growth of 2.1% compared with 26% for the CFG25 index. Given the sound fundamentals of the companies in the sector, it is foreseeable that they will close this performance gap in 2008.

Looking at individual industries, the outlook for the **dairy products** sector is promising, due to the potential for increased market penetration, which is still insufficient. **Centrale** Laitière, the market leader with a share of nearly 60%, is expected to continue to grow (net earnings CAGR of 7.9%) due to an expanding product offering and continuing targeted investment in the progressive modernization of industrial facilities and expansion of production capacity.

The outlook in the **sugar industry** is mixed, with several unknown factors such as the implantation of new local producers, development of cultivated land with sugar producing plants and volatility of global prices. Given these challenges in the sector, **Cosumar** plans to base its strategy in the next few years on improving production costs in order to maintain its local position. The completion of a good sugar harvest and the continuing implementation of synergies from the Indimage 2012 project make good results seem likely in 2007 (net earnings CAGR of 69.1%). The refinery modernization program and the implementation of a tripartite contract (government, upstream agriculture and Cosumar) will help increase the visibility of all the sugar players.

In a context of rising international **food oil** prices, increased competition, particularly from Savola Maroc, and the removal of customs duties on cattle cake, Lesieur should see a decline in earnings in 2007 before returning to earnings growth in 2008 underpinned by a progressive upturn in sales of food oil and a return to normal prices. The company's net earnings CAGR 08/06 is 45.4%.

In the **beverages** sector, Brasseries du Maroc has a promising growth outlook (net earnings CAGR 08/06 of 25.3%). The company is pursuing its strategic plan to develop production and distribution of its products via its subsidiary SMV, whether these are local in origin or imported by its parent company Castel. The leader of the Moroccan beer market (market share of 98%) should benefit in the next few years from strong growth potential in alcohol sales outlets, due to the development of modern distribution and the opening of new hotels as part of the promotion of tourism. The company should also continue to benefit from sales of flavored malt drinks, namely Fayrouz, which has proved very popular.

Information technology

Several measures have boosted the ICT market, including implementation of the e-Morocco strategy in 2001, launching the E-Gov project, creating dedicated public stakeholders and signing the Progress Agreement in Skhirat in September 2006. The APEBI has forecast average annual growth in the ITC sector (including telecoms and off shoring) of 15% for the period 2006-2012. Excluding Involys, which is expected to register a decline in profits for 2007, all operators in the sectors, particularly IT equipment distributors, offer a promising growth outlook.

The new recruit **Matel PC Market**, which was created from the merger in November 2006 of Matel and PC Market (ranking respectively first and second in terms of turnover) should achieve average annual earnings growth of 45.9% between 2006 and 2008. The retailer diversified its product portfolio by integrating the Cisco brand in November 2007. Matel PC Market is planning to create a subsidiary (specializing in IT distribution) in Tunisia. In our latest publication we recommend buying the stock up to a price of MAD700.

Growth in the sector should also benefit **Distrisoft** (net earnings CAGR 08/06 of 31.3%). To optimize its profitability, the company will add diverse products in the next few years, particularly developing electronic products (audiovisual and telecommunications) as well as designing an e-commerce solution in order to sell online. In our latest publication we recommend buying the stock up to a price of MAD1,200.
In a strongly growing global money market and a national market where the use of electronic payment terminals is becoming generalized, **HPS** has a good growth outlook (net earnings CAGR of 46.2%). The company should capitalize on a strategy directed towards strengthening its geographical presence and penetration of new markets, particularly in North America and Asia. The company's business should be driven by the commercialization of the latest version of its key product, the Power Card.

Telecommunications

Despite a tightening of competitive constraints with the arrival of the new operator Wana, the telecommunications sector, with **Maroc Telecom**, is expected to pursue an upward trend in the next few years (net earnings CAGR of 17.6%), capitalizing on improved penetration by mobile telephony and on its development on the regional market. Remember that this subsidiary of Vivendi embarked on two major initiatives in 2006. These were the acquisition of 51% of the capital of the Burkina Faso-based telecoms operator Onatel, and the rolling out, in France and in Belgium, of its Mobisud virtual platform, aimed at users of Northwest African origin.

The operator's shareholding structure also underwent major changes in 2007 (cf. page 11) which helped improve the visibility and the liquidity of the stock on the market. After moving for some time within a tight range of MAD128 to MAD145, the stock seems to have regained strength.

Conglomerates

Due to strong performances by their main assets and subsidiaries, the listed holding companies are expected to improve their earnings substantially in the next few years. **ONA**, the key stock in the sector, should register average growth of 26.9% between 2006 and 2008.
This should be achieved due to the sound health of financial activities, the maturing of the supermarket retail sector (remember that the group acquired the 49% shareholding of Marjane and ACIMA held by the French retail group Auchan), the growth of supermarket retail in West Africa and the return to normal profits by mining and agrofood companies. However, these achievements should be curbed to some extent by the impact of new activity in telecoms, due to a substantial planned program of investment (MAD6.5bn) and the time necessary to reach critical mass. However, this impact was minimized in the first half 2007 by potential capital gains from the sale of AXA shares.

Capital goods

The capital goods sector is expected to benefit from the strategic importance of the automotive sector, which is one of the main growth sectors identified in the country's new industrial strategy for the next few years. In this area, the memorandum of understanding signed between the Moroccan government and Renault-Nissan aims to create in Morocco a strategic platform to build major international models at the highest level of international competitiveness. The installed capacity of this platform will be 400,000 vehicles a year (Nissan and Renault models) with initial operating capacity of 200,000 vehicles from 2010.

Also contributing to growth in the sector is **Auto Hall**, which continues to consolidate its benchmark position and push up its fundamentals. The next three years are likely to be bright for the carmaker, with estimated average annual earnings growth of 43.1%. Furthermore, the EGM called for 5 March 2008 is expected to approve a planned capital increase via incorporation of reserves and the creation of 2,360,000 new shares allocated free on the basis of one new share for every existing share held.

Tourism

The tourism sector offers considerable growth potential due to synergies generated by the Vision 2010 project, the launch of new coastal resorts, the development of new areas of tourism, the penetration of new outbound markets and the growing strength of domestic tourism.
In this favorable economic environment, **Risma**, the investment firm owned by Accor Maroc, is further consolidating its leadership position. Via the acquisition of the Hilton hotel in Rabat, the group aims to raise the positioning of its brands, offering high-end luxury products and services as well as very good-quality low-cost options. We are expecting average annual earnings growth of 13.3% between 2006 and 2008.

Banks

The banks are expected to generate outstanding earnings in 2007. The Moroccan banking landscape should benefit fully from a generally favorable economic climate, driven by a rapid rise in revenues. In a context favoring investment and consumption, demand for credit is growing substantially and offsets in terms of volume the continuing erosion of margins. The Moroccan banks currently have robust solvency ratios that are allowing them to step up their local expansion plans and extend their agency networks as well as position themselves on regional markets (Maghreb and Sub-Saharan Africa). 2007 also saw the entry into force of the central bank's authorization of the marketing of alternative products (Ijara, Moucharaka and Mourabaha). This offering should extend the range of banking services and thus improve the number of bank accounts per capita (currently 25%). The three leading banks, Attijariwafa Bank, BCP and BMCE, are expected to register respective annual average earnings growth of 24.6%, 4.8% and 15.4% between 2006 and 2008.

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