

CASE STUDY

Helping Morocco Mitigate Currency Risk on Liabilities Owed to a Third Party

OVERVIEW

With investor appetite for euro-denominated bonds low, Morocco issued US dollar-denominated bonds for the first time in December 2012. However, Europe is its main trading partner and the Moroccan dirham is largely pegged to the euro. To manage the currency risk of its dollar-denominated liabilities, Moroccan authorities approached the World Bank to exchange the dollar-denominated coupon payments and the principal repayment of the US\$1 billion bond into euro. The World Bank acted as an intermediary for Morocco and executed the first non-IBRD hedge to help a member country manage risk of liabilities owed to a third party.



Background

Morocco has made significant economic headway since the 1990s, averaging 4.9 percent of growth over 2001-2011. The unemployment rate declined from 12.3 percent in 2000 to 8.9 percent in 2011. Absolute poverty decreased from 15.3 percent to roughly 9 percent between 2001 and 2007. Based on these achievements, Morocco reached “investment grade” rating in 2007, which was confirmed over 2009-2011 despite ongoing global economic turmoil. These achievements were in part the result of sound macroeconomic policies.

The policies adopted include a prudent debt

strategy which resulted in central government debt declining from 68 percent of GDP in 2000 to 50.3 percent in 2010. To improve debt management capacity, the debt management office strengthened its institutional structure by creating front, middle, and back office functions. The Ministry of Economy and Finance (MEF) also partnered with the World Bank to manage financial risks on its IBRD loan portfolio, making use of opportunities to execute interest rate and currency hedges.

Financing Objectives

As Europe is its primary trade partner, the Moroccan dirham is largely pegged to the euro. But with

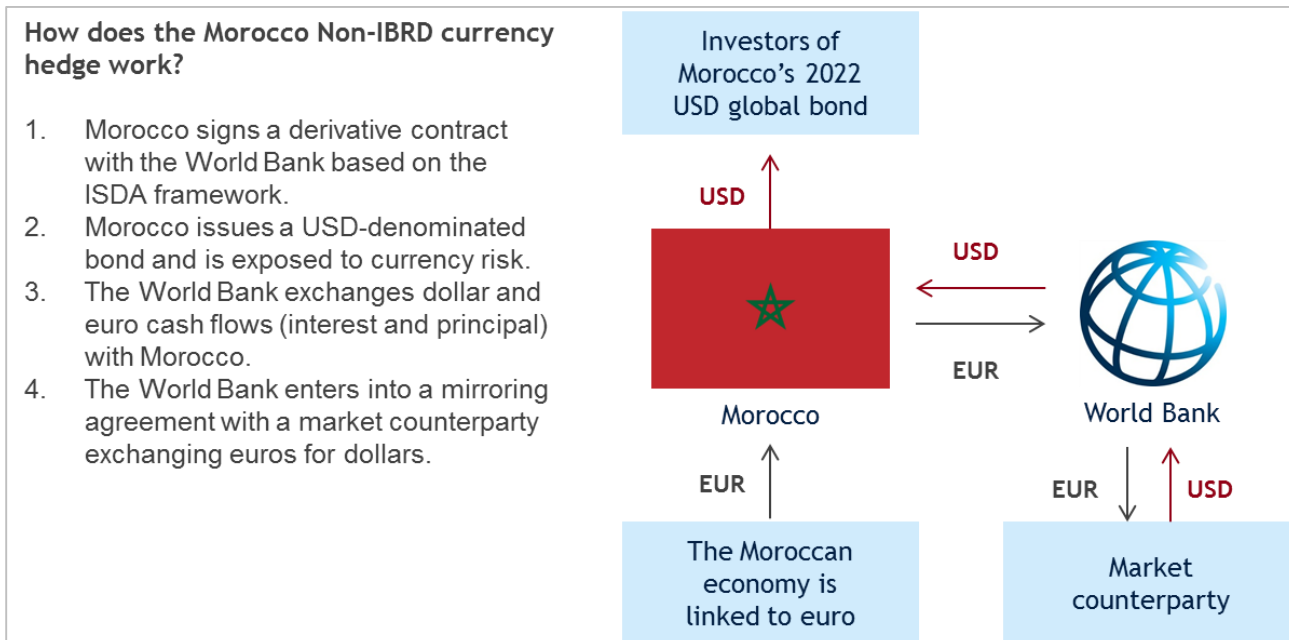
investor appetite for EUR-denominated bonds uncertain, the government issued a US\$1 billion 10-year global and a US\$500 million 30-year global bond in December 2012. However, the MEF was concerned about the currency risk on its dollar obligations and wanted to exchange its US dollar liabilities into euro.

Financial Solution

At the request of Morocco, the World Bank executed a free-standing currency swap, which allowed the country to manage its exposure to the dollar in relation to the US\$1 billion bond issuance. The USD/EUR cross-currency swap exchanges into euro the bond's semi-annual fixed rate coupon payments and the final notional exchanged at maturity. The terms of the swap exactly match those of the bond. The transaction was executed under the terms of an ISDA (International Swap and Derivatives Association) agreement signed with the World Bank in 2004. When executing the swap transaction with Morocco, the Bank also executed a mirror transaction with a market counterparty in order to off load the currency risk it took.

Outcome

This marked the first time that the World Bank and a client partnered to manage risk on liabilities owed to a third party. This will allow Morocco to better manage its exposure to the US dollar and protect its investments and development programs from fluctuations between the dollar and the euro. The transaction also helps Morocco maintain the composition of the external debt portfolio in line with the currency risk management strategy. This transaction was also part of the Bank's efforts to provide a comprehensive menu of financial solutions to meet the risk management needs of member countries.



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