

Monetary Policy Strategy in Morocco: Between Theory and Practice

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Abstract: Since the 1980s and 1990s, Morocco has made great efforts to consolidate its monetary policy strategy. Going through the strategy of targeted monetary aggregates until the arrival of BAM's autonomous status in 2006. Currently, BAM uses a multi-criteria monetary strategy as a diagnostic framework for inflation risk. For Morocco to use an inflation targeting strategy, it must meet certain operational and institutional conditions. This article will provide a scientific basis for different approaches that can identify the problems of BAM's strategy as a whole and will make a contribution that can be used for applied research purposes.

Key words: Monetary Policy, strategy, inflation targeting, BAM, credibility, transparency, Reforms, Morocco

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I. Introduction

Diabetes Most economists agree on the primary objective of a central bank, which must be price stability. And to achieve this objective, a strategy must be put in place. Thus, the introduction of the latter remains a major task for all central banks, and its choice is the crucial phase in the development of an effective and credible monetary policy.

The first attempt by central banks is the monetary targeting strategy. This strategy was deeply practiced by all issuing institutions and was very successful in the 1970s and 1980s. In the following years, the major central banks shifted from monetary targeting to inflation targeting because of the instability resulting from the relationship between monetary aggregates and target variables. In this regard, the inflation targeting strategy has been widely used by industrial and emerging countries and has generated much interest and debate among central bankers and monetary economists in recent years.

In Morocco, BAM has made efforts to implement an effective, efficient and effective strategy to maintain its primary objective. This included monetary targeting until 2006, when it became a bank independent of the executive branch, and then until the arrival of a multi-criteria strategy today. Therefore, BAM argues that the transition to the inflation-targeting strategy is only a matter of time and that the change in its statutes reinforces and consolidates this orientation, thereby increasing its institutional and operational credibility. In 2007, during a speech by the Governor of BAM, he announced that "the implementation of an inflation targeting policy requires credibility and a proven "anti-inflation" reputation of the central bank". At the beginning of 2018, Morocco took the first step towards inflation targeting through the gradual flexibility of its exchange rate, an unavoidable condition and step more than necessary to achieve this strategy.

In this context, our research aims to evaluate BAM's strategic approach in order to contribute to the work on monetary policy in Morocco. In this perspective, our work will be organized in four parts. First, we will decipher the different conditions and criteria for choosing a monetary policy strategy in Morocco. Then, we will present BAM's three-year strategic plans. Then, we will summarize the monetary targeting strategy developed by Morocco by examining the various causes of its failure. This will lead us to explain the inflation targeting strategy applied in the case of Morocco, and to present its institutional, technical and economic prerequisites. Finally, we will focus on the transparency and communication strategy by showing its implications for the credibility of monetary policy.

II. Material Conditions and criteria for choosing a monetary policy strategy in Morocco

The successful implementation of the strategy increases the credibility of monetary policy, thus its ability to anchor agents' inflation expectations in order to ensure price stability. Thus, the recognition of the importance of price stability by a central bank must be reflected in its strategy. Here, the strategy refers to the overall approach set by the Central Bank to achieve its overarching objective of maintaining price stability.

In this respect, the Bank-Al-Maghrib Articles of Association provide in Article 6 that "in order to ensure price stability, BAM shall determine and implement monetary policy instruments. Without prejudice to the objective of price stability adopted in consultation with the Minister of Finance, BAM shall carry out its

mission within the framework of the Government's economic and financial policy. From this perspective, economic agents must be convinced that the Bank-al-Maghrib Council is committed to maintaining price stability, that it has the necessary instruments and expertise to do so, and that it implements monetary policy with this objective in mind. Even if there is no quantitative definition, Bank-Al-Maghrib remains true to a tradition that acknowledges the achievement of this objective and pays attention to well-controlled inflation. Over the past decade, Morocco has never crossed the 2% barrier, manifested only by an average of 1.9% during 2000-2009 (Figure 1).

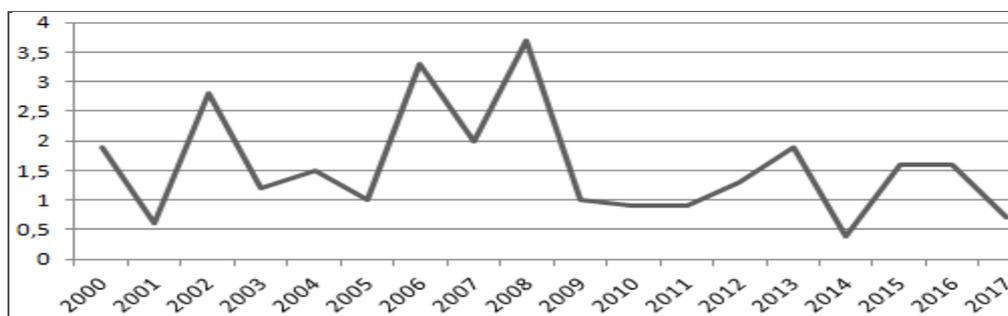


Figure 1 : inflation evolution in Morocco
Source : World Bank data and Authors' calculations

Indeed, several elements must be brought together in order to be able to discuss a monetary policy strategy in Morocco. To achieve its objectives, the strategy must be understandable and clear to economic agents. For the simple reason that the purpose of such a monetary strategy is to provide, on the one hand, an analytical framework that can ensure a consistent and systematic approach to monetary policy decision-making and provide a clear and transparent framework for explaining monetary policy decisions to the public. (ECB 2004).

However, one of the main intentions of monetary policy is to reduce uncertainty and improve the credibility of the Central Bank (Kamdem, 2015, p6). In the face of considerable uncertainty regarding the reliability of economic indicators, the structure of the economy and the transmission mechanisms of monetary policy. Thus, an effective strategy must be based on a wide range of relevant indicators (Edwin, 2016, p144). Moreover, a monetary strategy can only be efficient through a highly harmonized effectiveness-credibility dilemma. In other words, a policy is more likely to be effective if it is credible. Thus, it appears that credibility is one of the conditions for effectiveness in terms of macroeconomic performance and international practices.

After the harmful effects of the 2007-2009 financial crisis, financial stability was taken seriously in the development of the monetary policy strategy. In this sense, the crisis experiences have required coordination between monetary policy and macroprudential policy. The latter cannot be separated (Billi-Vredin, 2014; IMF, 2013a). However, BAM has put too much effort into strengthening this stability and including it in its strategies. At the analytical level, BAM continued to strengthen the analytical framework for macroprudential supervision and the development of macroprudential models and analyses, as well as to examine interactions with monetary policy and refine the framework for assessing contagion risk from Moroccan financial institutions operating abroad (ACAPS 2016).

III. Strategic planning of BAM

To increase its governance structure and to properly inform its prospects, since 2004 Bank-Al-Maghrib has implemented forward-looking strategic planning to facilitate the conduct of monetary policy in a three-year action plan characterized by well-defined strategic objectives accompanied by the resources needed to implement them.

In addition, a BAM strategic planning will require a mechanism for engagement and a process for achieving its strategic directions. Nevertheless, BAM will need to continue to work towards an analytical and operational framework for monetary policy that is consistent with its action plan.

In this vein, Mishkin (2011) suggests that without a commitment mechanism, monetary policy makers may find themselves unable to systematically follow an optimal plan over time. However, this optimal plan may be incompatible with the said time and will therefore soon be abandoned. As a result, BAM is obliged to carry out its three-year strategic plans and, ultimately, to maintain greater credibility with the public.

Table no 1 : BAM’s three-year strategic plans

Strategic plan	Strategic orientations of BAM
2004-2006	Framework reform and capacity building (IS and analytical framework)
2007-2009	Consolidation of improvements
2010-2012	To change monetary policy so that it contributes to a successful process of integration of Morocco into the world economy.
2013-2015	To be a key player that inspires trust through its expertise and commitment.
2016-2018	To be an high performance central bank, a force for change at the service of the country's emergence.
2019-2023	To be an high-performance, innovative central bank and a force for change at the service of the country.

Source: Authors (based on data from BAM)

In addition, the IMF announces that monetary policy will require careful planning to avoid sudden market shocks¹. To do so in Morocco, it was necessary to adopt a three-year plan that could coordinate monetary policy with any macro- and micro-prudential policy.

IV. Monetary rule and the possibility of adopting an inflation targeting strategy in Morocco

The monetary targeting strategy was widely adopted by most central banks in the 1970s and 1980s. It has flourished in industrialized countries that are largely passionate about the monetarist approach to monetary policy.

In this sense, the monetary anchoring strategy consists in acting on the money supply so that its evolution is compatible with the level of GDP and the price level and can preserve the fundamental macroeconomic variables. Moreover, the relevance of this strategy depends on the existence of a stable relationship between the targeted aggregates and the ultimate objective of price stability. Thus, according to Mishkin (2000), Marianna and Ján (2007), a monetary targeting strategy has three main aspects: 1) The central bank must rely on information reported by changes in monetary aggregates, 2) The central bank announces a targeted level of monetary aggregates, and 3) an accountability mechanism to avoid large gaps between the objective and its achievement.

Like several countries, Morocco has chosen to follow a monetarist strategy by setting an intermediate target corresponding to a monetary rule. From 1980, BAM began targeting the M2 aggregate until 1996 (Figure no 2). BAM then abandoned the M2 aggregate by targeting the M3 aggregate, which was considered more stable for three successive years (1996-1998).

The M3 aggregate was the subject of twilight for several monetary policy makers in Morocco, on the one hand because of its instability and failure to achieve its objective, and on the other hand, non-financial agents had the ability to arbitrate between liquid investments and monetary assets. During the period 1999-2005, the monetary authorities officially announced the anchoring of the narrow aggregate M1. For BAM, the M1 aggregate was considered more stable than the other targets, until 2006 the M3 aggregate reappeared again, due to the instability of M1 caused by the foreign exchange flows mentioned by tourism receipts and privatisation operations (Table no 2).

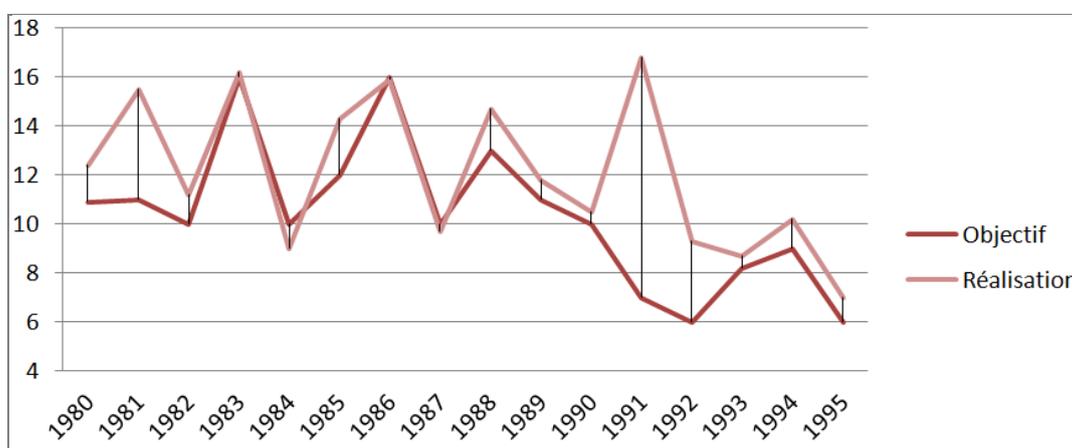


Figure no 2: evolution of the M2 target aggregate in terms of its realization (%)

Source : BAM data and Authors' calculations

¹ IMF, A Strategy for Renormalizing Fiscal and Monetary Policies in Advanced Economies1 Prepared by Carlo Cottarelli and Jose Viñals September, Fiscal Affairs and Monetary and Capital Markets Departments, 22, 2009

Table no 2 : Evolution of the targeted aggregates M3 and M1

Target aggregate	Year	objective (1)	realization (2)	Gap (2) - (1)	Inflation rate
M3	1996	7,00%	6,60%	-0,40%	3,00%
	1997	7,00%	8,10%	1,10%	1,00%
	1998	8,00%	6,00%	-2,00%	2,70%
M1	1999	[7,00% ; 8,00%]	12,00%	4,50%	0,70%
	2000	[6,00% ; 7,00%]	8,20%	2,20%	1,90%
	2001	[9,00% ; 10,00%]	15,90%	6,90%	0,60%
	2002	[6,50% ; 7,50%]	9,00%	2,50%	2,80%
	2003	[7,50% ; 8,50%]	9,60%	2,10%	1,20%
	2004	[6,50% ; 7,50%]	9,70%	3,20%	1,50%
M3	2005	[6,50% ; 7,50%]	14,80%	8,30%	1,00%
M3	2006	[7,50% ; 8,50%]	17,00%	9,50%	3,30%

Source : BAM data Authors' calculations

According to the Table 2 and Figure 2, it is noted that the control of the money supply in Morocco for 26 years was not effectively exercised. During the four monetary targeting periods: 1980-1995 (M2); 1996-1998 (M3); 1999-2005 (M1); 2006 (M3), the monetary target was never met and was often underestimated, so BAM failed by developing a better correspondence between the normative growth rate and the effective growth rate of the money supply. In this sense, Lajnaf (2014) notes that a central bank, which decides to commit to a rate of money supply growth that depends on the desired inflation rate and the expected growth rate of activity, must explain the deviations from the target.

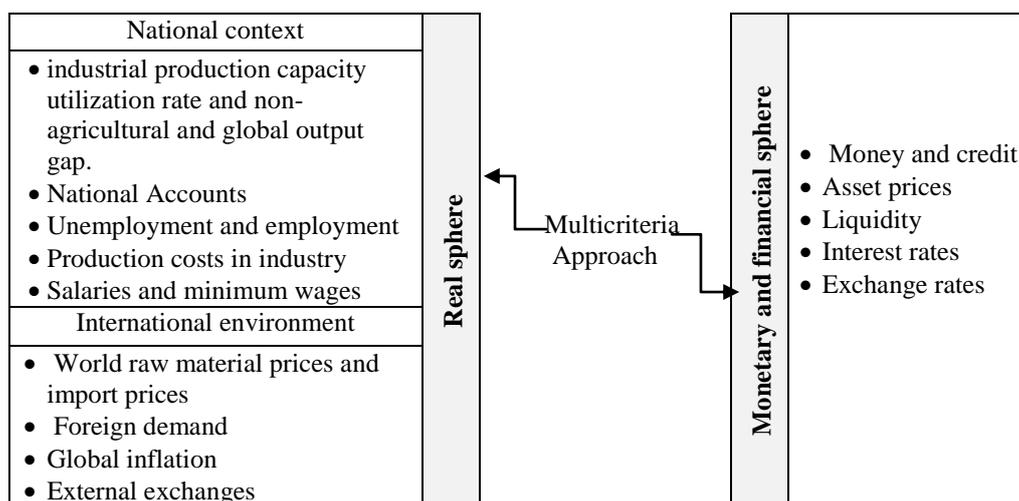


Figure no 3: BAM strategy based on a multi-criteria approach
 Source: BAM annual report (2008)

The monetary targeting strategy has proven to be unnecessary and ineffective (Mishkin and Posen 1997; Rich 1997; Jaillet 1998; Svensson 1999; Mishkin 2000, 2006, 2007a; Borio and White 2004). In this sense, Borio and White (2004) note that the reasons why the United States, Canada and the United Kingdom quickly abandoned monetary targeting include the early emergence of financial innovation and payment technologies, and the resulting instability in the relationship between monetary aggregates and target variables, such as inflation or nominal income. In fact, in the words of Gerald Bouey, former Governor of the Bank of Canada: « *We have not abandoned monetary aggregates, they have abandoned us* ».

In this respect, like several central banks, BAM questioned the monetary targeting strategy as early as 2006. And until 2018, Moroccan monetary policy has as its final objective price stability, it no longer sets an intermediate objective but adopts a strategy based on a multi-criteria approach as a diagnostic framework for inflationary risk based on a set of real and financial indicators that make it possible to estimate future inflation and to have an idea of other macroeconomic indicators in order to guide its decisions (Akaaboune 2017).

Since 2007, BAM has been getting rid of monetary targeting and has been thinking about the inflation targeting strategy. In the same year, and at a high-level regional seminar on inflation targeting, the Governor of BAM announced that *"There is convergence of views between the Ministry of Finance and BAM on the necessary developments to move towards an inflation targeting regime in the medium term"*, indicating preparations to meet the challenge of the inflation targeting strategy in Morocco.

Freedman and Laxton (2009) argue that an effective inflation targeting regime will have beneficial welfare effects by reducing uncertainty, anchoring expectations, and reducing the impact and severity of expansion and recession cycles. Indeed, monetary policy in inflation-targeting countries has gained more credibility (Neumann and von Hagen 2002, Fekir 2016).

Table no 3: Main characteristics of monetary targeting and inflation targeting

Monetary strategy	Policy Objective	Intermediate Target	Operational Target	Main Instruments
Monetary Targeting	Inflation (implicit)	Broad monetary aggregate	Reserve money	OMOs Standing facilities Reserve requirement)
Inflation Targeting	Inflation (explicite)	Inflation forecast	Interest rates	OMOs Standing facilities Reserve requirement

Source : Laurens et al. (2015), IMF Working Paper, p7

Among a range of inflation-targeting definitions² in the literature, we will take a consensus definition from Mishkin (2000), based on five main elements: 1) A public announcement of a quantitative target for the medium term; 2) An institutional commitment to consider price stability as the primary objective of monetary policy, to which the other objectives are subordinated. 3) An information strategy in which several variables are used (not only the exchange rate, monetary aggregates) to decide on the implementation of the policy instrument; 4) Transparent communication with the public about the different objectives, plans and actions of monetary authorities; 5) Increased accountability of the Central Bank for achieving its objectives. In this sense, the definition that BAM has adopted as part of this strategy is similar to that of Mishkin (2000).

Thus, at the end of 2015, and in a statement to the House of Representatives, the Governor of BAM suggested that an inflation targeting regime should be based on four principles: 1) The central bank is responsible for ensuring price stability and, to this end, has a large degree of autonomy; 2) A quantitative inflation target is set; 3) The central bank reports on the achievement of the target in accordance with the strategy's transparency obligations and its implementation; 4) It carries out a forward-looking assessment of inflation, based on a range of information³.

Before adopting the inflation targeting strategy, BAM must ensure that several economic, institutional and technical conditions are met, without which it would be difficult to approve the strategy. Indeed, the literature (Bernanke et Mishkin, 1997; Svensson, 1997; Masson et al., 1997; Calvo, 2001, Schaechter et al., 2000; Carare et al. , 2002; Pétursson, 2004) refers to six essential conditions for successful inflation targeting: 1) Central bank independence (financial, political and instrumental); 2) Bank accountability; 3) Transparency and communication of monetary policy; 4) technology for central bank to collect information and make reliable forecasts; 5) financial stability; 6) exchange rate flexibility. In contrast, many countries have successfully adopted inflation targeting without meeting all these conditions from the outset (Thorarinn, 2005). At the same time, the Governor of BAM referred to four approaches based on 4 prerequisites for a successful transition to an inflation-targeting policy: (1) *macroeconomic stability*; (2) *institutional progress*; (3) *strengthening the soundness of the financial system and market development*; and (4) *strengthening the central bank's technical capacity*⁴.

² Leiderman and Svensson (1995), Masson, et al. (1997), Cottarelli and Giannini (1997), Mishkin and Schmidt- Bernanke et al. (1999) Hebbel (2001), Truman (2003), King (2005).

³ Governor of BAM , Jouahri Abdellatif (2015), "Monetary Policy, Context, Conduct and Challenges", House of Representatives: Committee on Finance and Economic Development, BAM report, 14 October 2015, p43.

⁴ Speech by the Governor of BAM, High-Level Regional Seminar on Inflation Targeting, International Monetary Fund and Bank Al-Maghrib Rabat, Morocco, 4 April 2007, p2.

Table no 4: Institutional, economic and technical prerequisites for inflation targeting.

	Conditions	Contents
Institutional conditions	Independence of instruments Contents	the central bank must be autonomous in the choice of monetary policy instruments; the central bank must have at least one main instrument for: <ul style="list-style-type: none"> - inform markets about its desired position on the conduct of monetary policy - influence inflation expectations
	Responsibility for announcing the inflation target	the adoption of an inflation target can be announced by the central bank or announced by the central bank or jointly by the central bank and the government.
	Communication	the central bank must communicate clearly and frequently with the Government, the market and the public. This condition is often similar to the objective of transparency.
	Floating exchange rate.	the adoption of inflation targeting cannot be designed without a flexible exchange rate regime that allows domestic monetary policy to determine monetary conditions.
	Coordination with other economic policies	monetary policy must not be subject to budgetary constraints (lack of seigniorage). A sound fiscal situation enhances the credibility of inflation targeting.
	Public Support	the strategy adopted should be designed by the Public as the most appropriate.
Economic and technical conditions	Choice of an appropriate price index	The inflation target should be defined in terms of an index that is widely known to the public.
	Choice of horizon amplitude Target	the mean of the target band should be close to price stability. (It serves as a guide for the public)
	Adequate knowledge of monetary policy transmission mechanisms	Decision-makers must be well trained in the immediate effects of their implemented instruments on key macroeconomic aggregates.
	Availability of inflation forecasting models.	In the context of direct inflation targeting, expectations play a fundamental role.

Source : Aguir Abdelkader (2011),

BAM has already almost met most of the institutional and technical conditions (Table 4) , the last prerequisite is exchange rate liberalisation, in this phase BAM has chosen to cross it gradually until the Dirham becomes more flexible. This progressive flexibility of the exchange rate regime in the context of the adoption of an inflation-targeting regime can strengthen BAM's room for manoeuvre and further strengthen its credibility (Bennouna et al., 2016, p26).

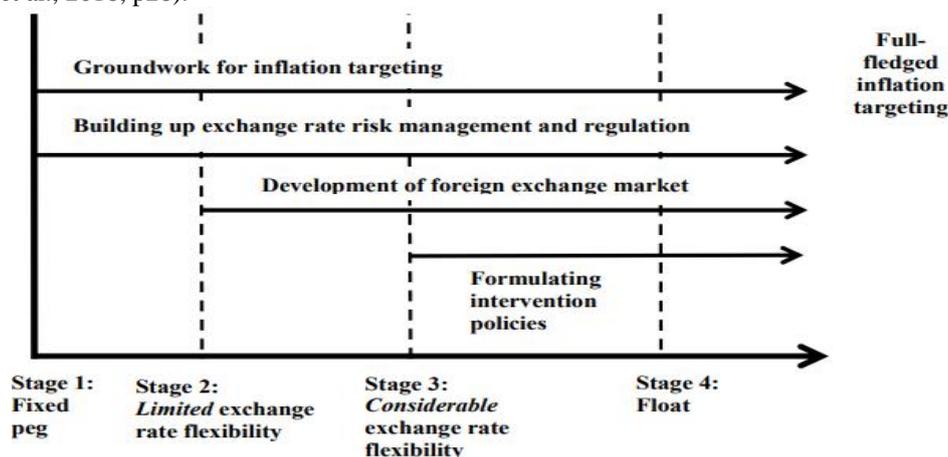


Figure no 4: inflation targeting and a gradual transition to a flexible exchange rate regime.

Source : Duttagupta et al. (2004),

Figure 4 shows the steps to be taken to gradually prepare for the transition from a flexible exchange rate regime to an inflation-targeting regime. Since 2018, Morocco has already reached the second stage marked by a wider fluctuation band of the Dirham ($\pm 2.5\%$, against $\pm 0.3\%$). Since the acceleration towards flexibility, the Dirham has always kept its stability towards the basket currencies⁵. As a result, BAM is pleased with the success of its transition and the implementation of its 2016-2018 strategic plan⁶.

⁵ From 2015, Morocco will develop an intermediate exchange rate regime with a fixed parity with basket weights of 60% EUR and 40% USD

⁶ Among the strategic orientations of this plan are the following: work towards an analytical and operational framework for monetary policy consistent with a more flexible exchange rate regime and inflation targeting.

However, the profound changes that Morocco has undergone in recent years (new constitution of 2011, international financial crisis 2007-2009...) have called into question the status (2006) of its central bank by launching another bill with the new status of BAM (2017)⁷. In addition, this decision is intended to further strengthen BAM's independence and to clarify BAM's responsibilities in terms of exchange rate policy and economic and financial stability. All this will consolidate a better transition to the inflation targeting strategy in Morocco.

Today, Svensson (2019) lists four monetary policy strategies: flexible price-level targeting, flexible average-inflation targeting, flexible temporary price-level targeting, and nominal-GDP targeting.. The last strategy cannot be applied to the formulation of Moroccan monetary policy as long as the BAM does not set a two-dimensional objective as if the FED case. The main conclusion is that, overall, average flexible inflation targeting has some advantages over other strategies.

V. Transparency strategy and communication of the Monetary Policy of BAM

Another strategy that all central banks must adopt today is transparency and communication of monetary policy. Indeed, the latter's actions should not be carried out on a day-to-day or ad hoc basis, but should have the status of indicators and indices. In addition, several articles (Mishkin, 2004; Dincer, Eichengreen, 2014; Serhiy et al. 2016) identified four main characteristics of this transparency, citing: (1) *accessibility (openness) of information, i. e. provision of information in open access or at first request*; (2) *completeness of information coverage, i. e. provision of sufficient information to explain a central bank's past and future actions*; (3) *speed, i. e. information should be provided as soon as possible (including future forecasts)*; (4) *information integrity: information policy tools and channels should be coherent and coordinated with each other*.

Table no 5: BAM publications

Communication from BAM	BAM publications
Publications Institutional	Annual Report
	Report on Payment Systems and Means
	Annual Report on Banking Supervision
	Financial Stability Report
Analysis documents and reference:	Monetary Policy Report
	Review of the economic situation
	Methodological and reference documents
Documents information and of statistics	Monetary statistics
	Monthly business survey in industry
	Real estate price and asset indices
	Quarterly bulletin
Strategic publications	BAM publishes its monetary policy action plans (three-year plans).
Press publications	BAM organizes training sessions for the press to improve understanding of monetary policy decisions.
Website	BAM publishes on its website the methodologies followed and the data used.

Source : Authors

In their empirical results, Dincer and Eichengreen (2007) imply that greater transparency reduces volatility and inflation persistence. In addition, these BAM publications can be very useful in ensuring that financial market forecasters understand the central bank's strategy, thereby reducing uncertainty and facilitating the transmission of monetary policy to the Moroccan economy.

In recent years, BAM has made a huge effort to associate transparency with its monetary policy decisions. It remains true that BAM has been committed since its independence status (2006) to communicate all actions carried out within a national and international framework. Article 56 of the Act supports this strategy, stating that "decisions of the Board relating to monetary policy shall be made public in accordance with the procedures it defines". In addition, BAM communicates its monetary policy through several institutional publications and analytical and reference documents (Table no 5).

VI. Conclusion

Today, as in the past, the central banks' strategy remains the core of an effective and credible monetary policy. As already mentioned in our article, BAM is working to improve the development and choice of its strategy. In order to remedy the shortcomings noted by this modest paper, the author approaches BAM and proposes that it take the greatest care to explain democratically the mandate entrusted to it, its strategic approach (choice of strategy, strategic planning), which are at the root of the monetary policy decisions it takes, and the achievement of its objectives in terms of price stability with a view to improving its operational credibility.

⁷ Bill n°40-17 (23 June 2017) on the new status of BAM

However, with the renewal of BAM's new statutes (Bill 40-17), Morocco must further strengthen the independence of its issuing bank from the political power, and try to avoid as much as possible financial and instrumental dependence, as well as hidden financing from the state.

In this perspective, with the new situation of the exchange rate regime in Morocco, inflation targeting is proving to be the best option for price stability. Thus, the success of this strategy requires better coordination and synergy between monetary policy and other economic policies (fiscal and exchange rate), and still requires interaction with an effective financial stability policy.

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