Reply to referees comments

1. We would like to thank the anonymous referees for their valuable remarks and comments. The issues raised will help us to improve the paper and deepen the analysis of the question of the Moroccan exchange rate regime flexibilization.

2. We confirm that the simulated model is very similar to the model used in Ben Ali's paper (2006). This later model is similar to the one proposed by Agénor (1994). We clearly assert that our model is inspired from Agénor's, Ben Ali's and Zhang's (2001) papers. Our contribution is a preliminary exploration of the possible choices of Morocco's authorities concerning the exchange rate regime. Thus, we preferred to use an existing model to shed light on this topic. The main contribution of our paper is the application of the available framework to explore the Moroccan case knowing that it has similar common patterns with the Tunisian experience. Before and after the exercise, we are completely aware of the deficiencies of the model.

3. Equation 4 describes the mechanism by which domestic firms fix the price of non-tradable goods P_N. These firms respond to two elements: 1. the deviation of the real exchange rate $E_r = E_n \frac{P_T}{P_N}$ from the real equilibrium exchange rate E_r^* and 2. domestic money supply M. Thus, things look like this:

$$P_N = \left[\frac{E_n \frac{P_T}{P_N}}{E_r^*} \right]^\rho * M^\nu$$

Log-transforming and differencing the price of non-tradable goods and taking into account of the fact that the price of tradable goods is exogenously determined (i.e. $p_T = \ln P_T - \ln P_{T-1} = 0$) will lead to equation 4. It is important to note that in equation 4 we must speak about the expected exchange rate E_n^a (under a flexible exchange rate) if we want to be precise. The above formula provides the price of non-tradable goods applied by domestic firms to preserve their margins taking into account the expected exchange rate. We recognize that our exposition is not as precise as it must be.

4. For us equation 5 resumes the objective-function of monetary authorities which includes the preservation of the external competitiveness of the economy and the maintenance of inflation at its targeted level. This objective function is defined as a loss function; <u>consequently we add the sign minus</u>[1] and we minimize this function. <u>We are not interested to the fact that this formulation is a Taylor rule or not</u>. Equation 6 provides a welfare measure of domestic firms. The link between equations 4 and 6 is obvious. Domestic firms are interested to the fact that the only price that <u>they anticipate P_N^a be as close as possible to its value observed</u>. For this, they minimize the deviation of P_N to its value determined by equation 4. This leads directly to equation 6 which is the loss function of domestic firms.

5. We confirm the dependence of the results on the calibration. This is due to the sensitivity of the results on/to some parameters, especially the two elasticities ρ and v. **S**mall variations in these parameters impact significantly the results.

6. Currently we are developing a more complex set up in order to take into account the structural characteristics of the Moroccan economy. We will enrich the model by introducing <u>more agents</u> (households, firms operating in the tradable sector and those operating in the non-tradable sector, fiscal authorities, etc.) and by taking into account more directly the extent of financial liberalization (financial openness). This is likely to add realism to the model and to provide more insightful results concerning the issues related to the flexibilization of exchange rate regime.

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[1] In faut préciser qu'on a ajouté le signe négatif à la première composante de la fonction seulement et pas à la fonction toute entière.