MINUTES OF THE MONETARY POLICY COMMITTEE MEETING

JUNE 29 - 30, 2006

The thirteenth meeting of the Monetary Policy Committee of the Central Bank of The Gambia was held in the Conference Room of the Bank on June 29, 2006.

Present were:

Famara L. Jatta	-	Governor, (Chairman)
Momodou B. Saho	-	First Deputy Governor, Member
Basiru Njai	-	Second Deputy Governor, Member
Mod Secka	-	Deputy Permanent Secretary, DOSFEA, Member
Momodou Ceesay	-	Principal Economist, DOSFEA, Member
Bakary Kolley	-	Senior Economist, ERD (Secretary)

In Attendance Were:

M.A. Ceesay	-	Adviser to Governor
Oumie Samba-Savage	-	Director, FISD
H. M. V Carr	-	Director, AD
Omar Jatta	-	Deputy Director, FD
Essa Drammeh	-	Deputy Director, FSD
Haddy Joof	-	Deputy Director, AD
Ousainou Corr	-	Deputy Director, FISD
Pa Alieu Sillah	-	Commissioner of Insurance
Fatou Deen-Touray	-	Deputy Director, MFD
EAC Ndong	-	Principal Officer, FD
Paul Mendy	-	Principal Bank Examiner, FSD
Abdoulie Jallow	-	Principal Bank Examiner, FSD
Ebrima Wadda	-	Senior Economist, ERD
Ismaila Jarju	-	Senior Economist, ERD

Bakary Jammeh	-	Senior Econometrician, ERD
Maimuna John-Sowe	-	Senior Economist, ERD
Karamo Jawara	-	Senior Banking Officer, BSD
Anita Riley	-	Senior Banking Officer, BSD
Amadou Koora	-	Senior Bank Examiner, FSD
Buba Touray	-	Statistician, ERD
Nyakassi Sanyang	-	Statistician, ERD
Sheriff Touray	-	Economist, ERD

Before turning to its immediate policy decision and against the background of the forward looking business sentiment survey, and the latest output and inflation projections, the Committee discussed balance of payments (BOP), money market, monetary, banking sector and international developments.

(1.0) Developments in the International Economy

Provisional estimates suggest that world GDP rose by 5.2 percent in the year to the first quarter, up from 4.9 percent in the fourth quarter of 2005. Although there are signs of a softening of overall economic activity, America and Japan will enjoy solid growth in 2006, falling slightly in 2007. The economies of a number of countries, including Portugal, New Zealand, the Netherlands, Britain and Australia are forecast to grow strongly in 2007.

Economic indicators in Europe have been upbeat. The European Commission revised its estimate for economic growth in the euro zone to 2.1 percent in 2006, up from the 1.9 percent initially projected. However, rising oil and gas prices caused a bigger-than-expected trade deficit of US$2.5 billion in the second quarter after 0.6 billion euro surplus in the first quarter of 2006. The ECB in early June voted to raise euro zone interest rates by one quarter of a percent point to 2.7 percent, as widely expected. This was in response to rising inflation which rose to 2.5 percent in May 2006 above the 2.0 percent target on the back of higher energy prices and the economic recovery.

The US economy grew at an annual rate of 5.3 percent in the first quarter of 2006, faster than the initial estimate of 4.8 percent. However, according to the minutes of the Federal Open Market Committee, released in early June 2006, growth is likely to moderate and hence the Fed's dilemma that; given the threat of inflation and slowing growth, it was uncertain about how much, if any, further tightening would be needed.

The US current account deficit decreased to $208.7 billion in the first quarter of 2006, helped by steadier oil prices. This compares favourably with the $223.1 billion recorded in the preceding quarter and equalled 6.4 percent of GDP. The deficit is expected to rise next quarter as oil prices continue to increase. Analysts expect the large current account deficit to continue exerting pressure on the U.S. dollar.

Japan's economic recovery continues. In the first quarter of 2006, Japan's economy grew by 3.1 percent, the fifth consecutive quarter of economic expansion. Its equity markets, however, took a tumble in the second week of June 2006 amid concerns over inflation and higher interest rates. The Nikkei dropped 4.1 percent on June 8, 2006 alone amid concerns that rising US interest rates would stem growth and hit Japan's export market.

Japan's core consumer prices, which exclude fresh food, rose by 0.5 percent in the year to April 2006, the sixth straight month of rising inflation. Industrial production grew by 3.8 percent over the same period.

Although the Bank of Japan has ended five years of zero interest rates policy, it has been urged by the government to hold the policy rate low for now in order not to disrupt the country's steady economic recovery.

Chinese investment surged in the first five months of 2006, suggesting the government is failing to cool the economy. The economy expanded at an annual rate of 10.3 percent in the first quarter of 2006. According to analysts, the main risk to the economy is the investment boom busting. And what the government needs to do is to ensure a soft landing by incrementally deflating the investment bubble now.

China's trade surplus widened to a record $13 billion in May 2006 further swelling the already high foreign reserves.

Consumer prices in the UK rose, driven mainly by higher gas and electricity prices. Inflation rose to 2.2 percent in May 2006, from 2.0 percent in April 2006, above the government's 2.0 percent target. However, the Bank of England appeared not be worried about the slight increase in inflation and it voted to keep rates at 4.5 percent for the tenth month in row at its last meeting. However, it is anticipated that the Bank would increase interest rates if inflationary pressures continue to accelerate.

According to the latest issue of FAO's Food Outlook report, commodity markets have become more volatile with a steady upward trend in prices. Political uncertainties and surging energy prices apart, agricultural production over the past year was also affected by natural disasters, ranging from devastating hurricanes to fast spreading animal disease.

The FAO predicts volality in the months ahead for several agricultural commodities and in most instances, the fundamentals point to further gains in prices. The food import bill for most poor countries in Sub-Saharan Africa continues to exert pressure on exchange rates. FAO is forecasting an increase of over 2.0 percent in the world food import bill in 2006 compared to 2005. The increase is expected to be strongest for cereals and sugar and smallest for meat. Given their higher share as importers of food and feed, the import bill is expected to be highest in developing countries and is forecast to grow by 3.5 percent in 2007.

(2.0) Balance Of Payments (BOP) Developments

Preliminary BOP projections suggest an overall balance of payments surplus of D240.0 million ($8.0 million) in 2006, from D320.9 million ($11.2 million) in 2005, reflecting projected decline in the capital account surplus and a widening of the current account deficit. The gross external reserves is projected to total US $99.2 million, up from $93.7 million in 2005 and adequate to cover 4.5 months of imports.

The merchandise trade balance is projected at a deficit of D3.0 billion compared to D2.9 billion in the preceding year largely reflecting higher oil-related imports and shortfall in export receipts. Exports are projected at D4.0 billion compared to D3.6 billion in 2005. Groundnut exports should total D435.0 million ($14.5 million) against D325.6 million ($11.3 million) in 2005.

Imports are also expected to increase to D7.0 billion, or 10.1 per cent from 2005. The value of oil imports is estimated at D1.4 billion ($46.6 million) compared to $40.3 million and $29.5 million in 2005 and 2004 respectively, reflecting the sharp rise in oil prices.

Travel income is projected to increase to D2.6 billion ($85.6 million), or 19.3 percent over 2005 on account of the projected 12.0 per cent increase in tourist arrivals. Reflecting the increase in the external debt stock, net interest payments is expected to rise to D1.5 billion ($51.5 million) compared to D1.3 billion ($45.5 million) in 2005.

Remittances are projected at D1.0 billion ($34.1 million) in 2006 compared to D856.3 million ($29.8 million) in 2005. Private unrequited transfers should amount to D129.0 million relative to D117.3 million in the preceding year.

The current account deficit, excluding official transfers is projected to widen to D2.6 billion in 2006. Including official transfers, the current account deficit is projected at D1.7 billion, same as in 2005.

The capital account is estimated at a reduced surplus of D2.0 billion in 2006, or 2.9 percent from the preceding year. Net official loans is projected at D510.0 million relative to D489.2 million in 2005, reflecting higher inflows from project-related loans estimated at D1.2 billion, over and above the D911.4 million in 2005. Amortization is projected to increase significantly to D657.0 million, from D422.2 million and D431.0 million in 2005 and 2004 respectively. Foreign direct investment (net) is projected to increase slightly by 1.0 per cent to D1.3 billion in 2006.

(3.0) Foreign Exchange Developments

The Dalasi remains firm, appreciating against all the major currencies in the inter-bank market reflecting healthier macroeconomic fundamentals, coupled with robust foreign inflows, particularly remittances and FDI. The dalasi strengthened against the GBP, USD, SEK (100) CFA (5000) and Euro by 1.3 percent, 1.5 percent, 8.6 percent 4.2 percent and 3.1 percent respectively, from a year ago.

Volume of transactions, that is, purchases and sales of foreign currencies in the inter-bank foreign exchange market totalled D27.9 billion in the year to end-May 2006, significantly higher than a year earlier. Central Bank transactions (combined purchases and sales) totalled D790.2 million, or an increase of 4.8 percent from a year ago.

In the international foreign exchange market, the Pound Sterling depreciated against the Dollar, reflecting speculation that the UK's interest rate differential with respect to the US dollar will turn negative over the coming months.

The Euro appreciated by 1.5 percent against the US Dollar owing to improved macroeconomic fundamentals in the euro area and the expectations that the European Central Bank is to tighten monetary policy more aggressively in 2006.

Looking ahead, the dalasi is forecasted to remain stable in the remainder of 2006. Inflationary pressures have been substantially reduced, private capital flows are projected to be much higher than initially estimated and receipts from re-exports and ground-nut exports should lead to an increase in the already high external assets of the banking sector. However, there are risks to the forecast particularly relating to high oil prices and expansionary fiscal policy.

(4.0) Fiscal Developments

The fiscal position of the government improved in the first four months of 2006 relative to the same period in 2005. Domestic revenue increased significantly while expenditure and net lending fell sharply.

Domestic revenue increased to D1.0 billion, or 21.6 percent relative to the corresponding period in 2005. Tax revenue (constituting 89.8 percent of total domestic revenue) totalled D920.4 million, an increase of 25.2 percent attributed to better tax administration and the introduction of new tax measures.

Direct tax revenue totalled D265.9 million, an increase of 16.8 percent. Indirect tax revenue amounting to D654.5 million also rose, albeit by a stronger 28.9 percent. Taxes on international trade at D491.8 million and accounting for 75.1 percent of indirect taxes rose markedly by 30.2 percent thanks to increase revenue from duty and sales tax.

Total expenditure and net lending declined to D1.1billion, or 22.1 percent. Current expenditure totalled D841.6 million compared to D885.1million in the first four months to April 2005 reflecting in part the decline in interest payments to D303.8 million from D405.5 million.

Domestic interest payments fell significantly from D304.6 million in the four months of 2005 to D260.5 million in the corresponding period 2006, reflecting the decline in the Treasury bills discount rate.

The overall budget deficit (without grants and HIPC Assistance) narrowed markedly from D627.5 million in the first four months of 2005 to D120.1 million during the period under review. The fiscal deficit (including grants) also fell from D498.2 million to D107.2 million during the review period.

The Committee, however, noted that government expenditure was higher than revenue and that the overall budget deficit is likely to widen given the lag in recording expenditures.

(5.0) Money Market Developments

The total outstanding stock of the interest bearing debt as at end-May 2006 rose to D5.2 billion, or 4.0 per cent from end-March 2006, but declined by 2.0 percent from December 2005.

The banking sector held the bulk of the interest bearing debt (59.0 per cent) followed by the non-bank, including parastatals (41.0 per cent). Commercial banks and the Central Bank of The Gambia held 39.0 per cent and 20.0 per cent of the stock respectively.

At end-May 2006, 1-year bills accounted for 70.0 per cent of total Treasury bills, 182 – day bills (22.0 per cent) and 91 – day bills (8.0 per cent) reflecting investors expectations of future interest rates cuts on the back of subdued inflationary pressures.

There was a positive net issuance of Treasury bills for most of the past year averaging D27.0 million monthly. Consequently, the stock of Treasury bills rose, albeit at a decreasing rate.

(6.0) Monetary Developments

Money supply grew by 15.5 per cent in the year to end-April 2006 compared to 24.3 percent a year earlier. Both components of money supply increased but quasi money grew at a faster pace (19.6 percent) than narrow money (12.6 percent). However, money supply increased by 12.0 percent when compared to end-December 2005.

Regarding the factors affecting money supply, the net foreign assets (NFA) of the banking system declined to D3.4 billion, or 5.8 per cent. This was due entirely to the decline in the NFA of the deposit money banks by 26.4 percent to D1.3 billion. Deposit money banks' foreign assets decreased to D1.4 billion, or 23.4 percent while foreign liabilities increased to D137.9 million, or 22.3 percent.

The net domestic assets (NDA) of the banking system rose to D3.4 billion, or 49.6 percent on account of 36.2 percent increase in domestic credit. Credit to private sector and public entities rose by 29.2 percent and 20.7 percent to D1.9 billion and D272.5 million respectively. The banking system's net claims on government grew markedly by 55.7 percent to D1.6 billion.

Reserve money, the Bank's operating target, increased by 14.0 percent, lower than the growth rate of 15.2 percent a year ago. Reserve money grew by 10.6 percent from end-December 2005.

(7.0) Financial Stability Report

In the second quarter of 2006, the banking industry was characterised by an increase in capital and assets as well as improved asset quality. The average capital adequacy ratio increased to 64.0 per cent in June 2006 from 62.4 per cent in March 2006. Similarly, the banking sector's aggregate assets grew to D8.83 billion, or 3.2 per cent from end-March 2006. Return on assets was 4.0

per cent in May 2006. The industry's overhead ratio, which measures how much of the bank's income realised is spent on overhead expenses, declined from 43.0 per cent at end-December 2005 to 31 per cent as at end-May 2006.

Deposit money bank loans and advances declined to D1.89 billion, lower than the D2.16 billion in March 2006, owing to decreased lending to all sectors of the economy except agriculture. The bulk of agricultural lending went into ground-nut marketing.

The Non-performing loans to primary capital ratio declined by a percentage point, to 29.0 per cent from end-December 2005.

(8.0) Real Sector Developments

Real GDP is forecast to grow by 4.5 percent in 2006, premised on increased value-added of all the major sectors of the economy.

Data from the Gambia Ports Authority showed that export volumes in the first five months of 2006 totalled 47,308 metric tonnes, an increase of 20.2 percent over the corresponding period in 2005. However, foreign currency deposits on collection basis, an indicator of the level of re-exports at D3.69 billion, registered a fall of D404.2 million, or 9.9 per cent in the five months to end-May 2006.

(9.0) Private Sector Business Sentiment Survey

A higher percentage of respondents (42.0 percent) indicated that economic activity was higher in Q1, 2006 than those that indicated it was lower (4.0 per cent). However, the majority of respondents (54.0 per cent) reported same level of activity as in Q4, 2005. Respondents are optimistic about prospects in Q2, 2006.

The majority of firms (50.0 per cent) indicated that business activity was higher in Q1, 2006 compared to 18.0 per cent that reported lower activity. Both services and industry firms reported higher activity in Q1, 2006 relative to Q4, 2005 and are optimistic about prospects in Q2, 2006.

About 21.0 per cent of respondents reported higher employment in Q1, 2006 relative to 4.0 per cent that indicated lower employment. The majority of firms (75.0 per cent) reported same level of employment. The prospects for employment are unfavourable with 9.0 per cent of firms indicating that employment would be higher in Q2, 2006 compared to 18.0 per cent reporting lower employment.

The majority of respondents (21.0 per cent) reported that current prices are higher compared to only 12.0 per cent indicating lower prices. About 29.0 per cent of the respondents expect inflation to be higher in Q2, 2006 compared to 4.0 per cent that think it would be lower.

More respondents (33.0 per cent) indicated that exchange rates were lower in Q1, 2006. The Dalasi is expected to depreciate in Q2, 2006 with 17.0 per cent of the respondents indicating a higher exchange rate compared to 8.0 per cent that said it will be lower.

(10.0) Inflation

End-period inflation, measured by the consumer price index of low income population of Banjul and Kombo St. Mary area, declined from 3.4 percent in May 2005 to 1.5 percent at end-May 2006. Average inflation rate (12 month moving average) was 1.6 percent compared to 9.2 percent in the previous year.

Food consumer price inflation declined to 0.6 percent compared to 3.8 percent in May 2005. Non-food consumer price inflation rose to 3.6 percent relative to 2.6 percent at end-May 2005. This was as a result of the increase in the prices of ‘‘clothing, textiles and footwear’’, and ‘’miscellaneous items’’, to 2.9 percent and 4.9 percent compared to 1.0 percent and 2.0 percent in May 2005.

Core inflation, which excludes prices of energy and volatile food items, decelerated from 2.8 percent in May 2005 to 1.5 percent in May 2006.

Sustaining the deceleration in inflationary pressures would hinge on a myriad of factors, including prudent monetary and fiscal management, stable currency and subdued inflationary expectations.

The outlook for inflation is good, despite high and volatile oil prices. Headline and underlying inflation should remain subdued in the near term owing to the following:

(i) Despite strong global growth and high and volatile oil prices, global inflationary pressures remain modest. While headline inflation has picked up in response to higher oil prices, core inflation remains contained and inflationary expectations well grounded;

(ii) The Dalasi exchange rate is expected to be stable underpinned by inflows from remittances, transfers and foreign direct investment;

(iii) Growth in the monetary aggregates would be modest and in line with projections.

(11.0) The Taylor rule and what does it say about the Gambian Economy

The Committee discussed the Taylor rule and acknowledged that it provides useful guide as to how the Central Bank should set interest rates when economic conditions change to stabilize the economy in the short-run and achieve the long-run goal of price stability. Taylor argued that since it is the interest rate that affects spending, the Central Bank should think in terms of choice of interest rate rather than growth of nominal money to achieve the inflation target.

According to this rule, short-term interest rate should be determined based on three factors:

- The level of actual inflation compared to target inflation rate
- The output gap
- The level of short-term interest rate that is consistent with full employment

If inflation is equal to the target inflation rate and unemployment is also equal to the natural rate of unemployment, then the Central Bank should set the interest rate such that it will allow the economy to remain on the same path.

However, in case inflation is higher than the target inflation rate, then the Central Bank should raise interest rates above the desired level. Higher interest rates should lead to increase in unemployment and a subsequent reduction in the inflation rate.

If unemployment is higher than the natural rate of unemployment, the Central Bank should reduce the interest rate. A reduction in interest rates will increase output and increase employment. A modified version of the rule was applied to the Gambian economy using regression analyses.

Results show that all the variables were significant except the output gap. When inflation increases above the potential inflation rate by 1.0 percent, the real interest rate declines by 0.88 percent. In response to this, the Central Bank should increase the nominal interest rate by 1.88 percent.

The Committee discussed the recent depreciation of the dalasi against major foreign currencies. The view was that the depreciation was slight and therefore not worrying. Besides, the fundamentals of the economy are such that a sharp depreciation of the Dalasi is not expected in the near at least.

(11.0) Against this backdrop and in light of the latest inflation projection, the MPC decided to maintain the rediscount rate, the policy rate, at 15.0 per cent. The Committee would continue to monitor the situation and if the outlook changes, the MPC would review its stance.