# Minutes of the Monetary Policy Committee Meeting

## December 21, 2005

The ninth meeting of the Monetary Policy Committee (MPC) of the Central Bank of The Gambia was held in the Conference Room of the Bank on December 21, 2005.

**Present were:**

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| Famara .L. Jatta | - Governor | (Chairman) |
| Momodou .B. Saho | - General Manager | Member |
| Ousman Sowe | - Director, FSD | Member |
| Basiru Njai | - Director, ERD | Member |
| Amadou Colley | - Deputy Director, BSD | Member |
| Mustapha Yarbo | - Senior Economist, DoSFEA | Member |
| Buah Saidy | - Secretary | |

**In attendance were:**

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| Oumie Savage-Samba | Director | FISD |
| Omar Jaata | Deputy Director | FED |
| Bai M. Senghore | Deputy Director | MFD |
| Fatou Deen Touray | Deputy Director | MFD |
| Essa Drammeh | Deputy Director | FSD |
| Ousainou Corr | Deputy Director | FISD |
| Martin Brownbridge | Adviser | DoSFEA |
| E.A.C. Ndong | Principal Officer, | FD |
| Paul Mendy | Principal Bank Examiner | FSD |
| Abdoulie Jallow | Principal Bank Examiner | FSD |
| Bakary Kolley | Senior Economist | ERD |
| Ismaila Jarju | Senior Economist | ERD |
| Ebrima Wadda | Senior Economist | ERD |
| Bakary Jammeh | Senior Economist | ERD |
| Momodou Njie | Senior Bank Examiner | FSD |
| Karamo Jawara | Senior Banking Officer | BSD |
| Lamin Bojang | Officer | FD |

**Opening Remarks**

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, fiscal, money market, monetary, banking sector and international developments.

**(1.0) Developments in the International Economy**

Global growth is projected to exceed the initial estimate of 4.0 per cent in 2005 underpinned partly by robust expansion of the US economy but mainly stronger growth of the Asian economies, particularly the Chinese economy.

In the US, GDP growth eased moderately but is expected to remain the highest in the G-7 supported by solid productivity growth, high employment and disposable incomes and greater housing wealth which helped boost household demand. The US current account deficit is projected to rise to over 6.0 per cent of GDP in 2005, driven by higher oil prices and strong domestic demand.

Consumer prices in the US increased by only 0.5 per cent in August 2005, moving the year-on-year rate to 3.6 per cent. Core inflation remained subdued at around 1.7 per cent in the first half of 2005.

The UK economy grew at an annual rate of 1.5 per cent in the second quarter of 2005, its weakest since 1993. The UK Chancellor of the Exchequer indicated that the economy was unlikely to grow by the initial forecast of 3.0-3.5 per cent as a result of higher oil prices. The UK trade deficit reached US $10.0 billion in August 2005 due in part to significant increase in insurance claims in the aftermath of hurricanes Katrina and Rita.

Consumer prices in the UK rose to 2.3 per cent in July 2005 from 2.0 per cent in June 2005. Surging crude oil prices were the main drivers of inflation and the

Bank of England warned that prices may rise above the Government's 2.0 per cent inflation target in coming months.

In the Euro area, growth remains disappointingly low reflecting weak domestic demand and pervasive structural rigidities. With the expansion expected to gain momentum in the second half of 2005, Euro area GDP is projected at 1.2 per cent in 2005, rising to 1.8 per cent in 2006.

The Euro area's current account deficit is projected to rise to 3.0 per cent of GDP. Five countries - France, Germany, Greece, Italy and Portugal are expected to post budget deficits exceeding the 3.0 per cent Growth and Stability Pact limit.

Reflecting sluggish domestic demand, inflationary pressures in the Euro area eased somewhat. While headline inflation remains above 2.0 per cent, partly reflecting the impact of rising energy prices, core inflation slowed significantly.

Growth in GDP in Japan gained traction rising sharply in the first half of 2005. Recent data point to continued expansion in the remainder of 2005 underpinned by recovery in both consumption and business investment, strengthening labour market, high corporate profitability and abating deflationary pressures. GDP growth was 1.25 per cent in the year to the second quarter and overall growth is projected at 2.0 per cent in 2005 and 2006, with downside risks coming from external factors.

Core inflation in Japan declined by 0.2 per cent (year-on-year) in July 2005 and the GDP deflator fell by 0.9 per cent in the second quarter of 2005. The resurgence of deflation is a major concern causing the Bank of Japan to continue to maintain an accommodative monetary stance.

In emerging Asia, growth continued to be led by China and India. In China, GDP grew by 9.5 per cent in the second quarter underpinned by robust growth in industrial production. China's trade surplus totaled US $93.1 billion in August 2005 with foreign reserves excluding gold estimated at US $711.0 milion. Growth in India projected at 7.0 per cent in 2005, is supported by the continued boom in the services sector, including information technology (IT) and rising industrial production. In the rest of the region, GDP growth is expected to pick up, although much would depend on the rebound in IT and oil prices.

GDP growth in sub-Saharan Africa has been revised downwards to 4.8 per cent from 5.4 per cent in 2004 reflecting economic slowdown in Nigeria as oil production nears capacity. GDP growth in non-oil producing countries, though slowing, remains robust as the impact of high oil bills is partly offset by strong non-oil commodity prices.

In the discussions that followed, the Committee concurred that the global economy continues to grow at a robust pace. The US economy in particular continues to expand despite the havocs unleashed by Hurricane Katrina and Rita, thanks in the main to solid consumer spending. The Committee also judged that though core inflation remains subdued, the increase in headline inflation in August 2005, albeit slightly by 0.5 per cent may prompt the Federal Open Market Committee (FOMC) to increase the policy rate in the months ahead to stem inflationary pressures. Some Committee members noted that though they share the view of a possible rate hike, there is the likelihood of a halt of the monetary tightening cycle as the policy rate approaches neutral level.

With regards to the Chinese economy, the Committee observed that domestic and external demand continued to expand strongly unlike the recent past when growth was mainly driven by exports. The recent upward revision of the growth of the Chinese economy to about 16.0 per cent in 2004 mainly reflected strong consumer spending by the expanding middle class. There is, however, the risk that robust growth in GDP, coupled with high liquidity in the banking system may lead to an increase in the already high levels of credit and investment with the attendant inflationary pressures.

The Committee concurred that rapid growth in the Euro area is stymied by structural rigidities, including inflexible labour markets in the major Euro zone countries. There is also the possibility of a firming of monetary policy by the European Central Bank (ECB) to put a lid on inflationary pressures, but this could lead to the appreciation of the Euro thereby hurting exports, the main driver of growth.

The Committee commented that despite the downward revision of the growth rate of sub-Saharan Africa, economic output remains robust, but not strong enough to significantly reduce poverty. While structural reforms are steadily bearing fruit, more needs to be done if sub-Saharan Africa is to realize its potentialities and reduce poverty.

Regarding the impact of surging oil prices on inflation, the assertion was made that global inflation remains subdued. In particular, core inflation and inflationary expectations are well anchored, although high oil prices still pose a risk.

## (2.0) Balance of Payments (BOP) Developments

Latest balance of payments (BOP) estimates indicate that the overall balance will be higher than earlier projected reflecting in the main better-than-expected increase in private capital flows and workers' remittances. The overall balance is projected at a surplus of D320.9 million (US $11.2 million) in 2005 compared to the earlier estimate of D27.3 million (US $0.9 million). Gross official reserve is estimated at US $93.7 million, adequate to cover 4.5 months of imports.

The merchandise trade deficit is estimated at D2.78 billion compared to D2.37 billion in 2004. Exports are estimated to decline to D3.56 billion from D3.82 billion in 2004 reflecting lower exports of groundnuts by about 33.0 per cent. Other domestic exports, including fish and fish products and horticultural exports are projected to increase to D282.7 million, higher than the D269.0 million in 2004. Re-exports are estimated at D2.9 billion (97.4 per cent of total exports) compared to D3.0 billion (79.7 per cent) in 2004.

Imports are estimated to increase to D6.3 billion, or 7.4 per cent from 2004, reflecting in the main marked increase in the value of oil imports from D886.8 million (US $29.0 million) in 2004 to D1.2 billion (US $40.0 million) in 2005.

Services and private transfer balance is projected at a surplus of D675.4 million relative to D364.8 million in 2004. Travel income is estimated to increase to D2.2 billion, or 29.4 per cent over 2004 owing to 9.4 per cent increase in tourist arrivals. Reflecting the increase in the external debt stock, net interest payments is estimated at D1.3 billion, higher than the D1.2 billion in 2004. Remittances are projected at D856.9 million while private unrequited transfers should amount to D117.3 million, a slight decline of 0.2 per cent over the previous year.

The current account deficit, including official transfers is projected to narrow to D2.6 billion, an improvement of 1.8 per cent over 2004. Including official transfers, the current account deficit is projected to increase to D1.7 billion, or 21.9 per cent from 2004.

The capital account balance is projected at a surplus of D2.0 billion. Net official loans is estimated at D489.7 million, reflecting higher inflows from project-related loans estimated at D911.4 million, though lower than the D1.2 billion in 2004. Foreign direct investment (net) is projected to decline to D1.3 billion compared to D1.5 billion in 2004.

Some Committee members commented that given the decline in the international price of groundnuts and groundnut products and the inability of the major groundnut marketing company, GAMCO to export the produce, the value of groundnut exports would have to be revised downwards with the attendant worsening of the merchandise trade balance in particular and the overall balance in general. The other view point was that the downward revision of exports may not necessarily impact the overall balance because of the offsetting upward revision in FDI flows including proceeds of US $2.0 million from the sale of Senegambia Beach Hotel. Additionally, latest figures from The Gambia Tourism Authority revealed that the number of tourist arrivals is higher-than-expected which should raise travel income substantially.

The Committee agreed with the observation that the problem besetting the groundnut industry is mainly structural, including the use of poor seed varieties, poor soils, stop-go policies and ineffective marketing arrangements. And unless these problems are adequately and holistically addressed, the groundnut sector would continue to perform well short of potential.

The importance of remittances and obtaining improved statistics was emphasized by the Committee. The Committee noted that remittance flows, measured as the sum of workers remittances and compensation of employees, are large and growing and therefore greater effort should be put into collecting and compiling remittance statistics from source.

## (3.0) Foreign Exchange Developments

In November 2005, the Dalasi appreciated against the Pound Sterling, Dollar, Euro and CFA by 8.6 per cent, 6.2 per cent, 4.4 per cent and 7.1 per cent respectively from a year ago. The resilient currency reflects healthier economic fundamentals, including sizeable official reserves estimated at US $90.50 million in November 2005, benign inflationary pressures and improved business confidence.

Volume of transactions, that is, total purchases and sales of foreign currency in the inter-bank market total D21.8 billion in the 12 months to end-November 2005 compared to D18.2 billion a year earlier. Trading volumes would have been much higher but for the closure of the border by the Senegalese Authorities which temporarily halted the re-export trade.

Interest rate differentials notwithstanding, a sharp Euro rally against the Dollar is expected by end-December 2005. This had more to do with underlying structural negatives for the greenback than any impressive Euro zone fundamentals. The Pound Sterling is forecast to strengthen against the Dollar, also reflecting widening fiscal and current account deficits in the US.

Commenting on developments in the foreign exchange market, the Committee observed that given the strong economic fundamentals and implementation of prudent monetary policies, the risk of a steep depreciation of the Dalasi is negligible, although the strengthening Dalasi does cause problems for exports, including tourism.

On the reported shortage of foreign exchange in the market, in the months of September and October 2005, it was observed out this was temporal and that the market has since balanced out. Besides, if the shortage was that acute it would have caused a depreciation of the Dalasi which clearly was not evident.

## (4.0) Fiscal Developments

The improved performance in public finances achieved in 2004 was not repeated in 2005 mainly due to the lower-than-expected domestic revenue.

Domestic revenue is estimated to total D2.55 billion, lower than the 2005 budget estimate of D2.77 billion. The outturn was only 3.0 per cent higher than the domestic revenue outcome in 2004. Direct tax revenue is projected to fall short of the 2005 target of D676.0 million, by some D5.3 million while receipts from indirect taxes will be lower than the budgeted figure by D235.3 million. Indirect taxes on international trade are likely to register a major shortfall of about D163.0 million. Non-tax revenue is projected at D296.4 million compared to the revised budget estimate of D331.2 million. This is mainly attributed to the failure of certain public enterprises to meet their debt service obligations to Government.

Total expenditure and net lending, projected at D3.72 billion, is slightly higher than the budget estimate of D3.69 billion. Interest payments exceeded the budget estimates by some D194.0 million largely on account of higher-than-budgeted interest payments.

The overall fiscal deficit, projected at D947.4 million, is equivalent to 6.5 per cent of GDP, higher than the budget estimate of D662.6 million, or 4.5 per cent of GDP. The deficit was largely financed by domestic borrowing. As a result, domestic borrowing is expected to be higher than the budget estimate by about 2.0 per cent of GDP.

The Committee observed that given that fiscal policy was not very supportive, the disinflationary process was largely shouldered by the Monetary Authorities in 2005. However, if the fiscal authorities actualize their commitment to reduce the budget deficit including grants to 4.5 per cent of GDP in 2006 as enshrined in the budget, the burden of maintaining and sustaining macroeconomic stability will be jointly shared and this should allow for a further reduction in interest rates.

The Committee noted that the decline in international trade taxes was as a result of a combination of factors, including reduction in the nominal tax at receipts due to the appreciation of the Dalasi, increase in duty waivers, border closure by the Senegalese Authorities and rampant under-valuation of imports.

The Committee concurred that the budget speech was frank and practical, but the main challenge is to improve tax administration by Customs and Excise Department and curtail discretionary expenditure. It was also observed that the corporate tax rate of 35.0 per cent is very high and serves as an incentive for tax evasion. A member suggested that Government should explore the possibility of using the National Lottery as a vehicle to raise revenue.

**(5.0) Money Market Developments**

Total outstanding stock of interest bearing debt rose to D5.1 billion, or 12.6 per cent from end-December 2004.

The non-bank, including parastatals held the bulk of the debt (45.0 per cent) followed by deposit money banks (38.0 per cent) and Central Bank of The Gambia (1.0 per cent).

Reflecting decreased inflationary pressures, investors continue to be attracted to longer dated bills. The 1-year bill accounted for 61.0 per cent of outstanding Treasury bills, 182-day bills (24.0 per cent) and 91-day bills (15.0 per cent) in November 2005.

The downward trend in interest rates continues. The yield on the 91-day, 182-day and 1-year bills fell precipitously from 31.0 per cent in September 2004 to 8.8 per cent, 9.1 per cent and 16.4 per cent respectively at end-November 2005.

It was observed that the widening gap in interest rates between 1-year bills and 91-day bills is normal and simply reflects the time value of money. The Committee viewed the public debt as unsustainable and noted that the earlier we reach completion point and obtain debt relief under the HIPC Initiative the better. It is, therefore, paramount that we successfully conclude the Staff Monitored Programme (SMP) agreed with the Fund as a spring board to negotiate for a fully fledged Poverty Reduction and Growth Facility (PRGF) programme. Successful implementation of a PRGF is a key trigger to reaching HIPC completion point.

Regarding the domestic debt, it was indicated that restructuring is only a stop-gap measure and that a better and lasting solution is to rein in the budget deficit, and in so doing reduce domestic borrowing. There is also the need to demonstrate commitment to privatization and to use the proceeds to pay down the debt.

### (6.0) Monetary Developments

Growth in money supply accelerated to 20.0 per cent in the year to end-October 2005 compared to 13.1 per cent a year earlier. Money supply, however, grew by 8.8 per cent from end-December 2004. Both components of money supply increased, but quasi money grew at a faster pace (23.9 per cent) than narrow money (17.0 per cent).

Regarding the factors affecting money supply, the net foreign assets (NFA) of the banking system rose to D3.1 billion, or 8.3 per cent from the preceding year. This was mainly on account of the increase in the NFA of the Central Bank by 17.1 per cent to D2.0 billion. Gross official reserves rose to D2.6 billion, or 4.2 per cent while foreign liabilities decreased to D0.6 billion, or 23.3 per cent. Deposit money banks' foreign assets and foreign liabilities fell by 5.6 per cent and 41.0 per cent to D1.2 billion and D32.0 million respectively.

The net domestic assets (NDA) of the banking system rose to D2.8 billion, or 36.7 per cent over the previous year on account of 16.8 per cent and 33.2 per cent increase in domestic credit and other items net respectively. Credit to the private sector rose to D1.8 billion, or 19.1 per cent. Claims on public entities fell by 10.0 per cent to D206.3 million while net claims on Government rose by 19.3 per cent to D1.3 billion. Central Bank's net claims on Government decreased significantly to negative D381.6 million, or 191.8 per cent.

Reserve money, the Bank's operating target, grew by 15.9 per cent, higher than the growth rate of 8.3 per cent a year ago. Reserve money, however, grew by 3.9 per cent from end-December 2004.

The Committee noted that the acceleration in the growth of money supply is not particularly worrying given the expectation of a slowdown by end-December 2005. Money supply growth is forecast to be close to the end-December 2005 target of 9.4 per cent reflecting the projected subdued expansion of reserve money.

On the issue of the 171.5 per cent increase in the growth of the revaluation account, it was pointed out that this may not be the case in 2006 given that the Dalasi is not expected to appreciate to the levels experienced in 2005. Appreciation of the domestic currency causes an exchange loss which, in turn, has an expansionary impact on money supply.

The Committee discussed at length the relationship between excess reserves and the money multiplier. There is an inverse relationship between excess reserves and interest rates. At high interest rates, deposit money banks shy away from holding high excess reserves to take advantage of the high returns. Most countries, including The Gambia do not pay interest on excess reserves or even total reserves. The main reason is to keep the opportunity cost of holding reserves as high as possible. If excess reserves are held at a minimum level, the money multiplier (mm) is more predictable. The mm in The Gambia has been quite stable and predictable because deposit money banks have held excess reserves at a minimum. A predictable mm helps to better project money supply.

## (7.0) Financial Stability Report

The fundamentals of the banking system remain solid. The average capital adequacy ratio rose to 88.0 per cent at end-September 2005 compared to 26.8 per cent in September 2004. All the banks met the minimum capital requirement of 8.0 per cent. In other words, all the banks are adequately cushioned against unforeseen losses.

Reflecting strong macroeconomic conditions and concomitant improvement in business and consumer confidence, deposit liabilities surged to D918.8 million in September 2005, or 21.1 per cent from a year ago. Gross loans also rose to D1.85 billion, or 22.9 per cent from a year earlier.

The industry remains profitable. Return on assets rose to 2.8 per cent at end-September 2005 compared to 1.3 per cent in September 2004. However, return on equity decreased slightly to 7.1 per cent from 9.7 per cent in September 2004.

Although non-performing loans rose to D217.9 million, from D101.9 million in September 2004, indicating deteriorating asset quality, they were adequately provisioned.

The Committee agreed the banking system is strong, but expressed concern about credit concentration as indicated by the Herfindahl Index. Credit concentration can cause systemic crisis with profound macroeconomic implications. For example, default by a major borrower can hugely impact capital. The point was made that loan concentration may be a consequence of poor corporate governance and that the Banking and Financial Supervision Department (FED) should be alert to this dangerous phenomenon. Another view point was that if lending is concentrated on agriculture which is, needless to say, quite risky that should be a matter of utmost concern. But to the extent that lending is concentrated on distributive trade which has high returns and generates foreign exchange from re-exports, the situation may not be that gloomy.

The Committee lamented the increase in non-performing loans and urged banks to effectively screen their customers before granting loans. The establishment of a credit bureau should go a long way in vetting potential borrowers. The Committee also advised that it would be useful to include in the analysis, corporate governance since it is a key bedrock to financial viability. The meeting was informed that at least two of the banks have explicit corporate governance guidelines in place.

The Committee deplored the fact that the downward reduction in the policy rate has not translated into a decline in deposit money banks lending rates. The policy rate was 19.0 per cent in December 2005 whereas lending rates of some banks were as high as 30.0 per cent thus rendering the monetary policy transmission mechanism not very effective. Besides, low but positive interest rates impacts growth and curbs loan default.

**(8.0) Real Sector**

Economic growth is forecast at an unrevised 5.0 per cent in 2005 compared to 5.9 per cent in 2004. Value-added of agriculture, industry and services are projected to increase.

Agricultural output is estimated at 4.7 per cent compared to 14.2 per cent in 2004. Value-added of groundnuts is projected at 3.0 per cent, other crops (5.0 per cent), forestry (5.0 per cent) and fishing (7.0 per cent).

Industrial output is estimated at 5.9 per cent, the same as in 2004, premised on robust growth of manufacturing (6.0 per cent), construction and mining (6.0 per cent) and electricity and water (5.0 per cent).

The services sector is projected to grow by 5.0 per cent, slightly lower than the 5.8 per cent in 2004. Trade and hotels and restaurants, the dominant sub-sectors within the services sector, are expected to grow by 5.6 per cent and 10.0 per cent compared to 7.5 per cent and 20.0 per cent respectively in 2004.

The Committee noted that economic growth has been robust in both 2004 and 2005, but not large enough to positively impact the poor. High and sustained growth requires progress in many important areas, including upgrading skills to a critical mass, tackling market inefficiencies, improving infrastructure, stimulating technological innovations, raising the overall savings rate and improving the climate for private sector investment.

**(9.0) Inflation**

End-period inflation, measured by the consumer price index (CPI), declined from 11.4 per cent in October 2004 to 1.0 per cent at end-October 2005. Average inflation rate (12-month moving average) was 4.2 per cent compared to 15.7 per cent a year earlier.

Food consumer price inflation declined to 1.0 per cent compared to 13.1 per cent in October 2004. Non-food prices also decelerated to 0.5 per cent compared to 7.7 per cent in October 2004.

Core inflation, which excludes prices of energy and volatile food items fell from 4.4 per cent in October 2004 to 0.5 per cent in October 2005.

The marked deceleration in inflationary pressures is attributed to a confluence of factors, including appreciation of the Dalasi which dampened imported inflation, abundant and well distributed rainfall which caused agricultural output to increase substantially, increased competition in the retail trade sector, implementation of prudent monetary policies and subdued inflationary expectations.

## (10.0) Inflation Outlook

The near-term outlook for inflation is good. Although global inflation picked up reflecting high oil prices, it remains broadly subdued. Core inflation remains contained and inflationary expectations well anchored.

Recent data indicate that price and cost pressures in The Gambia remain benign. Central Bank projects that both headline and core inflation will remain subdued. End-December 2005 headline inflation is forecast at 1.6 per cent premised on the following: (i) The exchange rate of the Dalasi is expected to remain stable reflecting increased foreign flows, particularly from tourism, re-exports and remittances (ii) Money supply and reserve money grew by 8.8 per cent and 3.9 per cent respectively in October 2005 relative to end-December 2004. Expectations are that money supply and reserve money would grow close to the end-December targets of 9.4 per cent and 14.7 per cent respectively. Growth rates of money is a good indicator of future spending growth. (iii) Increased agricultural production should contain food inflation.

## (11.0) Monetary Conditions Index

Central banks use operational and intermediate targets to guide policy. When a central bank makes a change to the monetary instruments with the objective of impacting the final targets, the inflation rate and the growth rate of the economy, the transmission would take place through several channels. Interest rates and exchange rates are the two main channels through which the effect of changes in monetary policy are transmitted to the final targets. Since both interest rates and exchange rates respond to policy changes and both variables have an impact on the final target, it is not sufficient to monitor the two variables individually and independently. Therefore, a more appropriate indicator is the Monetary Conditions Index (MCI), a weighted average of the two variables.

The MCI that has been constructed assigns a weight of 1.0 per cent for interest rates and 2.4 per cent for exchange rates. The MCI shows that monetary conditions were tight between January-May 2005. Although there was policy easing during this period, interest rates on the 91-day bill, used as a proxy for real interest rates, declined only marginally. Monetary conditions, however, eased from July-October 2005 reflecting sharp decrease in real interest rates. The exchange rate was broadly stable.

**(12.0)** Against this backdrop and in light of the latest inflation projections, the MPC decided to leave the policy rate, the rediscount rate, unchanged at 19.0 per cent. The MPC was concerned about risks to the outlook, primarily relating to the future path of oil prices and the immediate fiscal outturn. The MPC would continue to monitor the situation and if the outlook changes, the Committee would review its stance.

**MPC DECEMBER 2005- ANNEX**

## (1.0) Developments in the International Economy

### (1.1) World GDP

Global GDP growth was strong in 2005. According to the *Economist,* global GDP grew by 4.4 percent in the third quarter, up from 4.0 percent and 4.3 percent in the first and second quarter respectively.

The **US economy** grew at an annual rate of 4.3 percent in the third quarter compared with 3.3 percent in the second quarter, the quickest pace since the first quarter of last year and evidence of resilience in the face of rising oil prices and the destructive forces of Gulf Coast hurricanes. The strong performance was mainly as a result of brisk spending by consumers and businesses as well as robust growth in housing construction.

Consumer spending grew 4.2 percent in the third quarter, stronger than the 3.9 percent previously estimated. Investment in housing construction and other residential projects grew at 8.4 percent in the third quarter, although down from the 10.8 percent in the preceding quarter. Manufacturing production jumped 1.4 percent in October, its biggest monthly rise in six years boosted by businesses recovering after the hurricanes that hit output in August and September, and growth in aerospace sector. However, the US trade deficit jumped to a record $66.1 billion in September, as oil prices soared following Hurricane Katrina.

Consumer price inflation rose at a rate of 3.6 percent in the third quarter, slightly less than initially estimated. When food and energy prices are excluded, “core” inflation – which the Federal Reserve watches very closely – actually decelerated. Core inflation rose at a rate of 1.2 percent, down from 1.7 percent in the second quarter.

The US Federal Reserve raised interest rates by a quarter-point to 4.25 percent on Tuesday December 13, 2005 but signaled that the current cycle of rate hikes may be nearing its end. The rate hike was widely expected by economists and investors, as the economy continues to show signs of strength. In its assessment of the US economy, the Fed said economic growth was solid and core inflation remained relatively low.

Economic growth in **China** remains strong in the first nine months of the year, despite efforts by the government to put the brakes on growth. The economy grew by 9.4 percent compared to 9.5 percent in the second quarter and 9.4 percent in the first quarter. Total GDP for the nine months to September grew to 10.627 trillion yuan ($1.3 trillion). The government has tried to slow growth by hiking interest rates, revaluing the yuan and restricting credit levels.

China's booming exports moved the trade surplus up to $90.8 billion in the first eleven months of 2005. China's foreign trade rose by 23.0 percent and was worth $1.2 trillion. Exports rose 31.3 percent to $546.4 billion while imports were up 16.0 percent to $478.1 billion. Inflationary pressure continued to ease. The consumer price index and the producer price index rose by 0.9 percent and 4.5 percent respectively. Despite the revaluation, analysts still perceive the Chinese currency as still being fixed at artificially low rate, thus boosting Chinese exports.

The Indian economy grew at a pace of 8.0 percent in the six months to September compared with a year ago. The strong performance was aided by growth in the tourism and financial sectors, and a robust manufacturing sector. Higher oil prices and sluggish exports failed to dampen the figures. Growth in the manufacturing sector averaged 10.2 percent in the six months period, while services continued their strong performance. Financial and real estate services grew at 9.1 percent relative to the same period last year.

Economic growth in the **United Kingdom** remains sluggish, held back by rising inflation. The economy – measured by gross domestic product (GDP) – grew by 0.4 percent in the third quarter, down from 0.5 percent in the previous three months. Although the annual growth rate improved to 1.6 percent from 1.5 percent in the preceding quarter, it was the slowest rate since 1993. Earlier in the first quarter, analysts had predicted that the economy would grow by between 3.0 percent and 3.5 percent but Chancellor Gordon Brown admitted recently that economic growth in the UK was unlikely to grow as strongly as forecast, owing to high oil prices.

The biggest drag on third quarter growth has been weaker oil output because of on-going repairs to the oil platforms in the North Sea. The manufacturing sector, however, reversed the 0.2 percent decrease in production suffered in the previous quarter, increasing output by 0.4 percent in the third quarter. The service sector also grew 0.6 percent.

UK inflation has fallen for the first time since September 2004, according to the Office for National Statistics (ONS). Inflation measured by the CPI declined to 2.3 percent in October from 2.5 percent a month earlier. The underlying rate of retail price inflation fell to 2.4 percent from 2.5 percent, while headline rate – which excludes mortgages – fell to 2.5 percent from 2.7 percent.

In the **euro zone**, industrial output dropped by 0.4 percent in the third quarter but industrial orders rose 1.1 percent during the same period. The picture varied across the euro area. In Germany, orders increased by 3.3 percent but declined by 3.8 percent in Italy. The euro zone's current account surplus shrank again in September to $1.4 billion but the EU25 external current account recorded a deficit of 21.1 billion euro in the third quarter of 2005, compared to a deficit of 9.1 billion euro in the corresponding quarter of 2004 and a deficit of 21.2 billion euro in the second quarter of 2005.

The euro area's average inflation rate edged down to 2.4 percent in November, from 2.5 percent in October. Germany's inflation rate remained at 2.3 percent while in Italy inflation stood at 2.2 percent.

In **Japan**, deflation continues with the overall CPI falling by 0.7 percent in October, the biggest drop in three years. Core inflation (excluding volatile fresh food prices) was flat. But if oil prices are excluded, the inflation rate is still firmly negative. Industrial production rose to 3.0 percent in October aided by recovery in business investment and growing exports.

**Sub-Saharan Africa**

Average real GDP growth in Sub-Saharan Africa (SSA) is expected to decline slightly in 2005 from its strong performance in 2004 owing to an easing of demand for imports in advanced countries and the continued worsening of the terms of trade of oil importers. The slowdown in 2005 is also attributable to lower growth performance in most of the oil-producing countries following the exceptional increases in oil-production capacity during 2003 and 2004. Non-oil producing countries are expecting average growth of about 4.5 percent, similar to that observed in 2004. Rising oil prices have led to deterioration in the terms of trade of most non-oil producing countries, although this has partly been offset by higher world prices for some beverages and metals.

Prices of food and agricultural raw materials have fallen in 2005 relative to 2004. The bumper harvest of 2004 could not be repeated in 2005 due to locust infestation in the Sahel region and from droughts in Southern Africa. The weakening of the euro against the US dollar caused import prices to rise in the CFA zone.

Inflationary pressures have increased in SSA due to higher oil prices and poor agricultural output. In South Africa, inflation is expected to remain within the

Reserve Bank's target 3 – 6 percent. Thirty countries are expected to record single digit inflation rates, up from 28 countries in 2004. Only Angola, the DRC, Guinea and Zimbabwe are expected to reach the 20 percent inflation level. However, inflation in the CFA zone increased in 2005 relative to 2004, following the depreciation of CFA franc against the dollar, but to remain below 3.0 percent. Given the prudent monetary policy stance in most countries and the continuous subdue of world inflation, consumer price increases are projected to decline to about 8.3 percent in the region as a whole. The existing policy of passing higher oil prices to consumers are expected to continue in most countries.

**Real GDP Growth** *(in percent)*

| | 1997-2001 | 2002 | 2003 | 2004 | 2005 |
|---|---|---|---|---|---|
| **Oil-producing countries** | | | | | |
| Angola | 4.8 | 14.4 | 3.4 | 11.1 | 14.7 |
| Chad | 3.9 | 9.9 | 11.3 | 29.7 | 5.9 |
| Cote d'Ivoire | 1.6 | -1.6 | -1.6 | 1.6 | 1.0 |
| Equatorial Guinea | 55.5 | 9.7 | 21.3 | 32.8 | 0.2 |
| Nigeria | 2.7 | 1.5 | 10.7 | 6.0 | 3.9 |
| **Non-oil producing states** | | | | | |
| Gambia | 5.8 | -3.2 | 6.9 | 5.1 | 4.7 |
| Ghana | 4.2 | 4.5 | 5.2 | 5.8 | 5.8 |
| Guinea | 4.1 | 4.2 | 1.2 | 2.7 | 3.0 |
| Guinea-Bissau | -1.1 | -7.2 | 0.6 | 4.3 | 2.3 |
| Mali | 5.1 | 4.3 | 7.2 | 2.2 | 6.4 |
| Senegal | 4.3 | 1.1 | 6.5 | 6.2 | 5.7 |
| Sierra Leone | -0.9 | 27.5 | 9.3 | 7.4 | 7.5 |

Oil Importers (SSA): Impact of Higher oil Prices on Current Accounts

*(in % of GDP; negative implies increased deficit)*

| | 2004 over 2003 | 2005 over 2004 | 2005 Jan-Jun) over 2004 | 2006 proj. over 2005 |
|---|---|---|---|---|
| **Net Oil importers** | **-1.00** | **-1.42** | **-0.58** | **-0.61** |
| Gambia, The | -2.09 | -2.73 | -0.98 | -1.07 |
| Ghana | -2.14 | -2.93 | -1.05 | -1.04 |
| Guinea | -0.78 | -1.71 | -0.66 | -0.46 |
| Guinea-Bissau | -1.07 | -1.63 | -0.67 | -0.64 |
| Senegal | -1.02 | -1.56 | -0.64 | -0.63 |
| Sierra Leone | -2.20 | -3.60 | -1.21 | -1.49 |
| South Africa | -0.55 | -1.14 | -0.50 | -0.53 |
| CFA zone oil importers | -0.91 | -1.44 | -0.60 | -0.59 |
| Non-CFA oil importers | -1.01 | -1.42 | -0.58 | -0.62 |
| Non-CFA (exc. SA) zone | -1.91 | -1.94 | -0.73 | -0.77 |

### (1.2) Commodity Prices

**Crude oil** prices have risen 30.0 percent this year to levels not seen since the 1980s. Higher fuel prices can cause unwelcome rises in inflation and restrict economic growth. Prices held steady above $61.0 on December 13, 2005 after OPEC paved the way for a production cut early next year and forecasters predicted more cold weather in the US, the world's biggest heating oil market. Global economic expansion is driving what the International Energy Agency (IEA) says is the biggest increase in oil demand for 24 years. While below the record $70.85 level reached in late August, crude futures have rebounded a tenth in December and are still up more than 40 percent so far this year.

Oil demand in industrialized countries is higher than expected and China's rapidly expanding economy has created a huge demand boost. US demand has risen because of strengthening economic activity and greater need for higher grade crude oil suitable for processing into petrol (gasoline) for consumption by American drivers. The IEA raised its 2006 demand growth forecast by 130,000 barrels per day (bpd) to an average 1.8 – 2.0 million bpd each year through 2010, reflecting strong demand from China and India. That compared with a 1.8 million bpd rise this year.

The terms of trade of oil importers continue to deteriorate. In some oil-producing countries, higher world prices for **beverages and some metals** have helped offset the impact of increases in oil prices. **Cotton** prices also recovered in the first half of 2005 from the trough of 2004 amid expectations of a decline in world production. The assistance that the US government continues to grant its cotton farmers has angered African cotton growers at the Hong Kong summit. As a result, they have threatened to walk out if the US does not agree to reduce cotton subsidies. However, prices of food and agricultural raw materials so far have fallen in 2005 following a strong increase in 2004.

## (2.0) Balance of Payments (BOP) Developments

The revised balance of payments (BOP) estimates indicate that the overall balance will be higher than earlier projected reflecting in the main better-than-expected increase in private capital inflows and workers' remittances. The overall balance of payments position is projected at a surplus of D320.9 million (US$11.2 million) in 2005 compared to the earlier estimate of D27.3 million ($0.9 million). Gross official reserves are estimated at $93.7 million, adequate to cover 4.5 months of imports.

**Current Account**

**(i) Merchandise Trade**

Aggregate value of exports is estimated to decrease to D3.6 billion, or 2.3 percent relative to the previous year, reflecting lower exports of groundnuts. Groundnut exports are valued at $11.3 million, or a decline of 33.0 percent from 2004, attributed to inadequate marketing arrangements. Other domestic exports, including fish and fish products and horticultural exports are projected to increase to D282.7 million against D269.0 million in 2004. Re-exports are estimated at D2.9 billion (97.4 percent of total exports) compared to D3.0 billion (79.7 percent) in 2004. Re-exports to the sub-region are largely influenced by price competitiveness of the domestic currency.

The value of imports is estimated to increase to D6.3 billion, or 7.4 percent from 2004. About 70.4 percent of imports are classified as imports for domestic consumption and the balance for re-exports. Food products, manufactured goods, machinery and transport equipment top the list of imports. The value of oil imports is estimated at $40.3 million, compared to $29.5 million and $14.0 million in 2004 and 2003 respectively reflecting the sharp rise in oil prices.

**(ii) Services and Private Transfers**

Tourism and international trade-related services are an important part of The Gambia's BOP profile. The value of travel income is estimated to increase to D2.2 billion, or 29.4 percent over 2004 owing to the projected 9.4 percent increase in tourist's arrivals. Reflecting the increase in the external debt stock, net interest payments is estimated at D1.3 billion compared with D1.2 billion in 2004.

Private remittances are estimated to constitute the second largest source of foreign exchange for the Gambian economy after foreign direct investment. Flows of workers' remittances have grown steadily over the years reflecting principally the increase in the number of Gambians living and working abroad. Remittances are projected at D856.3 million compared to D569.9 million and D346.2 million in 2004 and 2003 respectively. Private unrequited transfers should amount to D117.3 million, a slight decline of 0.2 percent over last year.

The current account deficit, excluding official transfers is estimated to have narrowed to D2.6 billion, an improvement of 1.8 percent over 2004. Including official transfers, the current account deficit is projected to increase to D1.7 billion, or 21.9 percent from 2004.

**Capital Account**

Medium and long term capital inflows continued to contribute significantly to the overall surplus in the capital account. Official loans (net) are projected at D489.2 million, reflecting higher inflows from project-related loans estimated at D911.4 million, though lower than the D1.2 billion in 2004. Amortization is estimated at D422.2 million, slightly lower than the D431.0 million recorded in 2004. Foreign direct investment (net) is estimated to drop to D1.3 billion, compared to D1.5 billion in 2004. Tourism continues to attract the bulk of the FDI inflows.

**Overall Balance and Financing**

Reflecting these developments, the overall balance of payments is estimated at a surplus of D320.9 million, but lower than the D988.3 million in 2004. As a result, gross official reserves are projected to increase by D277.2 million. Repayments to the IMF are estimated D43.8 million while exceptional financing is projected at zero.

**Outlook for 2006**

The overall balance of payments is projected to decrease to a surplus of $8.0 million in 2006 from $11.2 million in 2005 reflecting, in the main, the reduction in private capital inflows from $45.4 million in 2005 to $43.9 million in 2006. Gross official reserves are projected to increase to $99.2 million from $93.7 million in 2005, adequate to cover 4.5 months of imports.

## (3.0) Monetary Developments

### (3.1) Money Supply Growth ( End-October 2004 - End-October 2005)

Growth in money supply accelerated to 20.0 per cent compared to 13.1 percent a year earlier. However, money supply grew by 8.8 percent when compared to end-December 2004. Both components of money supply increased with quasi money growing at a faster pace.

Narrow money (M1), comprising currency outside banks and demand deposits increased to D3.3 billion, or 17.0 percent from the pervious year. Currency outside banks and demand deposits rose by 6.9 per cent and 24.9 percent respectively. The ratio of narrow money (M1) to broad money (M2), however, declined from 61.8 percent at end-October 2004 to 55.6 percent in October 2005.

Quasi-money (time and savings deposits) rose to D2.6 billion, or 23.9 percent over the previous year. Savings and time deposits increased by 15.6 percent and 54.0 percent respectively. Correspondingly, the share of quasi-money to broad money rose from 38.2 percent at end-October 2004 to 44.4 percent at end-October 2005.

### (3.1.1) Factors Affecting Money Supply

#### (a) Net Foreign Assets (NFA)

The net foreign assets (NFA) of the banking system rose to D3.1 billion, or 8.3 per cent from the preceding year. This was mainly on account of increase in the NFA of the Central Bank by 17.1 percent to D2.0 billion. Gross official reserves rose to D2.6 billion, or 4.2 percent while foreign liabilities decreased to D0.6 billion, or 23.3 percent.

Deposit money banks' foreign assets decreased to D1.2 billion, or 5.6 percent. Their foreign liabilities also fell by 41.0 percent to D32.0 million. Accordingly, deposit money banks' net external position declined to D1.2 billion, or 4.0 percent over the previous year.

#### (b) Net Domestic Assets (NDA)

The NDA of the banking system rose to D2.8 billion, or 36.7 percent from the previous year. This was on account of 16.8 percent and 33.2 percent increase in domestic credit and other items (net) respectively. Credit to private sector rose to D1.8 billion or 19.1 percent. Claims on public entities fell by 10.0 percent to D206.3 million while net claims on Government rose by 19.3 percent to D1.3 billion. Central Bank's net claims on Government decreased to negative D381.6 million, or 191.8 percent.

### (3.2) Reserve Money Growth

Reserve money grew by 15.9 percent, higher than the growth rate of 8.3 percent in the previous year. However, reserve money rose by only 3.9 percent from end-December 2004, lower than the end-December programmed target of 14.7 percent. The growth in reserve money was on account of the increase in both the

NFA and NDA of the Central Bank, which rose by 17.1 percent and 2.8 percent to D2.0 billion and D159.6 million respectively.

The NDA of the Central Bank rose slightly by 2.8 percent to D159.6 million. Central Bank's net claims on Government fell markedly by 191.9 percent mainly on account of the 30.7 percent increase in Government deposit. Central Bank's claim on public entities at D136.9 million was unchanged while lending to the private sector increased to D213.3 million, or 0.8 percent.

**(4.0) Money Market Developments**

**(4.1) Marketable Interest Bearing Debts**

The total outstanding stock of the interest bearing debt as at end-November 2005 rose to D5.1 billion or 12.6 per cent from end-December 2004, but it dropped by 1.5 percent from September 2005. The marketable interest bearing debts as at end-November 2005 comprised:

1. Treasury bills – (constituting 74.1 per cent of the total debt stock)
2. Discount note series – (" 0.0 per cent ")
3. Development Stock – (" 0.00 percent ")

(4.2) Distribution of Treasury Bills by Holder

A disaggregation of Treasury bills holdings as at end-November 2005 shows that the non-bank held the bulk of the stock (54.0 per cent) followed by deposit money banks (45.0 per cent) and the Central Bank (1.0 per cent). At end-September 2005, CBG holdings of Treasury bills accounted for 0.2 per cent of the total, deposit money banks (43.8 per cent) and non-bank (56.0 per cent). However, it is important to note that Social Security and Housing Finance Corporation held 57.0 percent of the total non-bank holdings and 31.0 percent of the total outstanding Treasury bills while the Standard Chartered Bank held 69.0

percent of the total deposit money bank holdings and 31.4 percent of the outstanding stock of Treasury Bills.

### (4.3) Distribution of Treasury Bills by Maturity

At end-November 2005, 1-year bills accounted for 61.0 per cent of total Treasury bills, 182 – day bills (24.0 per cent) and 91 – day bills (15.0 per cent). In the month ending December 2004, the picture was different. The 364 – day bills accounted for 51.0 per cent of the stock, 182 – day bills (11.0 per cent) and 91 – day bills (38.0 per cent).

### (4.3) The Yield Curve on Treasury Bills

The yield curve of the Gambia's money market has in the past been generally flat. However, between October 2004 and September 2005, the declining trend in the policy rate caused the discount rate on Treasury bills of the 91-day maturities not only decreased but it also reflected the time value of money. The benchmark 91-Day Treasury bills rate gradually fell from 31.0 percent in September 2004 to 8.77 percent in December 2005. The 182-day and 364-day bills declined from 31.12 percent and 31.35 percent in September 2004 to 9.10 percent and 16.42 percent respectively in December 2005.

### Fiscal Developments

Revised domestic revenues are projected at D 2,552.2 million, which falls short of the 2005 Budget Estimates of D2772.2 million by D 220 million, or 7.9 per cent. The revised projected outturn is only 3.0 per cent higher than the domestic revenue outcome of 2004.

Direct tax revenue is projected to fall short of the 2005 target of D676.0 million by some D5.3 million while revenue from indirect taxes will be lower than the budgeted figure of D1819.7 by D235.3 million. Indirect tax on international trade is likely to register a major shortfall of about D163.0 million. The impressive gains recorded from non-fuel customs duties in 2004 largely dissipated during 2005. This item recorded the largest shortfall relative to the Budget than any other tax item.

Non-tax revenue is projected D296.4 million compared to the revised budget estimate of D331.2 million. The shortfall has arisen mainly because of the failure of certain public enterprises to meet their debt service obligations to Government.

**A. Current Expenditure and Net Lending**

Total expenditure and net lending is now projected at D3,720.0 million. Although this is only slightly higher than the 2005 budget figure of D3,687.0 million, the aggregate totally masks large deviations between the projected outturn and the 2005 Budget Estimates in several categories of expenditure.

In particular, interest payments exceeded the budget estimates by D194 million, largely on account of the higher than budgeted domestic interest payments. Domestic interest payments are projected at D891.3 million. To offset the overspending on these items, severe restrictions were put on cash releases for departmental discretionary spending from the start of the second quarter of 2005. Releases for discretionary expenditure were cut by 22.0 per cent on average. As a result, expenditure on other charges and GLF capital expenditure for 2005 are projected to fall by D157 million and D87 million respectively.

**B. Fiscal Deficit**

The overall budget deficit is now projected at D947.4 million, equivalent to 6.5 per cent of GDP, higher than the 2005 Budget Estimate of D662.6 million, or 4.5 per cent of GDP.

The fiscal deficit is financed with net external borrowing (D443.3 million) and domestic borrowing of D504.1 million. The latter is D187 million higher than the domestic borrowing requirement of D271 million in the 2005 Budget Estimates.

**(4.0) Consumer Price Index (CPI)**

End-period inflation, measured by the consumer price index of low-income population of Banjul and Kombo St Mary area, declined from 11.4 percent in October 2004 to 1.0 percent at end-October 2005. Average inflation rate (12 month moving average) was 4.2 percent compared to 15.7 percent a year earlier.

Food consumer price inflation declined to 1.0 percent compared to 13.1 percent in October 2004. Prices of all food sub-groups declined. ‘‘Cereals and cereal products’’, ‘‘ roots, pulses, nuts and seeds’’, ‘‘ vegetables and fruits’’, ‘‘meat, poultry, eggs and fish’’, ‘‘milk and milk products’’ and other foods consumer price inflation decelerated to 0.9 percent, 0.7 percent, 1.6 percent, 0.9 percent, 1.1 percent and 1.1 percent compared to 25.4 percent, 7.4 percent, 5.4 percent, 9.1 percent, 12.3 percent and 18.1 percent respectively in the previous year.

Non-food consumer price inflation declined to 0.5 percent compared to 7.7 percent at end-October 2004 as a result of the significant decline in the prices of ‘‘ housing’’, ‘’fuel and light’’, ‘‘ clothing, textiles and footwear’’ and ‘‘miscellaneous items’’ to 0.0 percent, 0.7 percent, 0.2 percent and 0.7 percent compared to 13.2 percent, 18.8 percent, 2.1 percent and 2.8 percent respectively in the preceding year.

## (4.1) Core inflation

The first measure of core inflation (Core 1), which excludes energy prices (fuel, light and transportation) declined from 9.6 percent in October 2004 to 0.7 percent in October 2005.

Core 2 which strips out prices of energy and utilities and volatile food items (‘‘meat, poultry, eggs and fish’’, ‘‘tobacco and tobacco products’’, ‘‘cereals and cereal products’’, and ‘‘processed foods’’) also decelerated from 4.4 percent in October 2004 to 0.5 percent in October 2005.

## (4.2) Inflation Forecast

**Assumptions:**

- Stable exchange rate;
- Money supply growth of 10 percent;
- Government expenditure and net lending of 26 percent of GDP with zero central bank financing of the budget deficit.

**Factors that might affect the inflation dynamics in 2005**

**i** Sharp depreciation of the Dalasi would not only increase the input cost of manufacturing, but impacts inflation directly via imported consumption goods;

**ii** Larger-than-expected budget deficit and concomitant increase in financing, including Central Bank financing;

**iii** Sustained increase in world oil prices could put pressure on the exchange rate and inevitably consumer prices.

Regarding the demand for reserve money, the growth rate of currency in circulation declined to 7.1 percent from 11.6 percent in the previous year. Deposit money banks reserves increased by 36.7 percent compared to a contraction of 3.1 percent a year ago.

## (7.0) Financial Soundness Indicators

### (7.1) Capital Adequacy Ratio (CAR)

The banking industry registered an average capital adequacy ratio of 88.0% at end September 2005 compared to 26.8% a year ago. All banks have recorded CAR above the minimum requirement of 8%, thus pointing to a well-capitalised sector. In other words, banks have demonstrated the ability to deal with unforeseen loss.

### (7.2) Asset Quality

Total gross loans increased by D344.5 million (22.9%) from a year ago to level at D 1.85 billion end September 2005. As already stated, the increase in the industry loan portfolio is largely attributable to the declining interest rates, which makes it attractive for rational borrowers' since they will find it cheaper to borrow.

Non-performing loans rose by D101.87 million (87.8%) from September 2004 to level at D217.88 million this review period. The increase was prompted by the classification of Premier Agro Oil facilities with various banks in the industry. As an indicator of asset quality, non-performing loans represent 11.8% of total loans at end September 2005 compared to a ratio of 7.7% in September 2004. This is in part an indication of a deteriorating asset quality. Despite the high levels of provisions, the growing non-performing loans are a cause for concern.

### (7.3) Earnings

The banking industry registered a return on assets of 2.8% at end September 2005 compared to 1.3% during the same period last year, representing an increase of 1.5% in profitability. Interest income decreased by D29.3 million from September 2004 to stand at D148.82 million this review period. Other income rose by D19.77 million from September 2004 to level at D113.55 million this review period. Non-interest expenses stood at D128.23 million in September 2005 compared to D97.01 million a year ago.

### (7.4) Liquidity

The average liquidity ratio was 123.76 percent, compared to --- percent in the previous quarter. The lowest ratio was 60.7 percent and the highest ---- percent, which compares favorably to the minimum requirement of 30.0 percent.

## (8.0) Real Sector Developments

Economic growth is forecast at 5.0 per cent in 2005 compared to 5.9 per cent in 2004. The value-added of all the key sectors: agriculture, industry and services are projected to increase.

### (8.1) Agriculture

Agricultural output is estimated at 4.7 per cent compared to 14.2 per cent in 2004. Food crops such as sorghum and millet are expected to maintain their positive growth trajectory while groundnut production is projection at over 100,000 metric tonnes. The value- added of groundnuts is projected at 3.0 per cent, other crops (5.0 per cent), livestock (5.0 per cent), forestry (5.0 per cent), and fishing (7.0 per cent).

### (8.2) Industry

Industrial output is projected at 5.9 per cent, the same as in 2004, premised on robust growth of manufacturing (6.0 per cent), construction and mining (6.0 per cent) and electricity and water (5.0 per cent).

### (8.3) Services

The services sector is projected to grow by 5.0 per cent, slightly lower than the 5.8 per cent in 2004. Trade and hotels and restaurants output are estimated at 5.6 per cent and 10.0 percent compared to 7.5 per cent and 20.0 per cent respectively in 2004. The output of public administration is estimated at 3.0 per cent higher than the 1.0 per cent in 2004 while the value-added of transportation and communications, real estate and business services and other services (banking insurance, personal and household services, social and recreational and related services) are forecast to grow by 5.0 per cent, 3.0 per cent, and 3.0 per cent respectively, the same as the actual output in the preceding year.

### (8.4) Growth Projections (2006)

Real GDP growth is forecast at 4.5 per cent in 2006 premised on agricultural value-added of 4.7 per cent industry (5.9 per cent) and services (4.6 per cent).

### (9.0) Foreign Exchange Developments

Reflecting strong macroeconomic fundamentals and increased foreign inflows the dalasi continues to be stable.

### (9.1) Volume of Transactions

Volume of transactions, that is, total purchases and sales of foreign currencies in the inter-bank market totaled D21.8 billion in the year ending November 2005 compared to D18.2 billion in the corresponding period in the previous year. Central Bank combined purchases and sales totaled D1.27 billion compared to D0.92 billion a year earlier.

### (9.2) Market Share of Key Currencies in the IBM

The dollar continues to be the most traded currency in the inter-bank market. In Q3, 2005, it accounted for 60.6 percent of trading volume compared 60.3 percent in Q2, 2005 .The pound had a market share of 14.3 percent in Q 3, 2004 compared to 18.9 percent in Q2, 2005. The euro recorded a market share of 19.7 percent, higher than the 18.1 percent in Q2 2005. The CFA, SEK and other currencies recorded market shares of 0.6 percent, 0.2 percent, and 1.4 percent relative to 0.9 percent, 0.5 percent, and 1.2 percent in Q2, 2005 respectively. Indications from the October-November 2005 data are that the U.S Dollar would continue to be the dominant currency in the inter-bank market in Q4, 2005.

### (9.3) Exchange Rate Movements

In the year ending November 2005, the Dalasi appreciated against all the major currencies in the inter-bank market. It strengthened against the GBP, USD, SEK, CFA and Euro by 8.6 percent, 6.2 percent, 19.6 percent, 4.4 percent and 7.1 percent respectively compared to the corresponding period in 2004.