Minutes of the Third Monetary Policy Committee Meeting (MPC/03/04)

December 2 - 3, 2004

The third meeting of the MPC took place in the Conference Room of the Bank on December 2, 2004. The following members of the Committee were present:

Famara L. Jatta	-	Governor (Chairman)
Momodou B. Saho	-	Member
Ousman Sowe	-	Member
Basiru Njai	-	Member
Amadou Colley	-	Member
Mod Secka	-	Member
Buah Saidy	-	Secretary

Absent:

Ms. Teneng Jaiteh (Member)

Observers:

Oumie Savage-Samba	-	Ag. Director, FISD
Omar Jatta	-	Ag. Deputy Director, FED
Momodou Mboge	-	Special Assistant to the Governor
Mr. Essa Drammeh	-	Principal Officer, FSD
Abdoulie Jarra	-	Senior Economist, ERD
Bakary Jammeh	-	Econometrician, ERD
Momodou Sabally	-	Economist/Statistician, ERD
Ebrima Wadda	-	Economist, ERD
Ismaila Jarju	-	Economist, ERD
Maimuna John-Sowe	-	Economist, ERD
Modou Njie	-	Bank Examiner, FSD
Jainaba Saidy	-	Bank Examiner, FSD

Karamo Jawara - Banking Officer, BSD

Opening

In his opening remarks, the Chairman thanked all those who took part in the preparations for the meeting and for the timely submission of the reports despite bringing the date of the meeting forward. He further intimated that henceforth minutes of the meetings would be posted on the Bank's website and urged the Research Department and the Information Technology Unit to work on this task assiduously.

Before reaching a policy decision and against the backdrop of the forward looking business sentiment survey and the latest projections for inflation, the Committee discussed developments in the world economy, balance of payments, foreign exchange, fiscal sector, money market, money and credit and the real sector.

1. International Developments

The Committee took note of the fact that the US and China are the main engines of growth in 2004, but felt that growth in the US may stall and the Dollar would further weaken against the major currencies if the US twin deficits continue to grow. And to put a lid on the current account deficit estimated at 6.0 per cent of GDP in 2004, the U.S authorities would either have to adopt a weak currency policy or slow down economic activity. The view was expressed that the US authorities are in actual fact deliberately ignoring the weak dollar *a la* benign neglect to boost U.S exports and curtail imports.

It was also observed that should there be a slow down in the US economy, it was unlikely that growth would pick-up elsewhere in the world sufficiently to raise world output in 2005 to the level experienced in 2004. For example, business confidence in the Euro area remains weak and the strong Euro and high oil prices are depressing exports. There is also the added problem of how to further stimulate Japanese consumer demand, and at the same time cool down the Chinese economy, which has been growing at a frantic pace without jeopardizing growth in Asia.

On the issue of whether The Gambia's terms of trade has deteriorated in light of the sustained increase in oil prices, the consensus was that this may be so notwithstanding the increase in the international price of some of our major exports.

It was opined that on the basis of anecdotal evidence, coupled with the significant increase in foreign currency collection items, the re-export trade appears to be doing well which bodes well for growth. However, to get a clearer evidence of the magnitude of re-exports, the Committee recommended that a comprehensive survey of the sector be carried out with input from the Central Bank, Department of State for Finance and Economic Affairs (DOSFEA), Central Statistics Department (CSD) and Department of State for Trade, Industry and Employment (DOSTIE). The Committee was reminded that a task force under the auspices of DOSTIE was established a year ago to specifically look into the contribution of re-exports to the Gambian economy but was aborted owing to financial constraints.

2. Balance of Payments

The Committee expressed optimism that the overall balance of payments would be significantly higher than in 2003 thanks to increased private flows, particularly foreign direct investment. The resultant increase in foreign assets (reserves) of the Central Bank enabled The Gambia to adequately meet all external obligations, including fully repaying the non-complying disbursements of the 1999-2001 Poverty Reduction and Growth Facility (PRGF). The Committee urged that structural reforms be deepened to create a more conducive environment for domestic and foreign investment, especially those geared towards exports if we are to significantly dent the ballooning trade deficit.

3. Foreign Exchange Developments

It was observed that the restrictive monetary policy stance since mid-2003, coupled with supportive fiscal policies, higher exports and increased private flows helped to stabilize the Dalasi in 2004. Remittances were also identified as an important if not the most crucial source of foreign exchange and that the magnitude may be understated in the balance of payments statistics. To better quantify remittances, Financial Supervision Department was tasked to collate the data from the banks and foreign exchange bureaux.

4. Fiscal Developments

Fiscal performance improved in 2004 as a result of tax increases, tightening of tax administration as well as expenditure restraint. The Committee hailed the prudent fiscal policies in supporting the disinflationary process and urged the authorities to further reduce the budget deficit to a sustainable level in the next budget cycle. The Committee expressed disappointment of the slow pace of the land sales projected to fetch Government only D60.0 million in 2004 as opposed to the earlier estimate of D103.0 million. The marketing strategy was faulted for the dismal performance.

Notwithstanding the improved fiscal performance, the Committee cautioned that the primary balance was still too low with profound implications on the public debt. It was noted that under Staff Monitored Programme (SMP) the basic primary balance target (floor) of D1021.8 million for end-December 2004 was likely to be met.

5. Money Market Developments

The Committee observed that the yield curve remains flat which suggests in large part market segmentation. With inflationary expectations waning, coupled with the market optimism of the future stance of monetary policy, investors have been shifting their portfolio to longer dated instruments. The Committee urged the Domestic Debt Committee to quickly complete their assignment on the restructuring of the domestic debt.

6. Monetary Developments

There was a discernible deceleration in the monetary aggregates indicative that the end-December 2004 monetary targets would be met. Year-on-year growth in reserve money and money supply were estimated at 17.3 per cent and 16.1 per cent respectively at end-September 2004. Growth in narrow money, associated with spending on the economy continued to trend downwards. The share of narrow money to broad money was 56.3 per cent compared to 61.3 per cent a year earlier. Variable and unanticipated inflation produces portfolio shifts towards short-term instruments such as currency and demand deposits. As the liquidity premium rises, longer-term instruments become less attractive. To the extent that inflationary pressures have been abating there has been a flight to long-term instruments.

The Committee took note of the declining trend in private sector credit, which has implications for economic growth. It was pointed out that private sector credit grew at an unsustainable 64.0 per cent in 2003 as borrowers took advantage of low real interest rates. To the extent that real interest rates rose significantly in 2004, the market simply corrected itself. Private sector credit is expected to pick up in the latter part of 2005 in line with the projected decrease in borrowing rates.

7. Financial Stability and Banking Soundness

Analysis of the portfolio of the banking industry indicated a drop in their total assets. This was attributed to the decline in loans and advances to the private sector and high dividend payments to shareholders. The spread between deposit and lending rates was considered too high attributed in part to the oligopolistic banking structure. Overall, the banking industry remains solid with an average capital adequacy ratio of 26.8 per cent in the third quarter compared to 25.7 per cent in second quarter of 2004.

8. Real Sector

Owing to the higher-than-expected agricultural output, the GDP growth rate was revised upwards to 8.0 per cent from 7.0 per cent. The Committee felt that the high growth rate though welcomed, may not be sustainable. Agriculture, an important engine of growth is at the mercy of the weather. In addition, the sector is saddled with other constraints such as inadequate marketing arrangements for the main crop, groundnuts and the pervasive use of rudimentary farming equipments.

The Committee expressed the need to broaden the base of economic growth by creating the enabling environment for investment particularly into small and medium scale manufacturing. Investment in manufacturing should also enable The Gambia to take advantage of the opportunities provided by the Africa Growth and Opportunity Act (AGOA) which allows exports from qualified African countries to the U.S duty free.

9. Business Sentiment Survey

The forward looking sentiment survey indicated no change in attitude on economic activity at the country level but perceptions of activity at the company level shifted noticeably to an unfavourable outlook.

Despite the sustained stability of the Dalasi and the deceleration in inflation, expectations on inflation moved from an optimistic outlook in the August-September 2004 survey to an unfavorable outlook in the October-November 2004 survey. This change in attitude was attributed to the upward adjustment in the pump price of petroleum at the beginning of the third quarter of the year.

The Committee lamented the poor response rate in the last survey and recommended that the survey be conducted quarterly and to devote more human and material resources into it to ensure a better response.

10. Consumer Price Index

Two measures of consumer price inflation were presented: headline and underlying inflation.

End-September headline inflation was 12.3 per cent compared to 17.9 per cent in September 2003. Average inflation rate (12 months moving average) stood at 16.2 per cent. Food consumer price inflation declined to 14.2 per cent compared to 19.8 per cent in September 2003. Non-food consumer price inflation also decelerated from 14.2 per cent at end-September 2003 to 8.3 per cent in September 2004.

Two measures of underlying inflation were used: Core 1 and Core 2. Core 1 inflation which strips out the prices of energy (fuel, light and transportation) from the consumer price basket was estimated to have declined from 16.3 per cent in September 2003 to 10.3 per cent in September 2004. Core 2 inflation, which excludes prices of energy and volatile food items also decelerated to 4.7 per cent compared to 12.0 per cent a year earlier.

The short-run error correction model (ECM) and calibration technique were used to forecast inflation. The ECM assumes: (i) revised growth in money supply of

16.1 per cent (ii) revised Government expenditure and net lending of 26.0 per cent of GDP, and (iii) stable exchange rate for the entire 2004. End-December inflation was forecast at 10.7 per cent compared to the previous forecast of 12.3 per cent. In the calibration technique three scenarios were used: (i) maintaining the same inflation path as was in 2003 (ii) assuming average trend in 2002 and 2003 and (iii) petroleum price adjustment by 20.0 per cent and sales tax on building materials of 15.0 per cent.

Scenario 1 projects end-December 2004 inflation of 17.7 per cent. Scenario 2 forecast inflation of 15.2 per cent while Scenario 3 estimates 19.7 per cent inflation rate.

11. Decision

Given the marked deceleration in the monetary aggregates, coupled with supportive fiscal policies and the stability of the Dalasi, the disinflationary process was forecast to be sustained. The Committee took note of the downside risks to the forecast primarily associated with the volatility in commodity prices and global uncertainty related to the price of oil.

Taking the above factors into consideration, including the risks to the inflation outlook, the MPC decided to reduce the Rediscount Rate, the policy rate, by 2.0 percentage points to 31.0 per cent. The MPC would continue to monitor the situation and if the outlook changes, the Committee would review its stance.

MPC DECEMBER 2004 - ANNEX A

1. World Economic Outlook

World economic growth has remained strong despite higher oil prices. Though output growth in the industrialized countries eased in the spring, global growth in 2004 is likely to approach rates last seen nearly thirty years ago. All developing regions are now growing faster than their average growth rates of the 1980s and 1990s.

(i) World Output

The world economy is estimated to grow by 6.0 per cent, driven by the United States with strong support from Japan, India and China. Growth was slower to take hold among European high-income countries, where growth has largely been driven by external demand. Economic growth is expected to slow in 2005 and 2006, expanding by *3.2* percent in each year attributed mainly to:

- the investment cycle in the United States is almost at its peak and a slow down in growth is expected;
- excess demand over supply will continue to push the prices of oil and non-oil commodities, moderating demand in many countries;
- higher interest rates will slow investment growth as central banks continue shifting from a loose to a more neutral stance;
- efforts in China to bring growth down could contribute to weaker global demand.

Despite the rosy growth prospects across regions, there are downside risks to the forecast:

(a) If petroleum prices rise again or failed to moderate, this could restrain global demand and reduce incomes of most developing economies, particularly oil importing countries. While we expect a downward slide in the price of oil, demand may continue to rise with its attendant negative effects on all oil-importing countries, especially developing countries with current account difficulties;

(b) The large twin deficits in the US requires financing, and the continued downward pressure on the dollar may trigger higher interest rates and slow growth. Failure to rein in these deficits could result in an ever increasing stock of dollar- denominated debt and rising future financing burdens;

(c) Given China's importance as a driver of world trade growth, a slow down in growth in China could have a contractionary effect on global economic activity, particularly among China's major trading partners.

Growth in the United States and Japan continue to out-perform the Euro area. The US economy is estimated to grow by 4 percent mainly fuelled by the Information Technology Revolution. In October, 337,000 new jobs were created with much larger gains in August and September than previously reported, reflecting a rise in industrial production. With robust underlying growth in productivity and the job surge, the Fed raised its target rate by a quarter-point, to 2 per cent on November 10, the fourth such rise in as many meetings. Another quarter-point rise at the Fed's December 14 meeting is likely on the premise that policymakers would continue their "measured" pace of tightening.

However, the twin deficits (budget and trade deficits) have been the major source of concern for US policymakers. The trade deficit is in excess of 5 per cent of gross domestic product (GDP) and heading toward 7 percent and there has been little private foreign investment in US equities and government bonds lately. Majority of international economists argue that the deficit is unsustainable in the long run because it is pilling big foreign debts on the next generation and unsustainable in the short run because it threatens to trigger a financial crisis. As of November 10, 2004 the deficit stood at $52 billion, the third largest ever after June and August. The deficit in the current account – which covers trade in goods and services as well as investment income and unilateral transfers - increased to a record 5.7 percent of GDP in the second quarter. This overshot the previous high of 3.5 percent in 1986, when the trade deficit stirred calls for the US government to protect domestic industries against Japanese and European imports.

In China, GDP was reported to have grown by 9.1 percent in the third quarter. The selective credit rationing adopted by the Chinese authorities appear to have eased the growth of imports of raw materials such as steel, copper and various ores in recent months. The forecast predicts that growth will slow to about 7.5 percent by 2005, making a soft landing achievable and slowing growth in the entire Asian region.

In the Euro zone, growth continues to lag behind the US, Japan and China. The Euro area economies have seen a split between solid export gains and slow domestic demand. However, export growth is at a risk due to the strong euro and the expected slow down in the global recovery in 2005.

For much of the second half of 2004, Germany, the Euro zone's largest economy, has witnessed a slow down in economic activity. Growth in real GDP was weak in the third quarter and the monthly numbers suggest the fourth quarter will not be any better. The ZEW index of business expectations in November fell for the fourth month in a row to 13.9 per cent, its lowest level in two years. The number of jobless rose 12,000 in September, and the unemployment rate stayed at a 5-year peak of 10.7 percent. The IMF, on November 2, 2004 lowered its 2005 growth forecast for Germany from 1.8 percent to 1.5 per cent, the lowest in the 12-member euro zone.

Looking forward, the expectations for export growth in the Euro area are dimming because of the record surge in the euro. Since May, the euro has jumped some 9 per cent to a rate of $1.29 to the euro. Added to the rising euro are higher oil prices which have reached record highs. Statements from the European Central Bank (ECB) suggest it could hike rates in early 2005.

In the UK, quarterly GDP was estimated to have dipped to just 0.4 per cent in the third quarter, reflecting a sharp contraction in the industrial sector. House price inflation has declined a little more sharply than anticipated but the outlook remains extremely uncertain. The revival in investment continued. Capital expenditure by businesses rose 2.6 per cent in the second quarter, the fifth consecutive quarter of expansion.

Annual CPI inflation fell to 1.1 percent in September. According to the Bank of England's central projection, inflation should pick up next year, reflecting the pressure of demand on supply and higher import and energy costs. Inflation then rises more slowly, reaching the 2 percent target after two years. Consequently, in its November meeting, the MPC kept the official interest rate unchanged at 4.75 percent, given the underlying growth trend and the inflation outlook.

In the Middle East and North Africa, growth is projected to remain robust, supported by revenue from oil exportation. The region is also benefiting from the strengthening consumption demand, reflecting high oil incomes but this growth projection still falls below the highs observed in 2003, which were boosted by sharp increases in oil production.

Sub-Saharan Africa continues to benefit from the recovery in the prices of non-oil commodities, but many oil importing countries in Africa remain vulnerable due to high oil prices. Despite this improved performance, the region continues to lag behind the rest of the world by a significant margin, leading to the widening of income gaps. The terms of trade appear to be turning against most countries in the region, as non-oil commodity prices are expected to ease. In addition to development aid and debt relief, improved macroeconomic conditions and the efficiency of public expenditures are required to help the region to speed the pace of the march toward the Millennium Development Goals (MDGs).

(ii) Commodity Markets

Spot oil prices have exceeded $50 per barrel and are substantially higher that at the start of this year. The recent hike in petroleum prices reflects continued tensions in the Middle East, strong demand growth and weather-related and other disruptions to supply. The associated increase in futures prices suggests that higher oil prices are likely to persist into the medium term, though the price of oil remains well below previous historic peaks.

The global recovery, which boosted demand, coupled with supply shortages are mainly responsible for the rebound in non-oil commodity prices. The prices of metals and minerals recorded the highest price increases since 2001, increasing by almost 60 percent, but the 40 percent hike in petroleum prices has had the largest economic impact. The 15 percent depreciation of the US dollar means the impact of these price hikes were less important for many countries. These higher commodity prices have increased the incomes of low and middle-income countries by an estimated 1.1 percent of GDP.

The major beneficiaries were the Middle East and North Africa, Europe, Central Asia, Latin America and the Caribbean Regions - all of which include oil exporters. The net gains for non-oil commodity exporters were modest or even negative because most of the non-oil commodity gains were concentrated in metals and minerals prices, which restricted the benefits to a few resource-rich countries. The terms of trade impact on incomes of oil exporting countries was 5.6 percent of GDP whereas for oil importers the impact was a loss of 0.3 percent.

(iii) World Trade

The strong import demand from China and the concommittant increase in industrial production and investment and the continued tendency for domestic demand in the US to exceed production contributed to the exceptional 10.2 percent increase in world trade volumes. More than 20 per cent of the increase in trade volumes was accounted by China whose imports increased by 32 per cent. This was as a result of accession to the WTO, high rate of investment and consumption demand and robust demand for raw materials, in particular, oil, steel, and minerals reflecting in the main the rapid expansion in the Chinese manufacturing and construction sectors. China's share of world exports increased from 2.9 percent to 5.8 percent between 2000 and 2004. While some regions maintained their share of world trade, others lost market share.

In 2005 and 2006, slower activity throughout the global economy should translate into less rapid expansion in trade. A retreat from recent efforts to reduce trade barriers or a failure to make further progress - especially concerning agricultural subsidies - could have substantial negative consequences on many of the world's poorest countries. Moreover, should the US authorities fail to address the twin deficits, this could have significant impacts on developing countries, especially if that failure leads to an increase in protectionist behaviour. Trade in goods and non-factor services are projected to slow to 8.5 percent, down from an estimated 10 percent in 2004.

Table 1: World Economic Outlook Projections (Annual percent change unless otherwise noted)

	2002	2003	2004	2005
World Output	3.0	3.9	6.0	4.3
Advanced economies	1.6	2.1	3.6	2.9
United States	1.9	3.0	4.3	3.5

Euro area	0.8	0.5	2.2	2.2
Germany	0.1	-0.1	2.0	1.5
France	1.1	0.5	2.6	2.3
Japan	-0.3	2.5	4.0	2.3
United Kingdom	1.8	2.2	3.4	2.5
Other emerging market economies	4.8	6.1	6.6	5.9
Africa	3.5	4.3	4.9	5.4
Sub-Sahara	3.6	3.7	4.6	5.8
Developing Asia	6.6	7.7	7.6	6.9
China	8.3	9.1	9.0	7.5
India	5.0	7.2	6.4	6.7
Middle East	4.3	6.0	5.1	4.8

Source: IMF World Economic Outlook, Sept. 2004 & World Bank Projections

2. Balance of Payments

The overall balance of payments is projected to improve significantly to a revised surplus of D797.8 million in 2004 compared to the earlier estimate of D878.9 million. The surplus compares favourably with the deficit of D164.4 million recorded in 2003. The improvement should stem primarily from the increase in private capital inflows, particularly FDI.

A. Current Account

The current account balance, including official transfers, is estimated at a deficit of D581.9 million compared to D478.8 million in 2003 largely as a result of the worsening of the trade balance and the deterioration in net factor services balance. Excluding official transfers, the current account is projected to deteriorate to a deficit of D1.8 billion, or 22.7 per cent from the previous year.

The merchandise trade deficit is estimated at D1.6 billion relative to D1.1 billion in 2003 as imports (especially FDI-related imports) continue to grow faster than exports. The total import bill is projected at D5.2 billion, or an increase of 30.9 per cent from 2003. In terms of value, capital equipment, heavy machinery and general goods constitute the bulk of imports. Exports were revised downwards as a result of the less-than-expected performance of the re-export sub-sector. Exports are projected at D3.5 billion compared to the initial estimate of D3.9 billion but is higher than the D2.9 billion recorded in the preceding year. Total income from tourism is projected at D1.8 billion, from D1.5 billion in 2003.

Reflecting partly the strong growth in imports, net outflows with respect to insurance and freight costs are estimated to increase to D740.2 million compared to D572.0 million in the previous year.

The balance in the capital account, including short-term capital and errors and omissions, which recorded a surplus of D120.1 million and D192.1 million in 2002 and 2003 respectively, is projected to increase significantly to D1.4 billion in 2004 thanks to increased private capital inflows, particularly foreign direct investment (net). Foreign direct investment (net) is projected to increase to D1.4 billion, or 287.3 per cent from 2003. Tourism continues to attract most of the FDI inflows followed by the banking sector.

Reflecting these developments, the overall balance of payments is estimated at a surplus of D797.8 million in 2004 relative to a deficit of D164.6 million in 2003. As a result, gross official reserves are projected to increase by D464.8 million and repayments to the IMF amounting to D333.0 million. Exceptional financing in the form of London and Paris Club loans which amounted to D25.2 million in 2003 is projected at zero in 2004.

3. Monetary Developments (September 2003 – September 2004)

Money Supply

Year-on-year growth in money supply decelerated to 16.1 per cent at end-September 2004 compared with 50.5 per cent a year earlier. The substantial decrease in money supply was mainly due to the restrictive monetary policy stance of the Central Bank and supportive fiscal policies. Regarding the determinants of money supply, the net foreign assets (NFA) of the banking system increased by 136.0 per cent to D2862.14 million while net domestic assets (NDA) fell to D1973.43 million, or 33.1 per cent. Compared to end-December, money supply grew by 5.3 per cent.

Reserve Money

Reserve money grew by 17.3 percent relative to 60.8 per cent in the corresponding period the previous year.

The growth in reserve money was largely on account of the increase in NFA of the Central Bank. In contrast, the NDA of the Central Bank declined significantly. The NFA of the Central Bank increased by a whopping 770.9 percent. Gross official reserves rose significantly by 131.7 percent while foreign liabilities decreased by 9.4 percent.

The NDA of the Central Bank declined significantly by 91.4 percent attributable largely to the marked improvement in Government's position with the Central Bank. Central Bank's net claim on Government declined by 114.8 percent from the previous year. While gross claims by the Central Bank declined by 22.7 percent, Government deposits increased significantly by 103.3 per cent. Central Bank's claims on public entities remained unchanged at D136.9 million but lending to the private sector declined by 20.5 percent to D211.6 million.

4. Money Market Developments

The total outstanding stock of the interest bearing debt rose to D4.3 million at end-October 2004, or 31.1 per cent from year ago. The composition of the debt is as follows:

TABLE 1: COMPOSITION DOMESTIC DEBT (PERCENTAGE)

	Oct-01	Oct-02	Oct-03	Oct-04
Treasury Bills	67%	69%	66%	71%
Development Stocks	1%	1%	1%	0%
Discount Notes	4%	3%	3%	3%
Government Bonds	8%	7%	7%	5%
Other Fixed Loans	16%	16%	16%	12%
NIB Treasury Notes	5%	4%	4%	3%
	0%	0%	3%	6%
Total Debt	100%	100%	100%	100%

As at end-October 2003, the non-bank public, including parastatals held the bulk of the interest bearing debt (41.80 per cent) closely followed by the CBG (41.3 per cent) and deposit money banks (15.9 per cent). However, at end-October 2004 the picture was somehow different. The non-bank sector continued to hold most of the debt (45.0 per cent), followed by the deposit money banks, (33.0 per cent) and CBG (22.0 per cent).

Distribution of Treasury Bills by Holder

A disaggregation of Treasury bills holdings shows that the non-bank held the bulk of the stock (54.1 per cent) followed deposit money banks (42.0 per cent) and the Central Bank (3.9 per cent). In 2003, CBG holdings of Treasury bills accounted for 24.9 per cent of the total, deposit money banks (22.1 per cent) and non-bank (53.0 per cent). Social Security and Housing Finance Corporation held 56 percent of the total non-bank holdings and 30.4 percent of the total outstanding Treasury bills.

Distribution of Treasury Bills by Maturity

At end-October 2004, 1-year bills accounted for 54.1 per cent of total Treasury bills, 91 – day bills (26.6 per cent) and 182 – day bills (19.3 per cent). In October of the previous year, the picture was different. The 364 – day bills accounted for 44.4 per cent of the stock, 182 – day bills (10.8 per cent) and 91 – day bills (44.8 per cent).

5. Private Sector Business Sentiment Survey

Although there has been no change in sentiments on general business activity at the country level, the perception of business activity at the company level shifted noticeably to a more unfavourable outlook. All the sectors: agriculture, industry and services expressed lower expectation of business activity relative to the previous survey.

Despite the sustained stability of the Dalasi and the discernible abating of inflationary pressures, inflationary expectations which waned considerably in the previous survey with (-12) diffusion index shifted to an unfavourable outlook (+6) attributed in part to the upward adjustment in the pump price of petroleum.

As was succinctly noted in the previous business sentiment report, perhaps the trickiest factor determining the future path of inflation is expectations. Inflation is a self-feeding process. If companies and workers start anticipating rising prices, they act in ways that feed the inflationary spiral, thus making the containment of inflation exceeding difficulty.

6.0 Real Sector

Given this year's good rains, which should boost agricultural production, coupled with the expected robust growth of building and construction, mining and quarrying, tourism and re-exports, on balance, growth in GDP was revised upwards to 8.0 per cent from 7.1 per cent.

Risks

The projected growth rate of 8.0 could, however, be undermined by the following:

- Further increase in world oil prices which could negatively impact the terms of trade;

- Less-than-expected increase in tourist arrivals;

- Higher than projected budget deficit financed by the Central Bank and the concomitant increase in inflationary pressures

7.0 Fiscal Developments

Against a projection of D608.6 million under the IMF Staff-Monitored Programme (SMP), total revenue and grants was above the end-September 2004 target by D57.1 million. Total revenue and grants was, however, less than that of the previous quarter by 19.9 per cent. Domestic revenue comprising tax and non-tax revenue, contracted by 14.9 per cent to D5714.1 and was below its target (floor) by D11.2 million owing to the decline in revenue from both oil and non-oil imports as well as decreased non-tax revenue and grants.

Non-tax revenue declined to D58.0 million, or 19.6 per cent from the previous quarter, as a result of 76.9 per cent decrease in income from interest and property. Tax revenue totalled D513.1 million relative to D599.4 million in the second quarter but was above the target (floor) of D473.3 million by D86.3 million. Grants fell to D94.6 million, or 40.8 per cent from the second quarter; however, it outperformed its target of D48.8 million.

Total expenditure and net lending decreased to D651.1 million, or 2.6 per cent from the last quarter, but was above target (ceiling) by D571.7 million.

The budget deficit (excluding grants and without HIPC) on commitment basis improved markedly, narrowing from D177.0 million (1.4 per cent of GDP) in the second quarter to D48.5 million (0.4 per cent of GDP) in the third quarter. Similarly, the fiscal deficit (including grants) on commitment basis, decreased from D66.3 million (0.5 per cent of GDP) in the second quarter to D14.6 million (0.1 per cent of GDP) in the third quarter.

The basis primary balance (domestic revenue minus total expenditure and net lending excluding interest payments and externally funded capital expenditure) as a percentage of GDP, however, fell to 1.7 per cent in the third quarter compared to 2.3 per cent in the preceding quarter.

The budget deficit (on cash basis) was finance by foreign loans (net) amounting to D6.5 million and the non-bank borrowing totalling D125.7 million. There was net repayment of D31.6 million to the banking sector.

8.0 Financial System Soundness Indicators

Capital Adequacy Ratio (CAR)

The banking industry registered a capital adequacy ratio of 26.8 per cent at end September 2004 compared to 26.2 per cent a year ago owing to the increase in capital and reserves.

Asset Quality

Total gross loans decreased to D1.51 billion, or 12.3 per cent from September 2003 largely attributable to the high interest rates.

Non-performing loans declined to D116.01 million, or 48.1 per cent and accounted for 7.7 per cent of total loans compared to 14.4 per cent in March 2004 and 12.9% in September 2003.

Earnings and Profitability

The banking industry registered a return on assets of 1.3 per cent at end September 2004 compared to 5.7 per cent a year earlier. Return on equity also declined by 8.2 per cent to level at 9.7 per cent in September 2004.

Liquidity

The banking sector liquid asset ratio was 75.45 per cent, much higher than the minimum requirement of 30 per cent. This indicates that the sector has the wherewithal to meet short-term liabilities.

9.0 Inflation Report

End-period inflation, as measured by the consumer price index of low-income population of Banjul and Kombo St Mary area, declined from 17.9 percent in September 2003 to 12.3 per cent at end-September 2004. Average inflation rate (12 month moving average) stood at 16.2 per cent.

The first measure of core inflation, which strips out energy prices (fuel, light and transportation) showed inflation declining from 12.5 percent in August 2004 to 10.3 percent in September 2004.

The second measure of core inflation which excludes prices of energy and volatile food items ‘‘meat, poultry, eggs and fish’’, ‘‘tobacco and tobacco products'', ''cereals and cereal products'', and "processed foods'' showed inflation declining from 6.6 percent in August 2004 to 4.7 percent in September 2004.

9.1 Inflation Forecast

The short-run error correction model (ECM) assumed: (i) revised growth in money supply of 16.1 per cent (ii) revised Government expenditure and net lending of 28.0 per cent of GDP and (iii) stable exchange rate for the entire 2004. End-December inflation was forecast at 10.7 per cent compared to the previous forecast of 12.3 per cent.

9.2 Factors that might affect the inflation dynamics in 2004

(i) exchange rate depreciation would not only increase the cost of inputs for the manufacturing sector, but impacts inflation directly via imported consumption goods;

(ii) Sustained increase in world oil prices which may put pressure on the exchange rate and inevitably consumer prices;

(iii) The budget-financing requirement may increase, possibly leading to Central Bank financing of the deficit.