Minutes of the Monetary Policy Committee Meeting (MPC/01/05)

February 16, 2005

The first meeting of the MPC in 2005 took place in the Conference Room of the Bank on February 16, 2005. Present at the meeting were:

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

In attendance were;

- Oumie Savage-Samba	- Director, FISD
- Mr. Essa Drammeh	- Deputy Director, FSD
- ABS Gaye	- Deputy Director, BSD
- Pa Alieu Sillah	- Deputy Director, FSD
- Ibironke Janneh-Jagana	- Legal Adviser
- Ousainou Corr	- Deputy Director, FISD
- EAC Ndong	- Principal Officer, FED
- Martin Brownbridge	- Macroeconomic Adviser
- Fatou Deen-Touray	- Deputy Director, Microfinance Dept.
- ATB Jarra	- Senior Economist, ERD
- AS Koora	- Senior Officer, FSD
- Momodou Sabally	- Senior Economist, ERD
- Bakary Jammeh	- Senior Econometrician, ERD
- Buba Touray	- Economist, ERD
- Ebrima Wadda	- Senior Economist, ERD

- Karamo Jawara - Senior Officer, BSD
- Jainaba Saidy - Senior Officer, FSD
- Ismaila Jarju - Senior Economist, ERD

Opening

In his opening address, the Chairman welcomed the MPC members and thanked all those who were involved in preparing the reports. He instructed that for reasons of transparency and to enhance credibility, the adopted minutes of MPC meetings be posted on the CBG website without delay.

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 international economy, balance of payments (BOP), fiscal, money market, monetary and banking sector developments.

Global Economic Outlook

The Committee noted the projected decrease in global output to 4.0 per cent in 2005 compared to 5.0 per cent in 2004 and the possible easing of commodity prices. It was also observed that uncertainty remained about whether the large US current account deficit would trigger a further fall in the US Dollar, which may cause a slow down in US demand for foreign goods and services.

The Committee posited that the slow down in global output may negatively impact the Gambia given its openness to international trade. Tourism, a major source of growth of the economy, may be particularly vulnerable. Income elasticities for travel expenditures have been estimated to be as high as two to three in many studies. This implies that as incomes increase in real terms, expenditure on foreign travel should rise by 2 - 3 per cent. The Committee reechoed the need to diversify the economy and to ensure that growth is broad based. Accordingly, more resources should be channeled into those sectors in which The Gambia enjoys a comparative advantage such as tourism, banking and agriculture. Agriculture is particularly vital given its linkages with other sectors of the economy.

The Committee decried the poor marketing arrangements that continue to stifle efforts to substantially boost groundnut production. The Committee felt that given the laissez faire nature of the Gambian economy, farmers should have the leeway to dispose their nuts as they see fit.

The Committee applauded the robust economic growth churned by sub-Saharan Africa of 4.5 per cent in 2004, the highest since 1996 attributed to persistent implementation of sound macroeconomic policies and deepening of structural reforms. To sustain the high growth rate and to take advantage of globalisation, it is vital to considerably boost the competitiveness of African economies by building strong governance institutions, expanding the infrastructure base and building a critical mass of skilled labour that can adapt and use technology efficiently rather than rely solely on competitive exchange rates and low wages.

(2.0) <u>Balance of Payments</u>

Although the overall balance of payments is projected to be in a surplus, the Committee lamented the ballooning current account deficit caused by the expected surge in imports particularly oil related imports. The Committee emphasised the need to boost exports to significantly reduce the deficit and bring it into balance. It was observed that manufacturing equipment and machinery and project related imports tend to have a positive impact on long-term growth and should not be a cause for worry.

The Committee doubted the veracity of the tourism data, particularly the out-of-pocket expenditure and urged that a survey be conducted in collaboration with The Gambia Tourism Authority and Central Statistics Department in order to obtain a more up-to-date tourism data. It was further observed that the second phase of the private sector capital flows project should improve the data quality of the financial account component of the BOP particularly with respect to foreign direct investment, portfolio investment and other investment.

The Committee emphasized the need for an aggressive marketing campaign using renowned media outlets so as to fully realise the potentialities of the tourism sector.

(3.0) Fiscal Developments

Although the end-December 2004 fiscal targets under the Staff Monitored Porgramme (SMP) agreed with the Fund were met, the overall budgetary outturn of 8.0 per cent of GDP exceeded the 7.0 per cent target. The high budget deficit was as a result of the higher-than-expected externally funded project outlays.

The Committee emphasized the importance of high-quality fiscal measures that provide lasting savings by raising revenue while at the same time increasing investment in infrastructure and protecting priority projects. Since public investment contributes to the country's growth potential and to Government's future revenue stream, it is important that the country should increase the scope for such investment, albeit in a manner consistent with maintaining macroeconomic stability and debt sustainability.

(4.0) Foreign Exchange Developments

The major foreign exchange developments had been the continued vibrancy of the inter-bank foreign exchange market and the stability of the Dalasi. As at end-

December 2004, the volume of transactions in the inter-bank market increased by 16.0 per cent from the previous year attributed to increased inflows from tourism, re-exports and private remittances. In Dollar terms, the volume of transaction rose by 4.5 per cent.

There was a noticeable increase in trading volume of the Dollar. It was possible that positive changes in the risk premium on Sterling and Euro-denominated assets may have caused investors to diversify their portfolio by selling off Dollars.

The Dalasi was quite stable, depreciating slightly against the Pound Sterling and Euro, but appreciated against the US Dollar partly owing to increased foreign receipts and partly to the tight monetary policy stance, which caused a shift to Dalasi-denominated assets.

(5.0) Money Market Development

The stock of interest bearing debt rose to D 4.6 billion at end-January, 2005, or 40.0 per cent from a year ago. Although the MPC took the decision to reduce the policy rate by 1.0 and 2.0 percentage points during its October and December 2004 sittings respectively, other short-term interest rates changed little. The discount rate on the benchmark 91-day Treasury bill was 28.0 per cent in January 2005 compared to 30.0 per cent at end-October 2004.

It was observed that the domestic debt is unsustainable and exerts considerable pressure on interest rates and the budget. In order to bring lasting solution to the debt problem it is important to deepen fiscal consolidation and in due course use privalisation proceeds to pay down the debt.

(6.0) Monetary Developments

Annual growth in money supply decelerated to 18.3 per cent in December 2004 compared to 43.4 per cent a year earlier and lower than the programmed target of 20.0 per cent. There was a spike in the growth of money supply in the later part of the fourth quarter attributed to seasonality factors.

Narrow money, which may simply reflect current pressures in the economy increased by 8.2 per cent compared to 63.5 per cent a year ago. In theory, a key determinant of narrow money holdings is the level of interest rates. At low nominal interest rates, the benefit from holding wealth in interest – bearing accounts is low and cash balances should be high relative to consumption. A reduction in interest rates seems to have a greater impact on narrow money holdings at very low than at high levels of interest rates.

To the extent that real interest rates are quite high, there was a shift from narrow money to quasi money. Quasi money increased by 35.1 per cent over the previous year causing the ratio of narrow money to broad money to decrease to 57.2 per cent from 62.6 per cent at end-December 2003.

Reserve money, the Banks operating target, grew by 11.0 per cent relative to 62.7 per cent a year earlier and well below the end-December 2004 target of 20.0 per cent.

Although private sector credit decreased by 19.1 per cent in the year to December 2004 following a contraction of 10.3 per cent a year ago, credit to the sector may pick up in the third quarter as lending rates decline. There was a noticeable shift in lending from distributive trade to productive sectors of the economy by at least two of the banks, which bodes well for balanced growth and employment creation.

(7.0) <u>Financial Stability</u>

The capital adequacy ratio, a measure of banks ability to absorb losses, was 20.2 per cent in December 2004 compared to 26.8 per cent in September 2004 but was substantially higher than the 8.0 per cent minimum requirement.

The total assets of the banks' increased to D6.7 billion, or 15.8 per cent from end-September 2004. Compared to a year ago, assets rose by 21.5 per cent. Deposit liabilities also increased to D4.5 billion, or 23.7 per cent over the previous quarter and by 26.9 per cent year-on-year.

The banking industry net earnings decreased to D51.3 million, or 26.8 per cent owing to the less-than-expected decline in non-interest income and the substantial increase in overhead costs, particularly salaries and wages.

The Committee commended the decision to introduce a new regulatory accord in 2006 and expressed the hope that it would substantially improve the financial disclosure regime.

(8.0) Real Sector

Recent forecast point to a slowing of growth from 8.3 per cent in 2004 to 5.0 per cent in 2005 reflecting the significant increase in oil prices and the expected softening of commodity prices. Growth is projected to come from agriculture (4.7 per cent), manufacturing (6.0 per cent), construction and mining (6.0 per cent), electricity and water (5.0 per cent), trade (5.6 per cent) and hotels and restaurants (10.0 per cent).

Looking at the other factors that impact growth, particularly net export contribution to GDP, the Committee advised that export data should be obtained from both The Gambia Ports Authority (GPA) and The Gambia Civil Aviation

Authority (GCAA) taking into account that a good chunck of re-exports to Serra Leone, Guinea and Liberia passes through the airport.

(9.0) Business Sentiment Survey

The Bank's latest business sentiment survey indicated that though firms deemed current prices to be high, inflationary expectations have moved to a more optimistic outlook. This was attributed to the deceleration in inflationary pressures and the stability of the Dalasi.

Sentiments with respect to activity at both the company and country level were quite positive. Capital expenditure, employment, sales and profits were reported to be higher in quarter 4, 2004 relative to quarter 3, 2004. The survey also suggests that respondents are confident about sales, profit and employment prospects in quarter 1, 2005.

(10.0) Inflation

End-period inflation, measured by the consumer price index, declined from 17.6 per cent in December 2003 to 8.0 per cent at end-December 2004 and well below the target of 10.0 per cent. Average inflation rate (12 month moving average) was 14.2 per cent compared to 17.0 per cent a year earlier.

Food consumer price inflation declined to 9.9 per cent compared to 18.5 per cent in December 2003. Non-food consumer price inflation fell to 3.9 per cent relative to 15.6 per cent at end-December 2003.

Core inflations 1, excluding the prices of energy (fuel, light and transport) declined from 15.1 per cent in December 2003 to 6.9 per cent in December 2004. Core inflation 2, which strips out prices of energy and volatile food items, decelerated from 11.6 per cent in December 2003 to 2.1 per cent in December

2004. Seasonally adjusted inflation also declined from 15.6 per cent at end-December 2003 to 7.1 per cent in December 2004.

Inflation is forecast to decline to 5.0 per cent by end-March 2005. Thereafter, further deceleration, albeit at a measured pace, is expected. However, the 1.2 per cent inflation projection for end-2005 was considered flawed because it was based on the wrong assumption of Government expenditure and net lending of 20.0 per cent of GDP, instead of 26.0 per cent.

(11.0) Decision

Given the stability of the Dalasi and the expected deceleration in the growth of the monetary aggregates, the disinflationary trend is forecast to be sustained. But there are down risks to the forecast, primarily associated with the volatility of oil prices and fiscal slippages.

(12.0) 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 29.0 per cent. The MPC would continue to monitor the situation and if the outlook changes, the Committee and would review its stance.

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(1.0) World Economic Outlook for 2005

(1.1) World GDP

World GDP was estimated to have grown by 5.0 percent in 2004, underpinned by continued accommodative macroeconomic policies, rising corporate profitability, rising equity markets, house prices and the very strong growth in China. Looking forward, global growth is expected to slow to 4 percent in 2005 as these positive developments are undermined by the steady decline in output gaps across the world; the ongoing withdrawal of fiscal stimulus; and the impact of rising oil prices. Particular uncertainties relate to oil market; the evolution of the global current account imbalances, the prospect for house prices and the associated impact on consumption; and the reaction of prices to demand and cost pressures.

Several factors are likely to slow growth in 2005 including;

1. A slow down is expected in the level of investment in the United States;
2. Excess world demand over supply will continue to push the prices of oil and non- oil commodities, moderating demand in many countries;
3. Higher interest rates will slow investment growth as central banks continue shifting from a loose to a more neutral stance;
4. Efforts in China to bring growth down could contribute to weaker global demand given China's vital role in driving the global recovery.

Given the above factors coupled with the slow down in global trade, growth in most low- and middle-income countries is also expected to moderate but remain strong. Recent efforts to reduce general government and current account deficits and to pay down debt should enable most developing countries to withstand the higher interest rates expected without excessive adjustment costs.

In the United States, as the output gap narrows, productivity growth is projected to slow and unit labour cost to rise. These factors, in addition to external inflationary pressures from commodity prices, likely informed the Fed's decision to tighten monetary conditions. In its February 2, 2005 meeting, the FOMC decided to raise its target rate, the federal funds rate by 25 basis points to 2.5 percent. According to the FOMC, output appears to be growing at a moderate pace despite the rise in energy prices, and labour market conditions continue to improve gradually. The 2005 budget envisages a reduction in the budget deficit from 5.1 percent of GDP in 2004 to 3.6 percent in 2005 ($430b). Expenditures on domestic programmes including agriculture and housing will be cut but military spending is projected to rise.

In China, a soft landing is expected and GDP is forecast to grow by 8 percent in 2005, down from 9.3 percent in 2004. In South Asia, despite the slowdown in China and the OECD economies, growth is expected to accelerate in 2005 reflecting the gains of structural reforms and market opening. However, the Asian Tsunami is expected to lead to increased expenditures on reconstruction.

Output in Japan is expected to moderate but the outlook remains solid and the available indicators point to continued recovery in private sector demand. The Authorities continued to implement wide ranging structural reforms in the corporate and financial sector and there are signs that deflation has eased.

In Europe, growth is expected to continue gaining momentum in 2005 and 2006 as earlier investments begin to recover, despite the slowdown in the rate of world demand. However, given the euro zone's slow response to asymmetric shocks, the pace of the expansion is expected to remain moderate. In Germany, growth is expected to moderate to 1.5 percent (lowest in the euro area) as domestic demand continues to be relatively weak. Exports are projected to fall given the global slow down.

In France, the budget deficit is projected at 2.9 percent, down from 3.6 percent in 2004. Based on an annual forecast of 2.5 growth in GDP, the deficit will fall to 2.2 percent, 1.6 percent and 0.9 percent in 2006, 2007 and 2008 respectively. Inflation is expected to fall to 1.8 percent on the assumption of a very gradual decline in oil prices.

In the UK, GDP was estimated to have grown by 0.8 percent in the fourth quarter, tipping the annual growth rate from a previous estimate of 3.1 percent to 3.2 percent. But the inflation report shows a slightly higher profile of inflation than the previous report, boosted by higher wage settlements, resilient house prices and a strong performance of equities. Notwithstanding, the Bank of England left interest rates unchanged at 4.75 percent for the sixth month running on February 10, against a backdrop of growing market expectations for a rise later this year although forecast remain balanced.

In Sub-Saharan Africa, GDP growth rate reached 4.5 percent in 2004- the highest for the continent since 1996. Africa's leading reformers-Burkina Faso, Ghana, Mali, Tanzania, Uganda, Tunisia and Morocco- continued to perform well while Central and East Africa witnessed the most robust growth performance of 8.7 percent and 6.5 percent respectively. While Central Africa benefited from post-conflict dividends and higher oil prices, the performance in East Africa was boosted by the bumper harvest of 2004. Africa will also benefit from the revival in Europe, Africa's major trading partner, but many oil importing countries remain vulnerable to higher oil prices.

In addition to development aid and debt relief, there is the need for improved fundamentals and efficient public expenditures to hasten the pace towards achieving the goal of poverty reduction.

Table 1: Real GDP ***(Annual percent change)***

	2002	**2003**	**2004**	**2005**
World Output	**3.0**	**3.9**	**5.0**	**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	1.8
France	1.1	0.5	2.6	2.5
Italy	0.4	0.3	1.4	1.9
Japan	-0.3	2.5	4.4	2.3
United Kingdom	1.8	2.2	3.4	2.5
Other emerging markets and developing	4.8	6.1	6.6	5.9
Africa	3.5	4.3	4.5	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	9.3	8.0
India	5.0	7.2	6.4	6.7
Middle East	4.3	6.0	5.1	4.8
Western Hemisphere	-0.1	1.8	4.6	3.6

	2001	2002	2003	2004	2005
Africa	**4.0**	**3.5**	**4.3**	**4.5**	**5.4**
Cote d'Ivoire	0.1	-1.6	-2.8	1.7	4.3
Gambia, The	5.8	-3.2	6.7	8.0	5.0
Ghana	4.2	4.5	5.2	5.2	5.0
Guinea	3.8	4.2	1.2	2.6	3.8
Guinea Bissau	0.2	-7.2	0.6	1.0	3.4
Mali	12.1	4.3	6.0	4.5	5.6
Sierra Leone	18.5	26.8	9.4	7.2	7.0
Nigeria	3.1	1.5	10.7	4.0	5.9
Senegal	4.7	1.1	6.5	6.0	5.8

Source: IMF, World Bank and country Staff Projections

(1.2) Inflation

Global inflationary expectations have risen but remain moderate and the forecast has been revised upward to 2.6 percent in 2005. Domestic measures of inflationary expectations have been higher in emerging markets-notably China, Poland and Brazil-with smaller increases in industrial countries. The combination of higher global growth and rising commodity prices will mean that monetary policies will generally need to be tightened somewhat faster than earlier expected depending on the cyclical positions in individual countries and regions.

The risks of a marked pickup in inflation appear moderate given excess capacities well-grounded inflationary expectations and relatively moderate labour market pressures and rising profit margins. Nonetheless, policymakers will need to respond promptly if inflation edges up or spare capacities tighten faster than envisaged since the cost of a slow reaction could be costly and diminish central banks' credibility.

However, widespread relapses in globalization, deregulation, productivity increases, and relatively loose fiscal policies could roll back the achievements of low inflation of recent years (Rogoff, 2003). The immediate policy challenges remain rising terrorist risks, renewed protectionist pressures and failure to address medium-term fiscal problems.

(1.3) Commodity Markets

Accelerated world demand and supply shortages were responsible for commodity price increases during the global recovery. However, virtually all of the gain accrued to low- and middle-income oil exporters. Most developing country oil importers suffered net terms of trade losses. Apart from higher oil prices, other energy and metal prices rose.

The expected slowdown in global economic activity will lead to less demand for goods and contract world trade. However, there remains considerable scope for higher oil prices, particularly given the sensitivity of the oil market to supply disruptions. OPEC excess capacity is estimated to have fallen from 4.6 million barrels per day in 2001 to only 1.4 million barrels per day in 2004 in addition to the limited refining capacity for sweet crude.

Non-oil commodity prices are expected to ease although to remain above average levels in 2005. China's continued expansion has been the main driver of global trade in 2004 accounting for 20% of the increase in world merchandise trade. Although measures to cool the economy in 2004 impacted the commodity markets, somewhat, overall demand has remained strong as companies ran down inventories at the end of the second quarter. Following a pre-election spending spree in 2004, US demand for non-oil imports is expected to slowdown in 2005 as output contracts although to remain firmly above trend. Similarly, the slowdown in Japan, UK and the Eurozone is expected to ease demand for industrial materials and agricultural commodities.

(2.0) Balance of Payments Developments

The overall balance of payments is projected at a surplus of D27.3 million compared to D797.8 million in 2004. The current account balance including official transfers is estimated to deteriorate significantly as a result of the projected widening of the trade deficit. In contrast, the balance in the capital account is expected to improve due to the projected increase in private capital inflows.

(2.1) Current Account

(i) Merchandise Account

The trade deficit is expected to widen from D1.7 billion in 2004 to D2.0 billion in 2005 reflecting an upsurge in imports, which should more than offset exports. Domestic exports are projected at D937.4 million, an increase of 21.9 percent with groundnuts and groundnut products accounting for about 69.0 percent of total domestic exports. Re-exports are estimated at D2.9 billion, representing 75.8 percent of total exports.

Imports are projected to expand by 13.0 percent from D5.2 billion in 2004 to D5.9 billion, reflecting the rebound in re-exports, increased public sector investment and the effects of a higher oil import bill. Imports for domestic use are estimated at D4.0 billion compared to D3.4 billion in the 2004 while oil and oil products imports are expected to increase to D719.3 million compared to D604.8 million in 2004.

ii) Services and Private Transfers Account

The balance in the services account (net), comprising factor and non-factor services, is estimated at a deficit of D622.2 million compared to D230.8 million in 2004. The factor services balance (net) deficit is projected to worsen from D663.6 million in 2004 to D1.0 billion in 2005 owing to increased interest payments on the external debt. Net interest income, which recorded a deficit of D1.1 billion in the previous year, is projected to deteriorate to D1.5 billion in 2005.

The surplus of non-factor services is projected to decline to D388.2 million compared to D432.8 million in 2004. Travel income is estimated at D1.9 billion, representing an increase of 7.8 percent while net outflow on account of freight and insurance is expected to increase by 13.0 percent to D836.6 million, owing to the projected increase in imports.

Private unrequited transfers (net) is projected to increase by 7.1 percent to D126.1 million while net official transfers (project aid) is forecast to decline by 26.0 percent to D875.9 million. Remittances, on the other hand, are estimated to increase to D494.8 million compared to D440.3 million in 2004.

(2.2) Capital Account

The capital account is projected at D1.6 billion compared to D1.4 billion in 2004. Official loans (net) is estimated to decrease to a surplus of D344.3 million, or 6.0 percent due to the projected increase in amortisation from D372.2 million in 2004 to D562.8 million in 2005. Project-related loans are projected at D800.0 million compared to D738.5 million in the previous year. Programme loans are estimated at D107.1 million from zero in 2004. Private capital inflows should increase to D1.3 billion relative to D1.0 billion in 2004 comprising foreign direct investment (net) of D1.2 billion and other investments (D123.8 million) respectively.

(2.3) Overall Balance and Financing

The overall balance of payments is estimated at a surplus of D27.3 million compared to D797.8 million in the previous year. Gross official reserves are projected at $85.4 million, equivalent to 4.7 months of import cover. Disbursements from the IMF are projected at D262.8 million, which more than offset repayments totalling D61.2 million. Exceptional financing is projected at zero and The Gambia is expected to be current on its debt service payments.

(3.0) Tourism

Air chartered tourist arrivals in the 12 months ending December 2004 totaled 90,098, an increase of 1.2 per cent from the corresponding period last year. Tourist arrivals in January 2005 totalled 14,474, 12.7 per cent above the figure recorded in January 2004. Britain, the largest source market accounted for more than 50.0 per cent of total arrivals followed by the Netherlands, Germany and Sweden.

As reflected in the balance of payments, average out-of-pocket expenditure (excluding hotel accommodation, breakfast and meals) is projected at D250.00 a day the same as in the previous year. The average length of stay also remains unchanged at 13 days. Total out-of-pocket expenditure is estimated at D292.8 million compared to D289.5 million in the previous year. Income from hotel beds is project at D1.1 billion compared to D1.0 billion in 2003. Income from arrival fees is also estimated at D23.9 million, up from D23.2 million in the previous year. As a result, travel income is projected to increase from D1.3 billion in 2003 to D1.5 billion in 2004 reflecting increased number of tourist arrivals and to some extent the depreciation of the Dalasi.

It is worthy of note that according to industry sources in the U.K, The Gambia offers the best value for money for U.K tourists than any other destination. This can be attributed to the depreciation of the real effective exchange rate of the Dalasi and the fact that the accommodation infrastructure has been significantly improved over the past 12 months.

(4.0) Monetary Developments

(4.1) Money Supply Growth (End-December 2003- End-December 2004)

Growth in money supply decelerated to 18.3 per cent lower than the programmed target of 20.0 per cent and the 43.4 per cent growth rate a year earlier. Although narrow money rose modestly, quasi money increased markedly.

(4.2) Factors Affecting Money Supply

(a) Net Foreign Assets (NFA)

The net foreign assets of the banking system rose to D3.2 billion, or 70.0 per cent from the preceding year mainly reflecting the combined effects of an increase in the net foreign assets of the Central Bank and commercial banks.

The NFA of the Central Bank increased to D1.8 billion, or 104.3 percent. Gross official reserves rose to D2.5 billion, or 29.1 percent while foreign liabilities decreased to D0.7 billion, or 31.9 percent.

Deposit money banks' net external position rose to D1.4 billion, or 40.7 percent notwithstanding the 93.2 percent increase in their foreign liabilities. Deposit money banks foreign assets increased to D1.5 billion, or 42.8 percent over the previous year.

(b) Net Domestic Assets (NDA)

The NDA of the banking system decreased to D2.2 billion, or 17.6 percent from the previous year. This was attributed mainly to the decline in domestic credit by 22.6 percent. Lending to all the sectors decreased. Credit to public entities declined to D223.4 million, or 34.8 percent while net claims on Government fell by 32.5 percent to D1.0 billion largely reflecting increased Government deposits and reduced recourse to bank borrowing particularly from the Central Bank. Central Bank's net claim on Government declined to D186.8 billion, or 122.2 percent. Credit to the private sector decreased by 12.5 percent from a year earlier to D1.6 billion.

(4.3) <u>Reserve Money</u>

Reserve money grew by 11.0 percent well below the end-December 2004 target of 20.0 percent and the substantial growth rate of 62.7 percent in the previous year. The modest growth in reserve money was largely on account of the increase in NFA of the Central Bank, which rose by 104.3 percent to D1.8 billion. In marked contrast, the NDA of the Central Bank declined significantly by 70.5 percent to D292.0 million. Central Bank's net claim on Government declined by 122.2 percent owing to the 286.4 percent increase in Government deposit and the consequent non-recourse to Central Bank borrowing.

(5.0) Money Market Developments

The total outstanding stock of the interest bearing debt rose to D4.6 million at end-January 2005, or 40.0 per cent from year ago.

(5.1) Distribution of Interest Bearing Debt by Holder

As at end-January 2004, the non-bank public, including parastatals held the bulk of the interest bearing debt (47.92 per cent) followed by the CBG (34.43 per cent) and deposit money banks (17.65 per cent). However, at end-January 2005 the picture was somehow different. The non-bank sector continued to hold most of the debt (46.71 per cent), followed by the deposit money banks, (28.11 per cent) and CBG (25.11 per cent).

(5.2) Distribution of Treasury Bills by Holder

A disaggregation of Treasury bills holdings shows that the non-bank held the bulk of the stock (54.5 per cent) followed deposit money banks (35.4 per cent) and the Central Bank (10.1 per cent). In 2004, CBG holdings of Treasury bills accounted for 13.6 per cent of the total, deposit money banks (24.7 per cent) and non-bank (61.7 per cent). Social Security and Housing Finance Corporation held 55 percent of the total non-bank holdings and 26.6 percent of the total outstanding Treasury bills.

(5.3) Distribution of Treasury Bills by maturity

At end-January 2005, 1-year bills accounted for 45.2 per cent of total Treasury bills, 91 – day bills (45.3 per cent) and 182 – day bills (9.5 per cent). In January of the previous year, the picture was different. The 364 – day bills accounted for 47.0 per cent of the stock, 182 – day bills (14.2 per cent) and 91 – day bills (38.8 per cent).

(6.0) Private Sector Business Sentiment Survey

There was a sea change of sentiments at both the company and country level with respondents as a whole reporting higher level of activity in Q4, 2004 relative to the previous quarter. Correspondingly, capital expenditure, employment, sales and profits were reported to be higher. Prospects for the quarter ending March 2005 were reported to be quite good.

Although current prices were reported to be higher in Q4, 2004 relative to the previous quarter, the exchange rate, inflation and interest rates are expected to be lower in Q1, 2005.

(7.0) Real Sector

GDP growth in 2004 was estimated 8.3 per cent compared to the revised 6.7 per cent in 2003. The economic output is particularly substantial taking into account the fact that unlike 2003 the growth rate was from a high economic base.

(7.1) Forecast of Economic Activity for the Year 2005

(7.1.1) Economic Growth

Economic growth is forecast at 5.0 per cent in 2005 compared to 8.3 per cent in 2004. The value added of all the key sectors: agriculture, industry and services are projected to increase.

(7.1.2) Agriculture

Agricultural output is estimated at 4.7 per cent compared to 14.2 per cent in 2004. 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).

(7.1.3) 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).

(7.1.4) Services

The services sector is forecast to grow by 5.0 per cent, slightly lower than the 5.8 per cent in 2004, while 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 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.

(7.2) Risks to the Forecast

- Unforeseen changes in oil prices from the current $40 - $50 per barrel mark, which could cause severe terms of trade shocks.
- Less-than-expected increase in tourist arrivals;
- Budgetary slippages
- Poor agricultural output.

(8.0) Foreign Exchange Developments

The interbank foreign exchange market was quite vibrant owing to increased foreign currency inflows from foreign direct investment, tourism, re- exports and groundnut and groundnut product exports. The substantial inflows, coupled with the tight monetary stance and supportive fiscal policies caused the Dalasi to be stable throughout the year under review.

(8.1) Volume of Transaction

Volume of transactions, that is, total purchases and sales of foreign currencies in the interbank market, increased markedly to D2.14 billion, or 16.0 percent from 2003. Sales, indicative of demand and purchases reflecting supply increased by 30.1 and 40.0 percent respectively. In U.S Dollar terms, volume of transactions rose by 4.5 percent from a year earlier.

The US Dollar continues to be the dominant currency in the interbank market, accounting for 63.0 of percent market share at end-December 2004 higher than 58.3 percent market share recorded during the same period a year earlier. This was attributed to frantic selling of dollars as the currency continues to weaken against the major currencies particularly the Pound Sterling and Euro. The SEK and other currencies' market share also rose to 1.2 percent and 2.8 percent compared to 1.1 percent and 1.6 percent respectively at end-December 2003.

In contrast, the market share of the Pound Sterling and the Euro decreased to 18.0 percent and 15.0 percent compared to 21.5 percent and 16.9 percent respectively a year earlier. The market share of the CFA also fell to 0.2 percent against 0.6 percent at end-December 2003.

The Dalasi was quite stable depreciating slightly against all the major currencies except the U.S Dollar. The Dalasi weakened against the pound sterling and Euro by 5.3 percent and 5.2 percent respectively from a year ago, but strengthened by 4.1 percent against the dollar reflecting in part the weakening of the Dollar in the international currency markets. Against the CFA, the Dalasi fell by 4.5 owing in large part to the strengthening of the Euro, the anchor currency of the CFA.

(9.0) Financial Stability Report

(9.1) Financial Performance Indicators

(9.1.1) Capital Adequacy Ratio (CAR)

As at end December 2004, the industry's capital adequacy ratio decline to 20.21 per cent from 26.8 per cent in September. This was due largely to the decrease in banks capital and reserves by 8.0 per cent, the worst quarterly performance in the year.

(9.1.2) Asset Quality

The loans portfolio of banks increased to 1.6 billion, or 7.4 per cent from the third quarter. Lending to other sectors, agriculture and trade rose by 73.9 per cent, 22.9 per cent and 1.9 per cent to D181.4 million, D169.7 million and 496.0 million respectively.

Banks asset quality deteriorated from 7.7 per cent in the third quarter to 12.8 per cent in fourth quarter. This indicates that an additional 5.1 per cent of the industry's loans was classified as non-performing, the highest quarterly increase of bad loans in the year. In absolute terms, non-performing loans increased from D116.0 million in the previous quarter to D210.8 million during the quarter under review.

Compared to the same period last year, the industry's net income declined from D85.4 million at end-September 2004 to D51.3 million in December 2004.

Return on assets (ROA), which measures the return on each Dalasi invested, registered a marginal decrease of 0.01 per cent from the previous quarter ratio of 1.26 per cent attributed to the increase in total assets and decline in net earnings.

Return on equity, (ROE) rose from 9.2 per cent in the third quarter to 13.1 per cent in the fourth quarter, indicating a more efficient allocation of capital funds among competing uses.

(9.1.3) Liquidity Ratio

With a recorded 88.4 per cent liquidity ratio, compared to the regulatory requirement of 30%, it is quite evident that banks are highly liquid. The bulk of liquid assets were held in Treasury bills and foreign bank balances, indicating a low credit risk appetite.

(10.0) Consumer Price Index (CPI)

End-period inflation, as measured by the consumer price index of low income population of Banjul and Kombo St Mary area, declined from 17.6 percent in December 2003 to 8.0 per cent at end-December 2004. Average inflation rate at end-December (12 month moving average) stood at 14.2 percent.

(10.1) Food consumer price inflation declined to 9.9 percent compared to 18.5 percent in December 2003 owing to the decline in the prices of all its components. Consumer price inflation of ‘‘cereals and cereal products’’, ‘‘ roots, pulses, nuts and seeds’’, ‘‘ vegetables and fruits’’, ‘‘meat, poultry, eggs and fish’’, ‘‘milk and milk products’’ and other foods decelerated to 17.8 percent, 6.1 percent, 3.1 percent, 7.1 percent, 9.3 percent and 14.3 percent in December 2004 compared to 25.2 percent, 13.5 percent, 7.3 percent, 17.5 percent, 16.6 percent and 25.1 percent respectively in the previous year.

(10.2) Non-food consumer price inflation declined from 15.6 percent at end-December 2003 to 3.9 percent in December 2004 as a result of a significant decline in the prices of all its components. The consumer price inflation of “housing”, “fuel and light”, “clothing, textiles and footwear” and miscellaneous items decelerated to 3.4 percent, 9.1 percent, 1.5 percent and 2.4 percent respectively compared to 13.7 percent, 30.4 percent, 9.5 percent and 12.2 percent in the preceding year.

(10.3) Core Measures of Inflation

(10.3.1) The measures of core inflation attempts to strip out the effects of temporary disturbances (noise) from the headline inflation in order to uncover the underlying rate of inflation.

(10.3.2) The first measure of core inflation, which strips out energy prices (fuel, light and transportation), showed inflation declining from 15.1 percent in December 2003 to 6.9 percent in December 2004.

(10.3.3) The second measure of core inflation excludes prices of energy and volatile food items (‘‘ meat, poultry, eggs and fish’’, ‘‘tobacco and tobacco products’’, ‘‘cereals and cereal products’’, and ‘‘processed foods’’) also shows inflation declining from 11.6 percent in December 2003 to 2.1 percent December 2004.

(10.3.4) Seasonally Adjusted Inflation

Seasonally adjusted inflation declined from 15.6 percent at end-December 2003 to 7.1 percent in December 2004 solely attributed to the declining prices of both food and non-food items.

(11.0) Fiscal Developments

(11.1) Revenue and Grants

Total revenue and grants increased to D3.06 billion, or 65.5 per cent from the previous year. Domestic revenue comprising tax and non-tax revenue rose to D2.5 billion (20.2 per cent of GDP) compared to D1.57 billion (15.7 per cent of GDP).

(11.2) Expenditure and Net Lending

Total expenditure and net lending increased from D2.33 billion (26.7 per cent of GDP) in 2003 to D3.71 billion (30.0 per cent of GDP) in 2004 mainly as a consequence of increased capital expenditure and net lending.

(11.3) Fiscal Deficit

On commitment basis, the fiscal deficit (including grants) was targeted at D445.9 million (3.6 per cent of GDP) in 2004 relative to D472.3 million (4.7 per cent of GDP) in 2003.

However, the budget deficit (excluding grants and HIPC funds) was projected at D988.5 million (8.0 per cent of GDP) in 2004 compared to D718.5 million (7.2 per cent of GDP in the preceding year. The actual fiscal figures reveal that the deficit (excluding grants and HIPC funds) widens as a percentage of GDP from its target, recording 7.8 per cent in 2003 compared to 8.3 per cent in 2004. The deficit (including grants) on cash basis totaled D333.5 million in 2004. Notwithstanding this, the basic primary balance improved from the surplus of 5.0 per cent of GDP in 2003 to 9.4 per cent of GDP.

The deficit was partly financed by external loans(net) amounting D565.6 million. This comprises foreign borrowing (mainly for projects) of D962.6 million in 2004 (exceeding its limit of D738.5 million), as reflected in the sharp rise in capital expenditure. Similarly, amortization (the amount paid on the principal of the external debt) also rose by 42.0 per cent, from D279.7 million in 2003 to D397.0 in 2004. Amortization for the year, however, was targeted at D372.2 million.

(10.0) Consumer Price Index (CPI)

End-period inflation, as measured by the consumer price index of low income population of Banjul and Kombo St Mary area, declined from 17.6 percent in December 2003 to 8.0 percent (point-to-point) at end-December 2004. Average inflation rate at end-December (12 month moving average) stood at 14.2 percent.

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(10.3.3) The second measure of core inflation excludes energy, transportation and volatile food items (‘‘meat, poultry, eggs and fish’’, ‘‘tobacco and tobacco products’’, ‘‘cereals and cereal products’’, and ‘‘processed foods’’) . It showed inflation declining from 11.6 percent in December 2003 to 2.1 percent December 2004.

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