Minutes of the Monetary Policy Committee Meeting (MPC) 04/05

August 24-25, 2005

The fourth meeting of the Monetary Policy Committee (MPC) in 2005 was held in the Conference Room of the Bank on August 24-25, 2005.

Present were:

Famara .L. Jatta	-	Governor (Chairman)
Momodou .B. Saho	-	Member
Basiru Njai	-	Member
Amadou Colley	-	Member
Momodou Ceesay	-	Member
Bakary Kolley	-	Secretary

In attendance were:

Momodou A. Ceesay	Adviser	Governor's Office
Momodou B Mboge	Director	Internal Audit
Omar Jatta	Deputy Director	FED
Martin Brownbridge	Adviser	DoSFEA
Bai M. Senghor	Deputy Director	MFD
Essa Drammeh	Deputy Director	FSD
Ousainou Corr	Deputy Director	FISD
Momodou Njie	Senior Bank Examiner	FSD
Ida Fye	Senior Bank Examiner	FSD
Anetta Riley	Senior Banking Officer	BSD
Karamo Jawara	Senior Banking Officer	BSD
Abdoulie T B Jarra	Senior Economist	ERD
Ismaila Jarju	Senior Economist	ERD
Ebrima Wadda	Senior Economist	ERD

In his opening remarks, the Chairman welcomed the members to the fourth meeting of the MPC in 2005. He urged the Committee to discuss the issues exhaustively and bearing in mind recent economic and financial developments.

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

The Committee also deliberated on the concerns expressed by the Department of State for Finance and Economic Affairs that the Central Bank is using two operating targets, that is, short term interest rates and reserve money which has profound implications in the conduct of monetary policy. The Central Bank made it abundantly clear that it uses monetary targeting as a framework in the conduct of monetary policy. More specifically, reserve money is used as an operating target and money supply as an intermediate target. The policy rate, the rediscount rate, is used as one of a menu of instruments to influence the operating target.

(1.0) World Economic Outlook

Although global economic growth is projected at 4.0 per cent in 2005, lower-than the 5.0 per cent in 2004, there is growing evidence that the expansion would be broad based. In the US, GDP grew at an annual rate of 3.4 per cent in the three months to end-June 2005, the ninth consecutive growth exceeding 3.0 per cent. However, the growth rate was lower than the 3.8 per cent in the year to the first quarter. Consumer spending, the driving force of the US economy, rose by 3.1 per cent in the three months to end-June 2005, slower than the 3.3 per cent in the year to the first quarter. Spending on durable goods such as cars and refrigerators in particular jumped a robust 8.3 per cent.

The sustainability of the US economy seemed less in question. Although policy has been tightened, monetary conditions remain accommodative. This, coupled with robust underlying growth in productivity is providing on-going support to economic activity.

The Committee viewed the decision of Federal Reserve to incrementally raise interest rates to proactively rein in inflation prudent. The Federal Open Market Committee (FOMC) has raised the federal funds rate, the policy rate, by 25 basis points, to 3.25 per cent in June 2005, its ninth increase in a row.

The latest estimate of GDP growth indicates that given the slow response of the Euro zone to asymmetric shocks, the pace of expansion is expected to remain moderate. The German economy, the largest in the Euro zone, continue to grow at a disappointing pace owing in large part to structural rigidities.

A significant feature of global growth has been the emergence of Asia as engine of growth in the world economy. The Chinese economy grew by 9.4 per cent, higher than initial estimates and its trade surplus swelled to US $79.2 billion in the twelve months to June 2005. It is estimated that China's trade surplus will surge to D100.0 billion in 2005 compared to D30.0 billion in 2004. Some concerns were expressed over possible "overheating" of the Chinese economy with investment continuing to be the prime determinant of growth. China's investment rate, at 46.0 per cent of GDP, is the world's highest by far and has been rising fast, but its savings rate has been rising even faster. Between 2000-2004, China's national saving rate rose by an extraordinary 12.0 percentage points to 50.0 per cent of GDP. The country has kept its currency cheap and exported even more capital to the rest of the world.

In sub-Saharan Africa, growth prospects moderated somewhat mainly on account of sharp slowdown in Nigeria, where oil production is nearing capacity. The Committee applauded the commitment by the G8 to increase official development assistance by US $50.0 billion and aid to Africa by US $25.0 billion, but caution that aid is only effective if accompanied with sound macroeconomic policies, good political and economic governance, strong institutions and an effective public expenditure programme.

High and volatile global oil prices remain a significant and serious risk to the global economic outlook. The Committee observed that destabilizing effects of higher oil prices will be more impoverishing for the low income oil importing countries such as The Gambia, but judged that policy inertia and delays in adjusting prices would certainly raise the economic costs.

(2.0) Balance of Payments

The overall balance of payments is expected to be revised upwards reflecting better-than-expected inflows from private remittances and foreign direct investment (FDI). Returns on remittances from the banking sector indicate that gross remittances would exceed the initial projection of D494.8 million in 2005.

To ensure a more accurate and reliable data, the Bank intends to carry out a comprehensive survey in the fourth quarter of 2005 to capture data on all items in the current account of the BOP from source. Should the proposal submitted to the Department for International Development (DFID) and Development Finance International (DFI) of the UK for a repeat of the census on private capital flows be approved, the Bank would obtain better quality data on FDI, portfolio investment and other investment as well as determine the international investment position (IIP) for The Gambia.

(3.0) Foreign Exchange Developments

Owing to tight monetary conditions and increased foreign inflows, the Dalasi appreciated against all the major currencies in Q2, 2005 relative to Q1, 2005. The Dalasi rose by 6.4 per cent, 3.8 per cent and 8.7 per cent against the Pound Sterling, US dollar and Euro respectively. The Dalasi also strengthened against the Pound Sterling, US dollar and Euro by 5.5 per cent, 6.4 per cent and 5.3 per cent from a year ago respectively.

Looking ahead, on balance, and barring unexpected external shocks, the Committee expects the Dalasi to continue to strengthen against all the major currencies in the remainder of 2005 underpinned by improved economic fundamentals and increased private inflows and tight, albeit easing monetary conditions.

The Committee noted that although combined purchases and sales of foreign currencies was lower in Q2, 2005 compared to Q1, 2005, this did not in any way reflect a decline in foreign inflows. Rather, it was as a result of the fact that the Central Bank participated little in the inter-bank foreign exchange market. Central Bank combined purchases and sales amounted to D158.0 million in Q2, 2005 compared to D357.2 million in Q1, 2005.

(4.0) Fiscal Developments

Revenue and grants totaled D1.4 billion in the first 6 months of 2005 compared to D1.7 billion in the corresponding period in 2004. Domestic revenue comprising tax and non-tax revenue rose to D1.34 billion, or 2.7 per cent from the corresponding period in 2004.

Tax revenue amounted to D1.17 billion compared to D1.18 billion in the corresponding period the previous year. The lower-than-expected tax intake was as a consequence of 11.2 per cent and 13.6 per cent decrease in taxes on international trade and petroleum taxes respectively. Non-tax revenue rose to D165.4 million, or 31.4 per cent from the corresponding period in 2004.

Total expenditure and net lending declined to D1.9 billion, or 6.4 per cent from the corresponding period in 2004. This was mainly as a result of the significant decline in capital expenditure from D1.0 billion in the first half of 2004 to D469.5 million during the period under review.

The Committee decried the decrease in the basic primary surplus as a percentage of GDP from 6.4 per cent in the first 6 months of 2004 to 5.0 per cent in the first half of 2004. The implication is that in a decreasing primary surplus, Government would have to continue to borrow to service the existing debt. In point of fact, the 2005 budget estimated net borrowing of D370.0 million, but actual borrowing from January-August 16, 2005 amounted to D700.1 million

On the issue of public sector debt, it was observed that some of the parastatals have persistently failed to honor their obligations to Government. It was also posited while this may be true, a good number of parastatals are a drain on the Government budget simply because they are insolvent and thus highlights the urgent need to give impetus to privatization programme. Privatization should be seen in the context of a comprehensive structural reform programme necessary for high and sustained economic growth and poverty reduction.

(5.0) Money Market Developments

As at end-August 2005, the outstanding stock of interest bearing debt rose to D5.3 billion, or 15.0 per cent from end-December 2004 and 35.0 per cent from a year ago. Treasury bills accounted for about 76.0 per cent of the interest bearing debt.

The Committee observed that though the increase in the debt stock has slowed owing primarily to the reduction in supply, more needs to be done to reduce the stock to a sustainable level, including substantially reducing the budget deficit and by extension the public sector borrowing requirement (PSBR).

(6.0) Monetary Developments

Broad money growth slowed to 16.2 per cent in the twelve months to end-June 2005 compared to 28.2 per cent a year ago. Although both components of money supply increased, quasi money grew at a faster pace consistent with the current benign macroeconomic environment.

Narrow money, reflecting current pressures in the economy, grew by 8.8 per cent while quasi-money rose by 26.9 per cent. Correspondingly, the share of quasi-money to broad money rose from 40.8 per cent at end-June 2004 to 44.6 per cent in June 2005.

The major monetary development was the growth in private sector credit by 28.6 per cent after bouts of contraction over the past 18 months. This partly reflected the decrease in net claims on Government by the banking system but mainly to the decline in interest rates. The Committee drew a degree of comfort from the signs of acceleration in private sector lending, which should bode well for growth. However, there were concerns that a sustained high growth in credit may be a recipe for the emergence of inflationary pressures.

A noticeable development in the credit market was the 98.8 per cent increase in personal loans in the year to end-June 2005. This was found consistent with the fact that given the sensitivity of household credit to interest rates, the decline in rates may have caused increased borrowing.

Lending to distributive trade also rose by 11.0 per cent, but its share of the credit market fell to 26.1 per cent compared to 32.3 per cent for personal loans. The rationale for the measured expansion in lending to the trade sector was that importers and retailers tend to borrow less in the second quarter when economic activity is at a low ebb.

Reserve money, the Bank's operating target, grew by 11.3 per cent mainly on account of 29.5 per cent increase in the net foreign assets (NFA) of the Central

Bank. Gross official reserves of the Central Bank rose by 8.5 per cent to D2.6 billion, while foreign liabilities decreased to D632.0 million, or 27.5 from a year ago.

The fact that reserve money grew by 0.9 per cent in the 6 months to end-June 2005 and was below target by D76.04 million suggest that monetary conditions remain tight and this has spilled over into rapid deceleration in inflationary pressures.

(7.0) Real Sector

Various indicators suggest that robust growth in GDP of at least 5.0 per cent in 2005. The major factors include expected strong growth of the agricultural sector reflecting plentiful and well distributed rainfall, expansion of the tourism sector and re-exports as well as increased consumer spending reflecting gains in real income and the effects of declining trend in interest rates.

The growth of the manufacturing sector of 5.7 per cent in 2005 compared to an average of 2.3 between 1999-2003 is expected to be sustained. The sector is to benefit from increased domestic demand, but more fundamentally from depreciation of the real effective exchange rate of the Dalasi which has made domestically manufactured goods competitive vis-à-vis foreign goods.

The Committee noted that the economic growth trajectory could be much higher if the structural bottlenecks stifling the economy are removed. For example, energy-related costs constraint faster development of the manufacturing sector.

(8.0) Financial Stability

The banking industry remains sound and vibrant. The industry is well capitalized, with an average capital adequacy ratio of 57.5 per cent in June 2005 compared to 26.1 per cent in June 2004. Capital and reserves rose from D783.2 million in March 2005 to D804.6 million in June 2005 as banks take necessary steps to meet the new minimum capital of D60.0 million.

Total industry assets rose to D6.95 billion in June 2005, reflecting an increase of only 0.1 per cent from end-March 2005 and 17.9 per cent over end-June 2004. Gross loans and advances, accounting for 25.4 per cent of totals assets, increased to D1.84 billion, or 7.1 per cent from end-March 2005 and 25.1 per cent over end-June 2004. Non-performing loans (NPL) amounted to D169.5 million, or 9.2 per cent of total assets. This is an improvement over the 10.4 per cent in March 2005 and 10.6 per cent in June 2004. Actual provisioning (D135.6 million) exceeded the minimum required provisioning (D112.5 million).

All the banks posted positive net income in the second quarter of 2005. However, cumulative industry profit after tax decreased to D59.5 million, or 9.7 per cent from March 2004. Reflecting strong growth in private sector credit interest income from loans increased by 11.5 per cent from March 2005 and 18.0 per cent over June 2004. In marked contrast, interest income from investments decreased from D89.8 million in March 2005 to D81.7 million in June 2005 owing to the decline in the Treasury bill yields.

Although the fundamentals of the banking sector are strong, the contention was that the regulatory authorities should not waver in ensuring that only banks that meet the minimum capital requirement are allowed to operate when the requirement comes into effect in March 31, 2006.

(9.0) Inflation

End-period inflation, measured by the consumer price index of low income population of Banjul and Kombo St Mary area, declined from 15.8 per cent in June 2004 to 2.3 per cent at end-June 2005. Average inflation(12 months moving average) was 8.1 per cent compared to 17.5 per cent a year earlier.

Food consumer price inflation declined to 2.5 per cent compared to 18.0 per cent in June 2004. Non-food prices also decelerated to 1.9 per cent relative to 11.0 per cent in June 2004.

Core inflation 1, which excludes energy prices from headline inflation decreased from 13.7 per cent in June 2004 to 1.8 per cent in June 2005. Core inflation 2, which strips out prices of energy and volatile food items rose by only 1.3 per cent in June 2005 compared to 7.6 per cent a year ago.

(10.1) Prospects for Inflation

Robust expansion in world trade continued into the first half of 2005, though not as strong as the expansion in 2004. Non-fuel commodity prices seem to have stabilized due to moderating global demand and easier supply conditions. Global headline inflation, despite a pick-up due to higher oil prices, has remained at moderate levels, particularly in industrial countries. Pressures on domestic prices were more evident in emerging market economies where the impact of rising oil price is posing a serious risk of inflationary spiral and heightened inflationary expectations, with attendant pressures on monetary policy.

Recent data indicate that price and cost pressures in The Gambia remained benign, with end-period inflation most likely not to exceed 2.0 per cent at end-December 2005. The Dalasi is expected to remain stable consequent of increased foreign inflows and prevailing tight monetary conditions.

Growth in money supply, which decelerated from 28.2 per cent in June 2004 to 16.2 per cent in June 2005, is projected to ease to 10.0 per cent in December 2005. In the 6 months to end-June 2005, reserve money and broad money grew by only 0.9 per cent and 6.5 per cent respectively.

(11.0) Decision

Against this backdrop and in the light of latest inflation projections, the Committee judged that an immediate easing of policy was appropriate. The rediscount rate, the policy rate, was reduced by 4.0 percentage points to 21.0 per cent. The MPC would continue to monitor the situation and if the outlook changes, the Committee would review its stance.