OVERVIEW

Monetary Policy in the third quarter of 2005 continues to follow a prudent course to ensure deceleration in inflationary pressures, entrench exchange rate stability and support Government's economic policy of sustained economic growth and poverty reduction.

Growth in money supply accelerated to 20.1 percent in the year to the third quarter compared to 16.1 percent a year earlier. However money supply grew by 6.9 percent from end - December 2004, lower than the programmed target 7.0 percent.

Reserve money, the Bank's operating target, grew by 24.1 percent, higher than the growth rate of 17.3 percent in the previous year. However, reserve money rose by only 6.4 percent over end-December 2004, lower than the target of 11.0 percent.

The liquid assets of commercial banks decreased to D2.2 billion, or 4.6 percent from the corresponding quarter of 2004 due mainly to Central Bank intervention in the foreign exchange market. Notwithstanding, commercial banks', excess liquidity as a percentage of the statutory requirement was 69.0 percent, albeit down from 119.0 percent a year ago.

Reflecting in the main prudent implementation of monetary policies, sustained stability of the Dalasi and plentiful rainfall which boosted agricultural production, end-period inflation, measured by the consumer price index (CPI) of low income population of Banjul and Kombo St. Mary area, declined from 12.3 percent in September 2004 to 2.1 percent at end September 2005. Average inflation rate (12 months moving average) was 4.9 percent compared to 16.2 percent a year earlier.

Food consumer price inflation declined to 1.2 percent compared to 14.2 percent in September 2004. Non-food consumer prices also decelerated to 1.9 percent relative to 8.3 percent at end-September 2004.

Core inflation, which excludes prices of energy and utilities and volatile food items declined from 4.7 percent in September 2004 to 1.9 percent in September 2005.

Fiscal policy was aimed at entrenching macroeconomic stability and increasing public savings for higher levels of investment and economic growth.

In the first three quarters of 2005, total revenue and grants decreased significantly to D1.8 billion, or 21.6 percent from the corresponding period in 2004. Domestic revenue declined to D1.7 billion, or 6.7 percent attributed to lower-than projected tax revenue while grants fell to D101.8 million, or 79.1 percent solely attributed to the decrease in project related grants.

Total expenditure and net lending decreased to D2.3 billion, or 12.2 percent on account of reduced capital expenditure. As a percentage of GDP, total expenditure and net lending declined significantly to 17.6 percent from 21.7 percent in 2004.

The primary balance registered a surplus of D799.6 million (6.0 percent of GDP) compared to D1.07 billion (8.6 percent of GDP) in the corresponding period in 2004.

The overall budget deficit on cash basis and including grants amounting to D320.5 million was financed entirely from non-bank domestic sources. There was a net repayment to the domestic banking sector and external creditors amounting to D36.3 million and D2.3 million respectively.

Owing to tight, albeit easing monetary conditions, increased inflows from foreign direct investment (FDI) and private remittances as well as improved macroeconomic fundamentals, the Dalasi appreciated against all the major currencies, but was unchanged against the US Dollar in Quarter 3, 2005 compared to Quarter 2, 2005.

Volume of transactions, that is, purchases and sales of foreign currencies in the interbank market declined to D1.32 billion in quarter 3, 2005, or 26.6 percent from quarter 2, 2005 reflecting the seasonal decline in re-exports and tourism related inflows. The US Dollar remained the most traded currency in the inter-bank market accounting for 60.0 percent of transactions followed by the Euro (22.7 percent) and Pound Sterling (15.6 percent).

PART I

MONETARY DEVELOPMENT

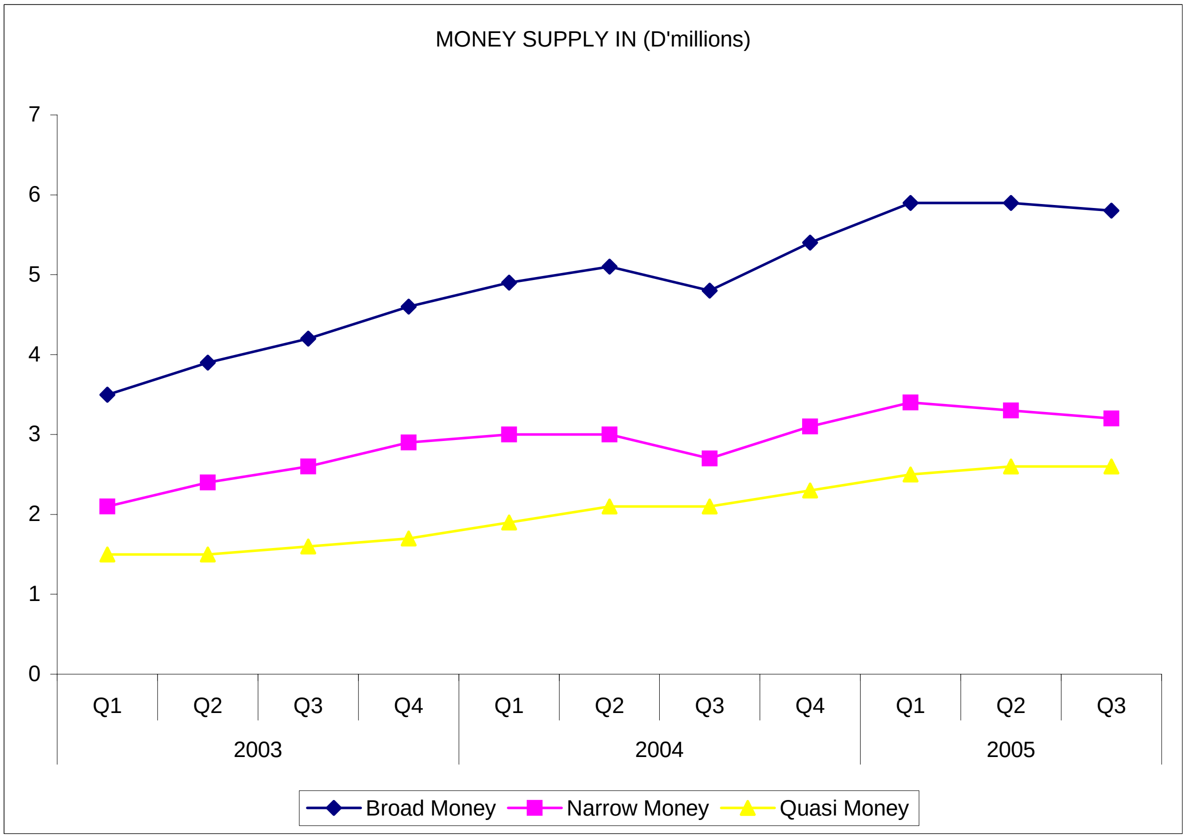
(1.0) Monetary Policy

Monetary policy in the third quarter of 2005 continues to follow a prudent course to ensure sustained deceleration in inflationary pressures, entrench exchange rate stability and support Government's economic policy of sustained economic growth and poverty reduction.

(2.0) Money Supply Growth

Growth in money supply accelerated to 20.1 per cent in the year to the third quarter of 2005 compared to 16.1 percent a year earlier. However, money supply grew by 6.9 percent compared to end-December 2004 and lower than the programmed target of 7.0 Percent. Both components of money supply increased, but quasi money grew at a faster pace.

Narrow money (M1), comprising currency outside banks and demand deposits increased to D3.2 billion, or 16.5 per cent from the pervious year. Currency outside banks and demand deposits rose by 4.6 per cent and 25.3 percent respectively. Compared to end-December 2004, currency outside banks contracted by 13.6 percent but demand deposits rose by 15.0 percent.



Quasi-money (time and savings deposits) rose to D2.6 billion, or 24.9 percent over the previous year. Savings and time deposits increased by 19.0 percent and 45.8 percent respectively. Quasi money rose by 13.6 percent from end-December 2004 with savings and time deposits increasing by 9.9 percent and 25.7 percent respectively.

(2.1) Factors Affecting Money Supply

(a) Net Foreign Assets (NFA)

The net foreign assets (NFA) of the banking system rose to D3.2 billion, or 8.8 per cent from the preceding year. This was mainly on account of the 20.9 percent increase in the NFA of the Central Bank to D2.0 billion. Gross official reserves rose to D2.6 billion, or 7.5 percent while foreign liabilities decreased to D0.6 billion, or 21.0 percent.

Table1: Monetary Survey in (D'millions)				
	Sept-04	% Δ	Sept-05	% Δ
Net Foreign Assets	2862.14	157.9	3112.68	8.8
Monetary Authorities	1654.92	1805.7	2001.52	20.9
Foreign assets	2434.87	175.5	2617.31	7.5
Foreign liabilities	779.95	-2.1	615.79	-21.0
Commercial banks	1207.22	18.0	1111.15	-8.0
Net Domestic Assets	1973.43	-35.4	2696.09	36.6
Domestic Credit	2855.17	-15.1	3327.42	16.5
Claims on Government, net	1098.44	-16.0	1247.08	9.2
Claims on Public Entities	321.70	-37.9	204.91	-36.3
Claims on Private Sector	1435.03	-6.8	1875.43	30.7
Other items, net	-881.74	-183.5	-631.33	28.4
o/w Revaluation account	-452.75	-24.1	311.53	168.8
Broad Money	4835.57	16.1	5808.77	20.1
Narrow Money	2721.48	6.6	3169.23	16.5
Quasi-Money	211.09	31.2	2639.54	24.9

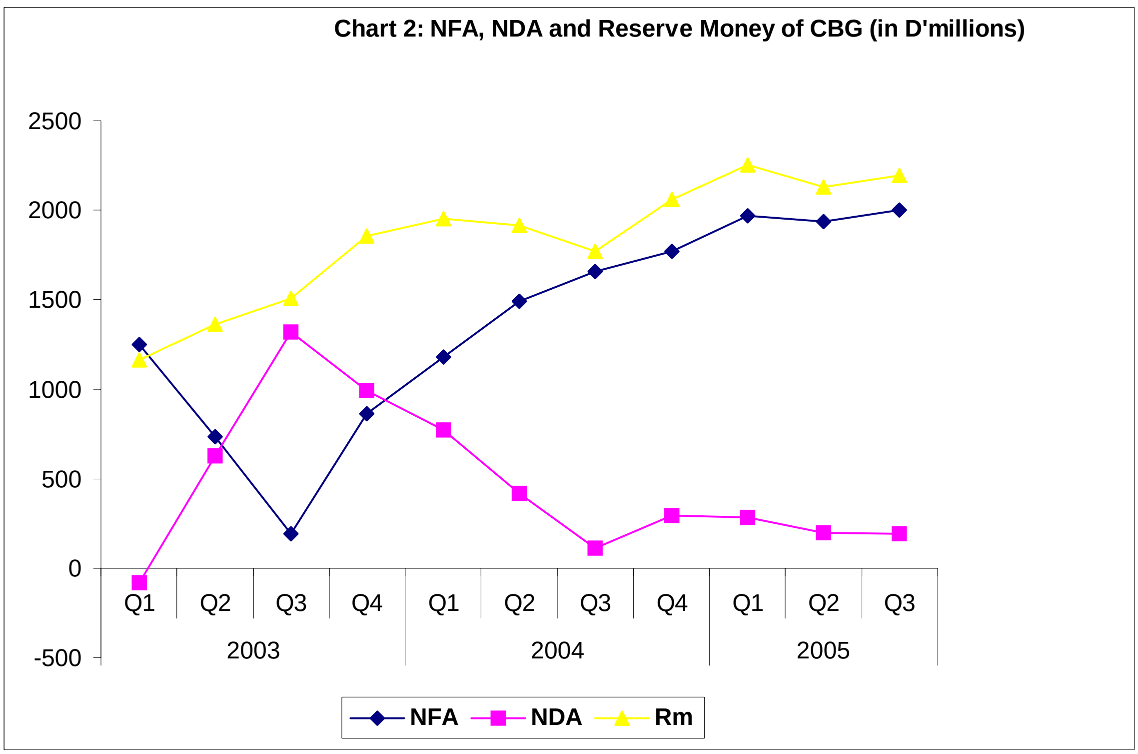
Deposit money banks' foreign assets decreased to D1.1 billion, or 9.4 percent. Their foreign liabilities also fell by 38.3 percent to D37.1 million. Accordingly, deposit money banks' net external position declined to D1.1 billion, or 8.0 percent over the previous year.

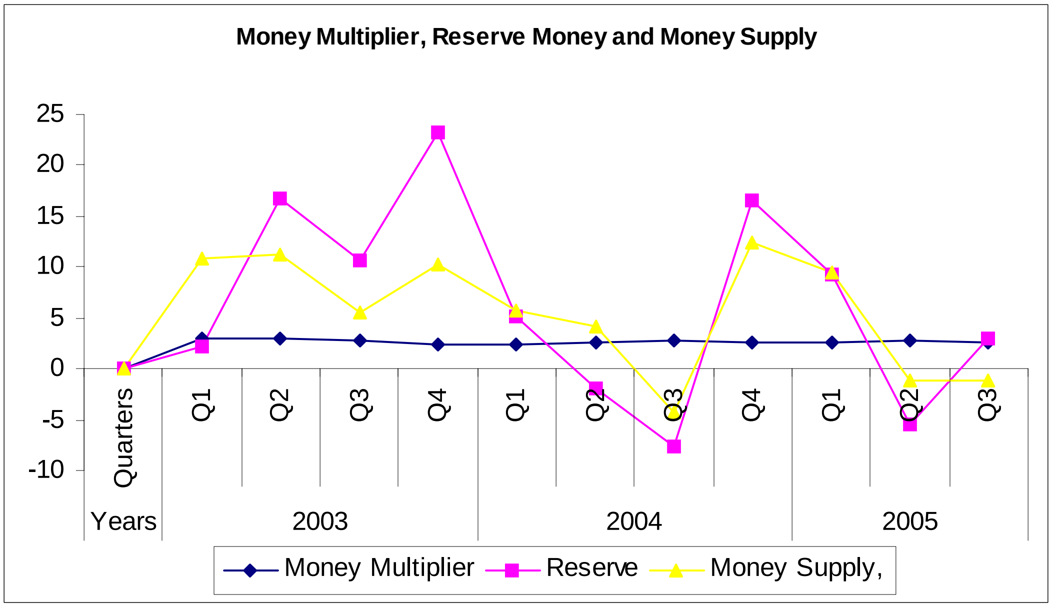
(b) **Net Domestic Assets (NDA)**

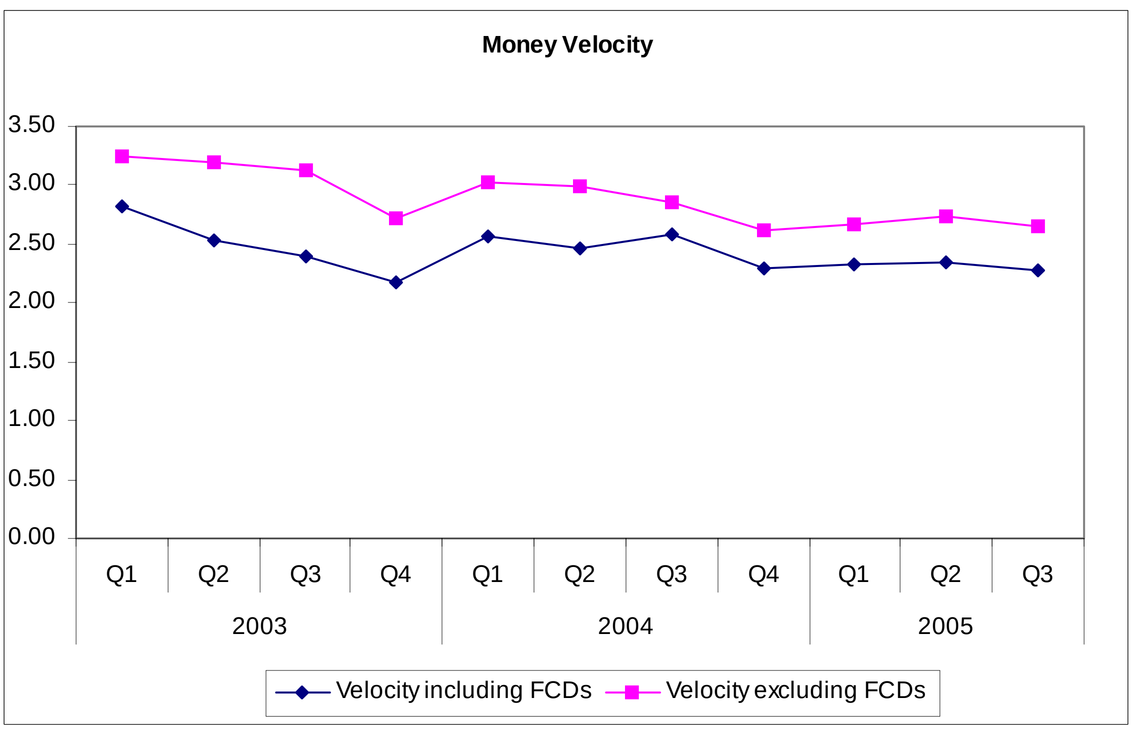
The NDA of the banking system rose to D2.7 billion, or 36.6 percent from the previous year. This was on account of 16.5 percent and 28.4 percent increase in domestic credit and other items (net) respectively. Credit to the private sector rose to D1.9 billion, or 30.7 percent while claims on public entities fell significantly by 36.3 percent to D204.9 million. Net claims on Government also rose by 9.2 percent to D1.2 billion, notwithstanding the 42.0 percent increase in Government deposits. Central Bank's net claims on Government surged to D1.3 billion, or 28.0 percent.

(3.0) Reserve Money Growth

Reserve money grew by 24.1 percent, higher than the growth rate of 17.3 percent in the previous year. However, reserve money rose by only 6.4 percent from end-December 2004, lower than the end-September programmed target of 11.0 percent.




Money Multiplier, Reserve Money and Money Supply
25
20
15
10
5
0
-5
-10
Quarters
Q1
Q2
Q3
Q4
Q1
Q2
Q3
Q4
Q1
Q2
Q3
Years
2003
2004
2005
Money Multiplier
Reserve
Money Supply,


Money Velocity
3.50
3.00
2.50
2.00
1.50
1.00
0.50
0.00
Q1
Q2
Q3
Q4
Q1
Q2
Q3
Q4
Q1
Q2
Q3
2003
2004
2005
Velocity including FCDs
Velocity excluding FCDs

4.0 Liquidity Position of Commercial Banks

In the third quarter of 2005, liquid assets of commercial banks decreased to D2.2 billion, or 4.6 percent from the corresponding quarter a year ago thanks mainly to Central Bank intervention in the foreign exchange market. However, commercial banks continued to maintain liquidity above the statutory requirement. As at end-September 2005, excess liquidity of commercial banks as a percentage of the statutory requirement was 69.0 per cent, down from 119.0 per cent a year ago.

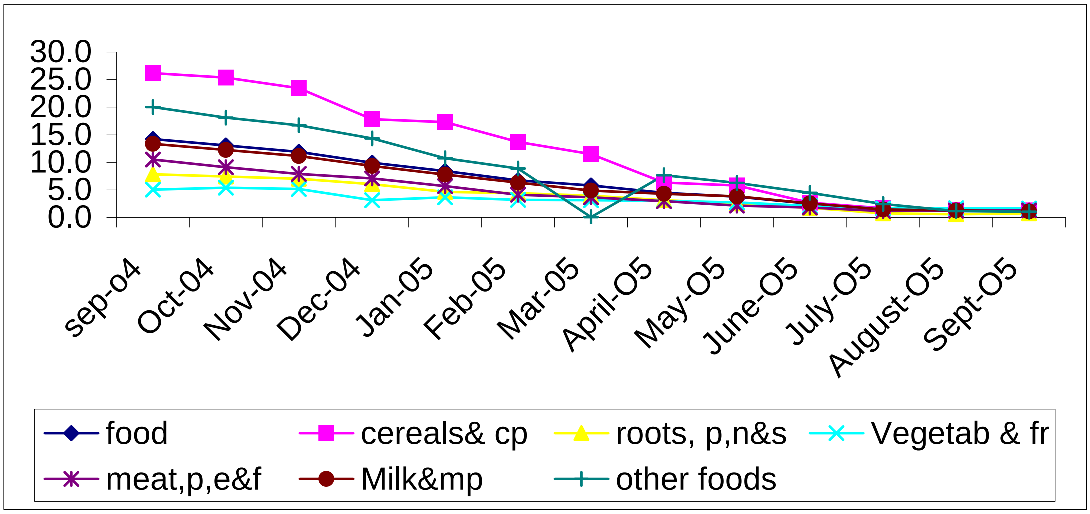
5.0 Inflation

5.1 Consumer Price Index (CPI)

End-period inflation, measured by the consumer price index (CPI) of low income population of Banjul and Kombo St Mary area, declined from 12.3 percent in September 2004 to 2.1 percent at end-September 2005. Average inflation rate (12 month moving average) was 4.9 percent compared to 16.2 percent a year earlier. The marked deceleration inflationary pressure is attributed in the main to the implementation of prudent monetary policies, sustained stability of the Dalasi and plentiful rainfall, which boosted agricultural production.

5.1.1 Food consumer price inflation declined to 1.2 percent compared to 14.2 percent in September 2004. Prices of all food sub-groups declined. ‘‘Cereals and cereal products’’, ‘‘ roots, pulses, nuts and seeds’’, ‘‘ vegetables and fruits’’, ‘‘meat, poultry, eggs and fish’’, ‘‘milk and milk products’’ and other foods consumer price inflation decelerated to 1.3 percent, 0.7 percent, 1.6 percent, 1.3 percent, 1.1 percent and 1.1 percent compared to 26.2 percent, 7.8 percent, 5.1 percent, 10.5 percent 13.3 percent and 20.0 percent respectively in the previous year.

Chart 1: Food Inflation September 04 – September 05



5.1.2 Non-food consumer price inflation declined to 1.9 percent compared to 8.3 percent at end-September 2004 as a result of the significant decline in the prices of ‘‘ housing’’, and ‘’fuel and light’’, to 0.0 percent and 3.3 percent compared to 13.2 percent and 22.1 percent respectively in the preceding year. On the other hand, consumer price inflation of ‘‘ clothing, textiles and footwear’’ and ‘‘miscellaneous items’’ rose to 2.7 percent and 5.0 percent compared to 2.1 percent and 2.6 percent at end-September 2004.

Chart 2: Non-Food Inflation September 04-September 05

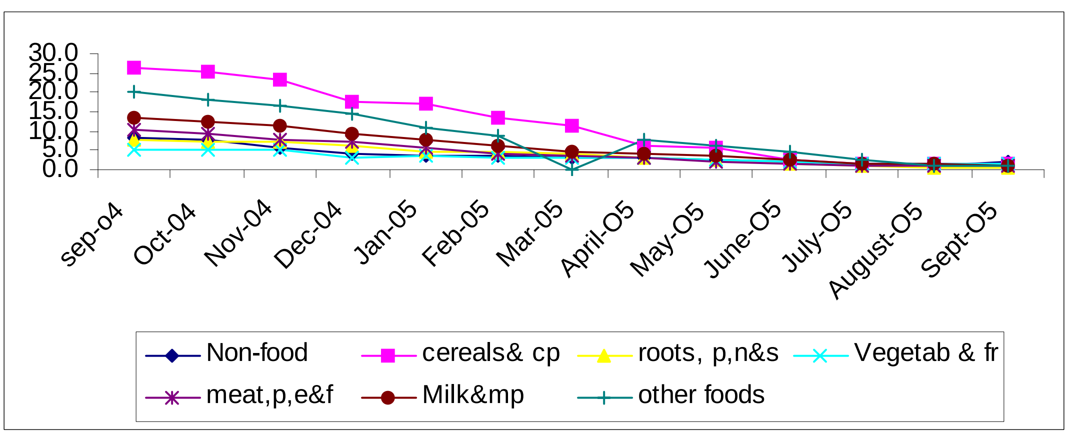
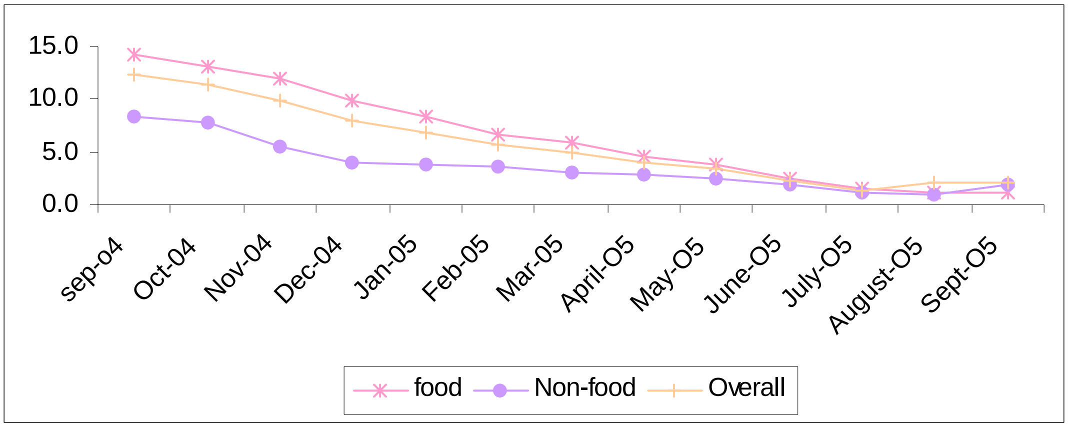


Chart 3: Inflation September 04- September 05



5.2 Core Measures of Inflation

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

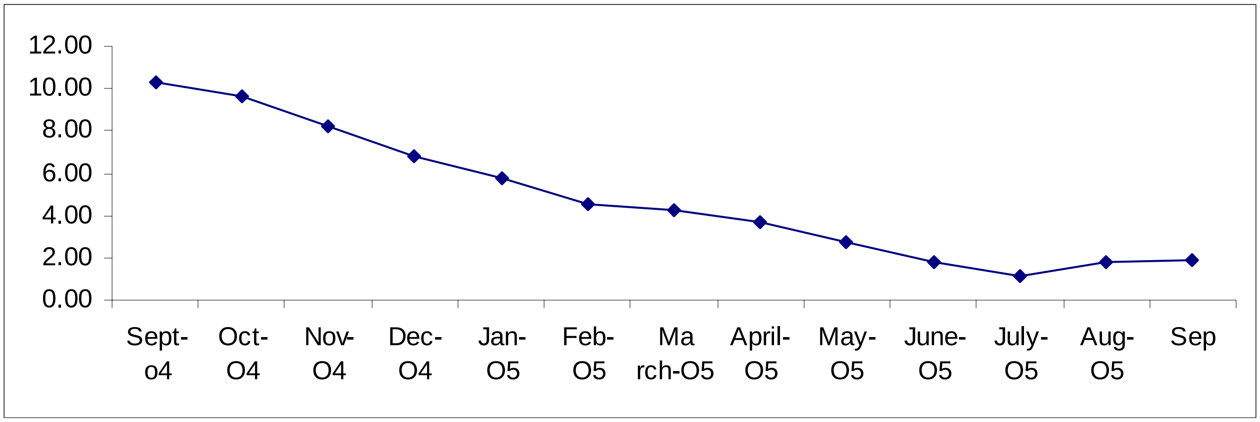
5.2.2 The so-called noise in headline inflation is striped out by excluding prices of energy and utilities (fuel, light and transportation) and volatile food items.

5.2.3 The first measure of core inflation (Core 1), which excludes energy prices (fuel, light and transportation) declined from 10.3 percent in September 2004 to 1.9 percent in September 2005.

Table 1: Core1 (excluding energy and transportation)

	Sep-o4	Oct-o4	Nov-o4	Dec-o4	Jan-05	Feb-05	Mar-05	Apir-05	May-05	Jun-05	Jul-05	Aug-05	Sep-05
Estimated core CPI	2254	2256	2257	2261	2263	2264	2265	2266	2267	2268	2270	2273	2297
yr.-on yr.-inflation rat	10.3 9.6	8.2	6.8	5.8	4.6	4.2	3.7	2.8	1.8	1.2		0.9	1.9

Chart 4: Core 1 Implied year-on-year inflation

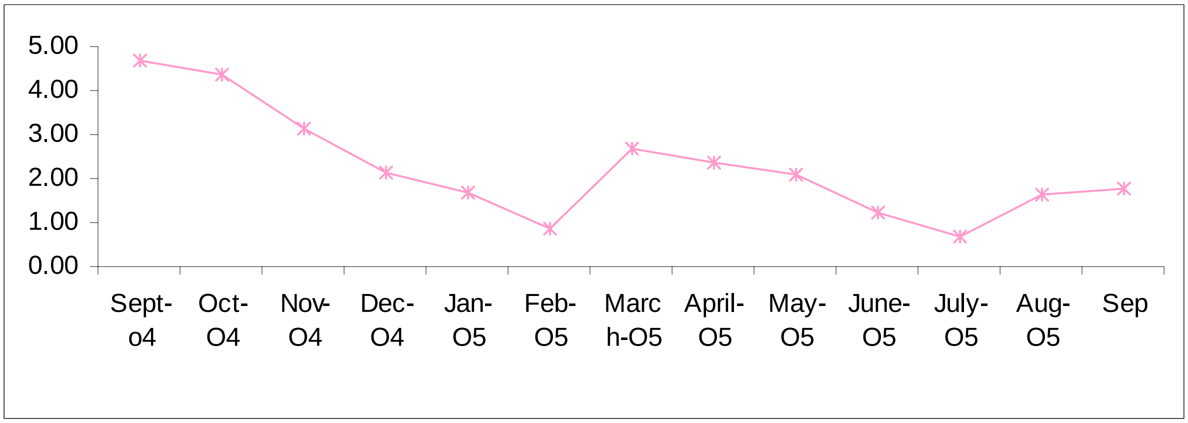


5.2.4 Core 2 which strips out prices of energy and utilities and volatile food items (‘‘ meat, poultry, eggs and fish’’, ‘‘tobacco and tobacco products’’, ‘‘cereals and cereal products’’, and ‘‘processed foods’’) also decelerated from 4.7 percent in September 2004 to 1.9 percent in September 2005.

Table 2: Core 2: (excluding prices of energy and volatile food items)

	Sep-o4	Oct-o4	Nov-o4	Dec-o4	Jan-05	Feb-05	Mar-05	Apr-05	may-05	June-05	Jul-05	Aug-05	Sep-05
Estimated core CPI	1092	1093	1093	1095	1096	1096	1097	1097	1097	1098	1098	1099	1111
yr-on-yr inflation	4.7	4.4	3.1	2.1	1.7	0.9	2.7	2.4	2.1	1.3	0.7	0.7	1.9

Chart 5: Core 2 Implied year-on-year inflation



6.0 FISCAL DEVELOPMENTS

Sound and sustainable fiscal policy promotes economic growth in many ways. Sustainable fiscal balance obviates the need to create money to finance public spending, resulting in low inflation, which in turn spurs economic activity. Low fiscal deficits also encourage the mobilization of savings for higher levels of investment, leading to higher economic growth.

The 2005 budget was based on the assumption of 4.5 per cent growth in real GDP, 5.0 per cent end-December inflation target, budget deficit (including grants) of 6.1 per cent of GDP and basic primary balance of 8.8 per cent of GDP.

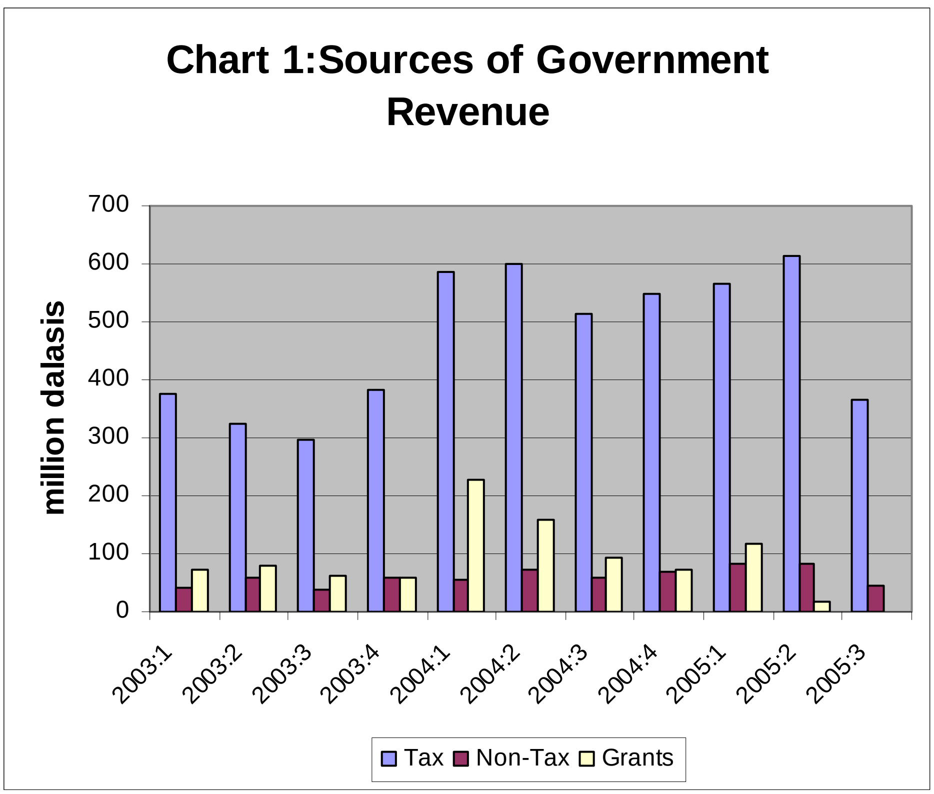
Total revenue and grants was projected at D3.0 billion (23.6 per cent of GDP), or a slight decrease of 0.03 per cent from 2004. Tax revenue was estimated at D2.4 billion (18.6 per cent of GDP), non-tax revenue at D405.4 million (3.1 per cent of GDP) and grants at D246.2 million, or 1.9 per cent of GDP.

The revenue targets were to be achieved through the broadening of the tax base, increase in customs duty on selected items and better tax administration, including the merging of Customs and Central Revenue Departments into a single Revenue Authority.

Total expenditure and net lending was budgeted at D3.7 billion (28.4 per cent of GDP). While current expenditure was projected to increase to D2.4 billion, or 18.9 per cent from 2004, capital expenditure was estimated at D1.2 billion compared to 1.7 billion in 2004 and net lending (D29.3 million), or 0.2 per cent of GDP.

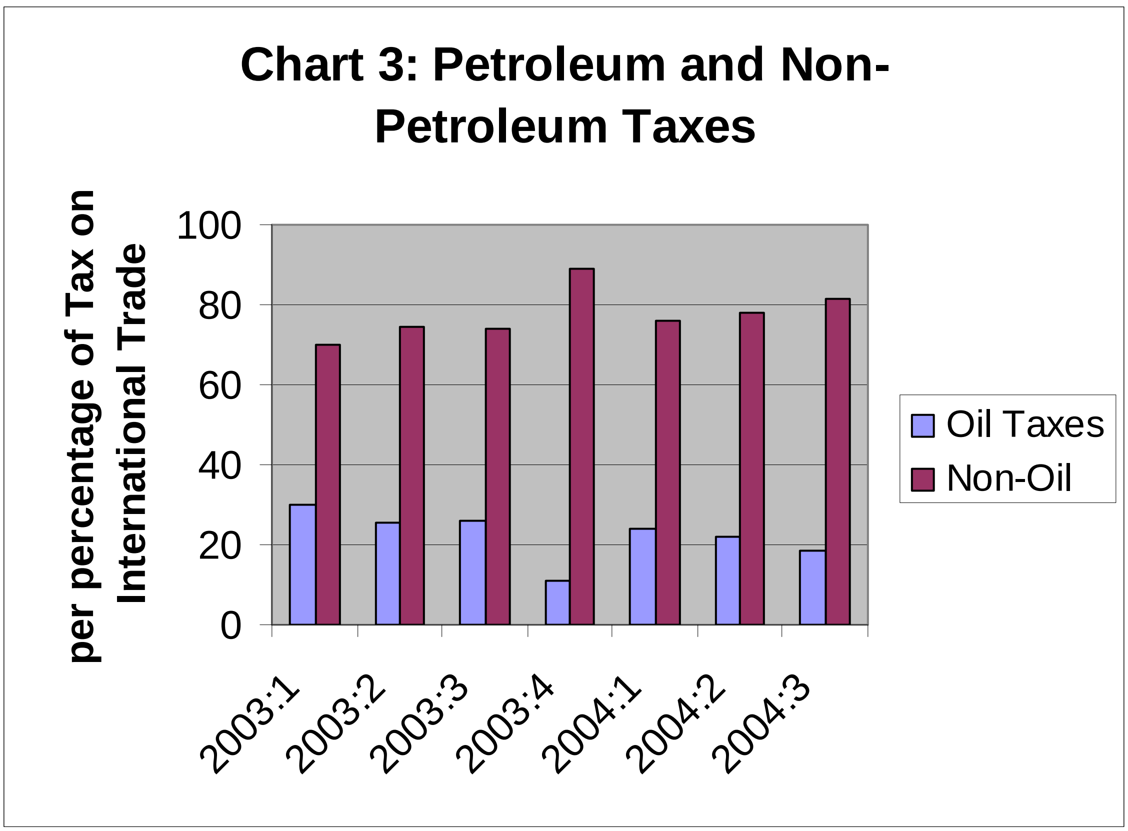
6.1 Total Revenue and Grants

In the first three quarters of 2005, total revenue and grants decreased significantly to D1.8 billion, or 21.6 per cent from the corresponding period in 2004. Domestic revenue declined to D1.7 billion, or 6.7 per cent attributed to lower-than-projected tax revenue.



Source: DoSFEA

Tax revenue declined to D1.5 billion, or 8.9 per cent. Both direct and indirect tax receipts decreased. Direct taxes, accounting for 29.2 per cent of tax revenue, declined to D451.3 million, or 7.2 per cent. Indirect taxes, constituting 70.8 per cent of total tax receipts, also fell to D1.09 billion, or 9.7 per cent mainly due to lower-than-envisaged tax receipts on international trade. Revenue from international trade, constituting 75.8 per cent of indirect taxes, decreased markedly to D828.6 million compared to D996.9 million in the first three quarters of 2004. Both duty and sales tax on non-oil imports declined by 25.3 per cent and 11.7 per cent to D316.6 million and D316.4 million respectively. Customs duty on petroleum products decreased by 31.7 per cent to D115.3 million while sales tax increased to D80.3 million, or 19.1 per cent.



Domestic tax on goods and services rose to D264.8 million, or 23.7 per cent owing primarily to 27.7 per cent increase in domestic sales tax. Excise duties also rose to D29.8 million, or 10.4 per cent, but revenue from stamp duty fell to D9.1 million, or 9.9 per cent.

Non-tax revenue, which includes government service charges, interest, dividends and property income, contribution to pension fund, non-tax revenues from Central Revenue

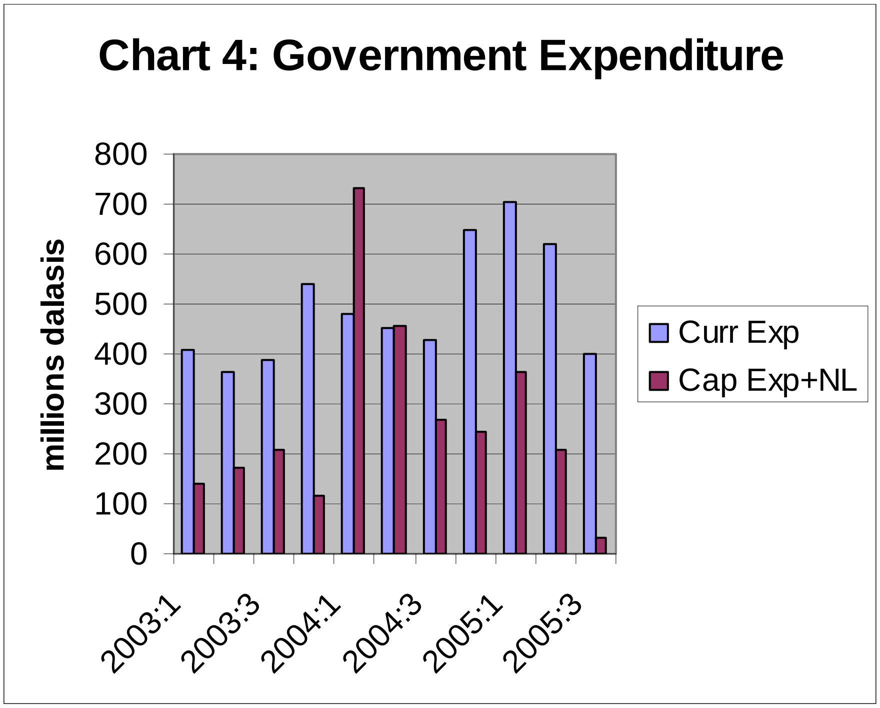
Department (CRD) and Customs and Excise Department (CED), increased to D210.6 million, or 14.5 per cent. CRD and CED jointly generated D81.1million in revenue. Government services and charges, interest, dividends and property income, contribution to the pension fund, all declined by 24.4 per cent, 53.6 per cent and 3.8 per cent respectively.

Grants fell to D101.8 million, or 79.1 per cent and was below the budgeted amount of D246.2 million solely attributed to the decrease in project-related grants. There were no programme and HIPC related grants in 2005 relative to D129.7 million in 2004.

6.2 Expenditure and Net Lending

Total expenditure and net lending decreased to D2.3 billion, or 12.2 per cent on account of reduced capital expenditure. As a percentage of GDP, total expenditure and net lending declined significantly to 17.6 per cent from 21.7 per cent in 2004.

Current expenditure, accounting for 74.4 per cent of total expenditure and net lending, increased to D1.7 billion against D1.3 billion in the first three quarters in 2004. Interest payments on domestic and external debts

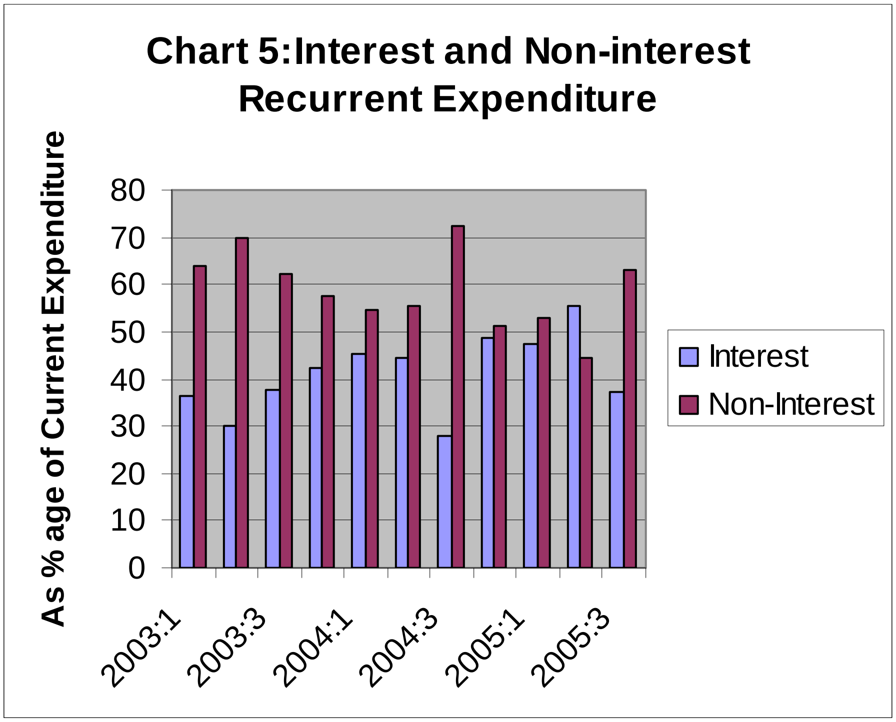


Source: DoSFEA

totaling D849.3 million accounted for the lion's share of current expenditure (48.3 per cent) compared to 39.6 per cent in the first nine months of 2004. Domestic interest payments increased to D630.1 million, or 65.1 per cent while external interest payments rose to D219.2 million, or 38.2 per cent.

Wages and salaries decreased to D355.9 million, or 6.2 per cent, reflecting in the main, repayments on "Tobaski''Advance. "Other charges" including expenditure on goods and services and subsidies and transfers surged to D552.1 million, or 39.2 per cent.

Net lending, that is, gross on-lending less repayments totaled negative D13.6 million. On-lending was zero while repayments totaled D13.6 million. In the corresponding period in 2004, net lending amounted to negative D11.6 million.

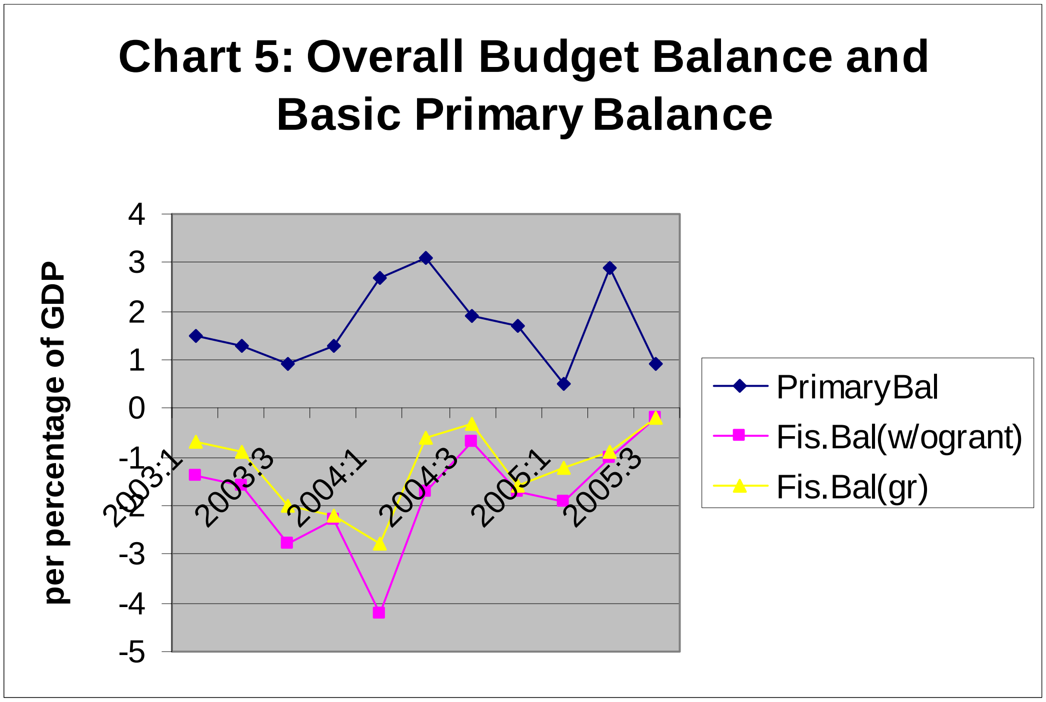


Source: DoSFEA

6.3 Primary or non-interest balance

The primary or non-interest deficit is measured by excluding interest payments from the conventional measure of the deficit. The balance indicates how recent fiscal actions of the Government affect the allocation of resources in the economy and Government debt.

The primary balance registered a surplus of D799.6 million (6.0 per cent of GDP) compared to D1.07 billion (8.6 per cent of GDP) in the corresponding period in 2004. The deterioration in domestic primary balance means that Government had to recourse to additional borrowing to service existing debt, thus increasing the debt stock as a percentage of GDP.



6.4 Overall Fiscal Balance

The overall budget deficit (commitment basis) excluding grants and with HIPC assistance contracted considerably to D606.9.0 million (4.5 per cent of GDP) compared to a deficit of D810.4 million (6.5 per cent of GDP) in the same period in 2004. Excluding grants and without HIPC II assistance, the budget deficit narrowed to D606.8 million compared to D688.9 million in the corresponding period in 2004. Including grants, however, the budget deficit worsened to D505.1 million against D323.2 million in the same period in 2004. Adjusted to cash basis, the overall fiscal deficit including grants was D321.3 million compared to D16.0 million in the first nine months of 2004.

The budget deficit on cash basis was financed entirely from domestic sources (D320.5 million). Domestic non-bank borrowing increased to D359.9 million, or 8.9 per cent. There was a net repayment to the domestic banking sector amounting to D36.3 million against a repayment of D859.5 million during the same period in 2004. There was also a net repayment of D2.3 million to external creditors.

7.0 FOREIGN EXCHANGE DEVELOPMENTS

7.1 Introduction

Owing to tight but easing monetary conditions, increased inflows from foreign direct investment (FDI) and private remittances as well as improved macroeconomic fundamentals, the Dalasi appreciated against all the major currencies, but was unchanged against the U.S Dollar in the Q3, 2005 compared to the Q2, 2005.

7.2 Volume of Transactions

Volume of transactions, that is, total purchases and sales of foreign currencies in the interbank market declined to D1.32 billion in Q3, 2005, or 26.6 per cent from Q2, 2005 reflecting the seasonal decline in re-exports and tourism related inflows.

Central Bank combined purchases and sales totaled D236.4 million in Q3, 2005 compared to D157.9 in Q2, 2005. Purchases amounted to D236.4 million and there were no sales.

Table 1: Volume of Transactions in the Inter-bank market in (millions of Dalasis)

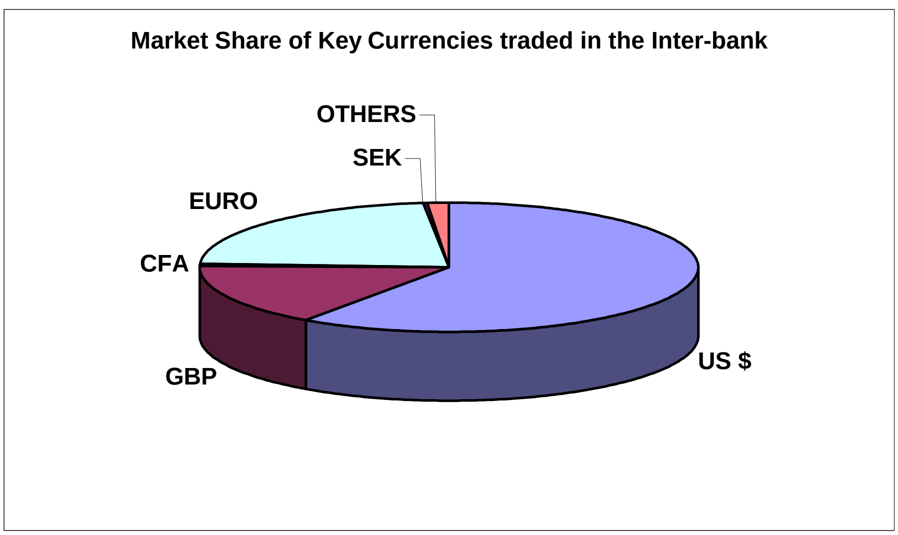
	2004			**2005**		
	Q2	**Q3**	**Q4**	**Q1**	**Q2**	**Q3**
Purchase	604.37	754.50	1068.60	1144.90	821.30	734.14
Sales	659.23	821.04	1073.64	900.69	977.46	586.21
Total	**1263.60**	**1585.54**	**2142.24**	**2045.59**	**1798.76**	**1320.35**

7.3 Market Share of Key Currencies

Table 1.2: Market share of Major Currencies Traded in the Inter-Bank Market

	2004			2005		
	Q2	**Q3**	**Q4**	**Q1**	**Q2**	**Q3**
U.S Dollar	68.6	54.2	62.8	55.5	60.3	60.0
Pound Sterling	15.6	20.8	18.0	20.8	18.3	15.6
CFA	0.7	0.8	0.2	0.6	1.5	0.5
EURO	12.8	22.0	15.0	19.8	18.4	22.7
SEK	0.7	0.5	1.2	1.2	0.4	0.3
Others	1.6	1.7	3.0	2.0	0.9	1.3

Figure 1: Average market share of key currencies in the inter-bank market as at end September 2005 (per cent)

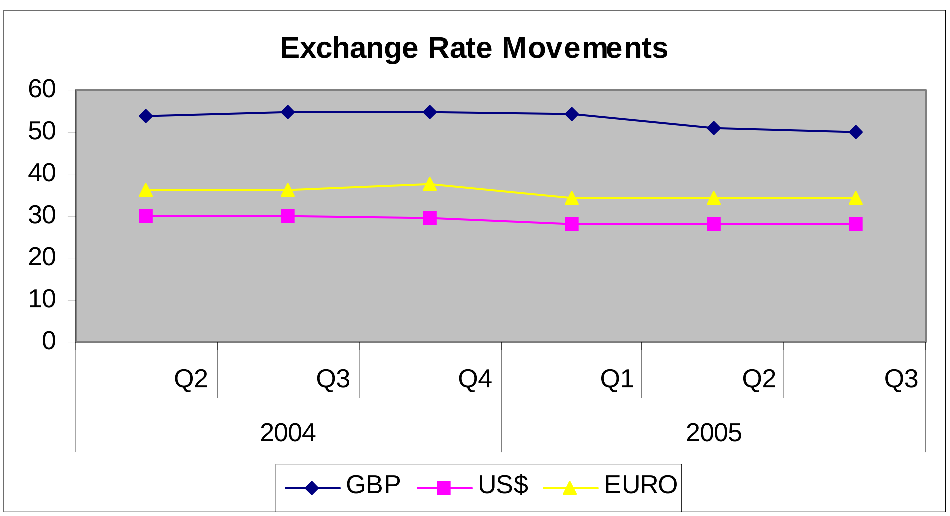


The U.S dollar remained the most traded currency in the inter-bank market, with a market share of 60.0 per cent compared to 60.2 per cent in Q2, 2005. The Pound Sterling market share was 15.6 per cent, lower than 18.3 per cent in Q2, 2005. The SEK and CFA recorded market shares of 0.3 per cent and 0.5 per cent compared to 0.4 percent and 1.52 per cent respectively in Q2, 2005. The market share of the Euro increased to 22.7 per cent compared to 18.5 percent in Q2 2005. Other currencies market share was 1.3 per cent compared to 0.9 per cent in Q2, 2005.

7.4 Exchange Rate Movements

Table 1.3: Exchange Rate Movements

2004	**GBP**	**USD**	**SEK**	**CFA**	**EURO**
Q2	53.7	30.1	391.5	260.8	36.1
Q3	54.7	30.0	385.9	269.7	36.0
Q4	54.7	29.7	409.9	281.8	37.7
2005	**GBP**	**USD**	**SEK**	**CFA**	**EURO**
Q1	54.3	28.1	371.0	271.7	34.2
Q2	50.8	28.1	371.0	271.7	34.2
Q3	50.2	28.2	354.5	249.6	34.2



The Dalasi appreciated against the GBP, USD, SEK, CFA and EURO by 7.13 per cent, 6.12 per cent, 8.15 per cent, 7.45 per cent and 5.52 per cent respectively from a year ago. The Dalasi also appreciated against all the major currencies except the U.S dollar relative to Q2, 2005. It strengthened against the Pound Sterling, SEK, CFA and Euro by 1.2 per cent, 4.4 per cent, 8.1 per cent and 0.1 per cent respectively but was unchanged against the US Dollar.

The Dalasi is expected to remain stable in the reminder of 2005 underpinned by inflows from tourism, remittances and FDI as well as improved macroeconomic conditions.

Other Developments

In July 2005 Leman Street Clinic, refurbished by Trust Bank Gambia Limited, to the tune of over D5 million was opened by the President of the Republic of the Gambia.

In August 2005, the Gambia Agricultural Marketing Company (GAMCO), unveiled a brand new milling plant at the former Gambia Produce Marketing Board (GPMB) deport near Denton Bridge. The plant, which cost U.S$2.1 million, has the capacity to mill 200 tons of groundnuts a day.

The Department for International Development (DFID) gave the Gambia Government a grant £2.9 million to support basic education.

In September 2005, Indian government donated a consignment of drugs worth D9.0 million to the Gambia through the Department of Health. Also, the Indian high Commissioner (designate) indicated the Government of India has decided to extend a line of credit of US$6.7 million, under the NEPAD programme, for a tractor assembling plant project in the Gambia.

PART II

DEVELOPMENTS IN THE INTERNATIONAL ECONOMY

Global Economic Outlook

World Output

Global GDP grew strongly in the third quarter of 2005 underpinned by robust expansion in the services sector, which more than offset the slowdown in global manufacturing output and trade. As a result of higher oil prices and two hurricanes in the United States, indicators point to reduced economic activity in major industrial countries, although global growth is expected to slightly exceed 4.0 percent in 2005.

In the US, GDP growth eased moderately but is expected to remain the highest in the G-7 underpinned by solid productivity growth, high employment and disposable incomes and greater housing wealth which helped boost household demand. Despite the havocs unleashed by hurricanes Katrina and Rita, the direct impact on GDP growth is expected to be moderate. The US current account deficit is projected to rise to over 6.0 percent of GDP in 2005, driven by higher oil prices and strong domestic demand.

According to figures released by the Office for National Statistics (ONS), the UK economy grew at an annual rate of 1.5 percent in the second quarter of 2005, its weakest since 1993. In the three months to June, GDP grew by 0.5 percent from to the previous quarter and consumer spending rose by only 0.4 percent. The UK Chancellor of the Exchequer indicated that the economy was unlikely to grow by the initial forecast of 3-3.5 percent as a result of higher oil prices. Meanwhile, UK trade deficit reached $10.0 billion in August 2005 due in part to the significant increase in insurance claims in the aftermath of hurricanes Katrina and Rita.

In the Euro area, growth remains disappointingly low reflecting weak domestic demand and pervasive structural rigidities. With the expansion expected to gain momentum in the second half of 2005, Euro area GDP is projected at 1.2 percent in 2005, rising to 1.8 percent in 2006. Domestic demand had been strong in Spain and France, but net exports have been negative. In Germany, the Euro area's largest economy, domestic demand has been relatively weaker although the economy benefited from strong net exports.

The Euro area's current account deficit narrowed to $10.3 billion in the 12 months to July while the fiscal deficit is projected to rise to 3.0 percent of GDP. Five countries – France, Germany, Greece, Italy and Portugal are expected to post budget deficits exceeding the 3.0 percent Growth and Stability Pact limit.

Growth in GDP in Japan gained traction rising sharply in the first half of the year. Recent data point to continued expansion in the remainder of the year underpinned by recovery in both consumption and business investment, strengthening labour market, high corporate profitability and abating deflationary pressures. GDP growth was 1.25 percent in the year to the third quarter and overall growth is projected at 2.0 percent in 2005 and 2006, with downside risks coming primarily from external factors. The consumer-spending index rose, indicating that households have become more optimistic. However, structural reforms to raise productivity and ensure greater domestic competition and labour market flexibility are needed to sustain economic growth.

In emerging Asia, growth continued to be led by China and India. In China, GDP grew by 9.5 percent in the third quarter underpinned by significant growth in industrial production. China's trade surplus totaled $93.1 billion in August 2005 with foreign reserves (excluding gold) estimated at $711.0 billion. However, high liquidity in the banking system may lead to an increase in the already high levels of credit and investment with the attendant inflationary pressures. Growth in India projected at 7.0 percent in 2005 is supported by the continued boom in the services sector, including information technology (IT) and rising industrial production. In the rest of the region, GDP growth is expected to pick up although much would depend on the rebound in IT and oil prices. In Singapore, GDP grew at an annualised rate of 3.2 percent in the three months to the third quarter and growth is projected at 3-3.5 percent in 2005.

After a strong rebound in 2004, GDP growth in Latin America has slowed, particularly in Brazil, where domestic demand declined in early 2005 in response to monetary tightening and political uncertainties. In Argentina, GDP growth accelerated to 10.1 percent in the year to the third quarter. Strong export growth and improved macroeconomic fundamentals should help sustain the regional expansion.

In the Middle East, revenue from oil exports continued to boost growth supported by improvements in external current account and fiscal positions. The major challenges confronting the region include effective coordination of fiscal and monetary policies to ensure that higher oil revenues translate into non-inflationary growth.

GDP growth in sub-saharan Africa has been revised downwards to 4.8 percent from 5.4 percent in 2004 reflecting sharp slowdown in Nigeria as oil production nears capacity. GDP growth in non-oil producing countries, though slowing, remains robust as the impact of high oil bills is partly offset by strong non-oil commodity prices. Growth is also supported by improved macroeconomic fundamentals, ongoing structural reforms, political stability in many countries and favourable weather conditions. The recent appreciation of the dollar against the euro, if sustained, should boost the non-oil commodity exports of the CFA zone.

Looking ahead, growth is projected at 5.9 percent in 2006, the strongest pace of expansion in sub-saharan Africa since the 1970s. However, with oil prices increasing at a faster rate than non-oil commodity prices, the risks to non-oil producing countries remain on the downside.

Inflation

Global inflation picked up in response to higher oil prices but remains subdued. Core inflation appears to be generally contained in industrial economies, inflationary expectations are well-anchored and wage increases moderate, although high oil prices still pose a risk. In emerging markets and developing countries, inflationary pressures accelerated at a stronger pace prompting the IMF to revise upwards the forecast for these regions in 2005. Oil exporting countries with large external surpluses run the risks of overheating while non-oil producing developing countries are impacted by higher oil prices.

In the UK, consumer price inflation (CPI) rose to 2.3 percent in July from 2.0 percent in June thanks to rising transport prices. Headline retail price inflation (RPI) which includes housing costs, was unchanged at 2.9 percent for the second month in July. Surging crude prices were the main drivers of inflation and the Bank of England warned that prices may rise above the Government's 2.0 percent target in coming months.

Consumer prices in the US increased by 0.5 percent in August, moving the year-on-year rate to 3.6 percent. Headline inflation dropped to around 3.0 percent in the first half of the year, reflecting higher prices for oil and other raw materials. Core inflation remained subdued at around 1.7 percent in the first half of the year.

Given sluggish domestic demand, inflationary pressures in the Euro area eased somewhat. While headline inflation remains above 2.0 percent, partly reflecting the impact of rising energy prices, core inflation slowed significantly. Unit labour costs are essentially flat and inflationary expectations remain generally well-anchored. Headline inflation is forecast to decline to 1.8 percent within the European Central Bank (ECB) target of close to but less than 2.0 percent.

In Japan, core CPI declined by 0.2 percent (year-on-year) in July and the GDP deflator fell by 0.9 percent in the second quarter of the year. The resurgence of deflation is a major concern causing the Bank of Japan to continue to maintain an accommodative monetary stance.

Commodity Prices

Oil prices exceeded $70.0 in September 2005 before decreasing slightly. Prices appear to be driven by expectations that the oil market would be tight in the future. The global economy is projected to grow at a robust pace and supplies are limited. Low spare capacity among oil producers, recent slowdown in non-OPEC production, limited upstream and downstream spare capacity and the recent damage caused by hurricane Katrina to the oil and gas infrastructure in the Gulf of Mexico, which accounts for nearly one-third of US crude oil domestic production, have limited the supply of crude products. Terrorism and insurgent attacks also remain a major risk to oil supplies. Oil prices rose markedly following the hurricane, but eased after the US Government offered to release oil from the Strategic Petroleum Reserves and an offer by Saudi Arabia to boost its daily output by 500,000 barrels per day. However, price differentials between light and heavy grades of oil remain high because of shortage of light crude oil and limited capacity to refine heavier grades of oil. With global demand for oil persistent, coupled with limited supply, price projections for 2005/06 have been raised upwards.

Non-oil commodity prices rose by 5.0 percent in US dollar terms (and 9 percent in SDR terms) during the first eight months of 2005 driven, in the main, by strong Chinese demand. The price indices of non-oil commodities are expected to moderate, increasing by an average 9.0 percent in 2005 as supply responds strongly to 2004 prices.

Metal prices rose by 9.0 percent since January as a result of increased demand from the construction and manufacturing sectors in China and the US but are expected to ease in 2006. The prices of iron ore, copper and uranium increased by 50.0 percent, 20.0 percent and 44.0 percent while beverage prices were unchanged.

Agricultural raw material prices fell by 1.0 percent in the first eight months of 2005 as supply outpaced global demand. Cotton prices rose by 5.0 percent owing to strong Chinese demand while the prices of rubber increased by 35.0 percent.

Interest Rates

The stance of monetary policy is a mixed bag reflecting different cyclical situations and growth performances. In both China and the US, the current pace of tightening appears appropriate, although rising investment in China would require a more robust increase in interest rates. In the Euro area, monetary policy has been unchanged and if the current recovery falters, the ECB may have to cut interest rates. Japan is currently fighting deflation and as a result the present accommodative stance is appropriate until the economy is back on its natural growth trajectory and deflation dissipates.

The US Federal Reserve raised short-term interest rates by 25 basis points for the 11th consecutive time, to 3.75 percent to proactively stem inflationary pressures that may rise as a result of higher and more volatile energy prices. In the UK, the Bank of England's rate-setting committee voted unanimously to keep interest rates steady at 4.5 percent reflecting the fact that the UK economy grew at a faster-than-expected rate in the second quarter and inflation and inflationary expectations remain subdued despite increase in oil and non-oil prices.