

# OVERVIEW

Qtr4, 2005

Monetary policy in Q4, 2005 continued to focus primarily on preserving macroeconomic stability and without prejudice to the price stability objective supporting Government's economic policy of sustained economic growth and poverty reduction.

Money supply grew by 13.1 per cent in 2005 compared to 18.3 per cent in 2004. The growth rate in money supply was, however, higher than the end-December 2005 programmed target of 9.4 per cent. Both components of money supply increased, but quasi money grew at a faster pace.

Compared to Q3, 2005, broad money increased by 5.8 per cent. Narrow money and quasi money rose by 4.8 per cent and 7.0 per cent respectively.

Regarding the factors affecting money supply, the net foreign assets (NFA) of the banking system declined slightly to D3.2 billion, or 0.7 per cent from 2004 mainly on account of 25.1 per cent decrease in the NFA of deposit money banks. In contrast, the net domestic assets (NDA) of the banking system rose to D3.0 billion, or 32.8 per cent reflecting 22.3 per cent and 16.2 per cent increase in domestic credit and other items (net) respectively.

The 5.2 per cent increase in the NFA of the Central Bank from Q3, 2005 was partly offset by 3.9 per cent contraction of the NFA of deposit money banks. The NDA of the banking system, on the other hand, increased by 10.2 per cent owing to strong growth of claims on public entities and Central Government.

Reserve money, the Bank's operating target, grew by 11.9 per cent, slightly higher than 11.0 per cent in 2004. However, reserve money growth was lower than the end-

December 2005 programmed target of 14.7 per cent. Reserve money increased by a modest 5.2 per cent over Q3, 2005.

The external debt stock decreased to D17.6 billion at end-December 2005, or 0.6 per cent from September 2005. However, the debt stock increased by 8.1 per cent from a year-ago.

The domestic debt, in contrast, increased to D3.8 billion, or 3.2 per cent from the preceding quarter. On an annualised basis, the debt rose by 20.4 per cent.

Total liquid assets of the commercial banks decreased to D2.1 billion, or 2.6 per cent from the previous quarter. However, banks continued to maintain liquidity levels in excess of the statutory requirement.

Total outstanding loans and advances decreased to D1.98 billion, or 1.5 per cent from the previous quarter. Lending to all sectors of the economy with the exception of distributive trade, personal loans and tourism increased.

Relative to the corresponding quarter of 2004 loans and advances increased by 22.8 per cent. Credit to the entire sectors rose with the exception of distributive trade and tourism, which fell by 4.1 per cent and 26.7 per cent respectively.

End-period inflation, measured by the consumer price index, declined from 8.0 per cent in December 2004 to 1.8 per cent at end-December 2005. Average inflation rate (12-month moving average) was 3.2 per cent compared to 14.2 per cent a-year-earlier.

Food consumer price inflation declined to 0.9 per cent compared to 9.9 per cent in December 2004. Non-food consumer prices also decelerated to 3.8 per cent compared to 3.9 per cent in December 2004.

Core inflation, which excludes prices of energy and volatile food items, also declined from 2.1 per cent in December 2004 to 1.6 per cent in December 2005.

Fiscal developments were characterised by increased domestic revenue and grants totalling D680.6 million in Q4, 2005 compared to D647.7 in Q3, 2005. Expenditure and net lending amounted to D840.4 million relative to D852.1 million in the previous quarter.

The overall budget deficit including grants amounted to D891.4 million in 2005, equivalent to 6.5 per cent of GDP, higher than the budget estimate of D662.6 million, or 4.5 per cent of GDP. However, the budget deficit excluding grants and without HIPC assistance amounted to D667.1 million, or 5.4 per cent of GDP.

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

Volume of transactions, that is, purchases and sales of foreign currencies in the inter-bank market totalled D6.7 billion in Q4, 2005 compared to D4.5 billion in Q3, 2005.

In 2005, the Dalasi appreciated against the Pound Sterling, Dollar and Euro by 0.8 per cent, 0.2 per cent and 1.3 per cent respectively, but depreciated slightly by 0.9 per cent against the CFA relative to 2004.

## **PART I**

### **DEVELOPMENTS IN THE DOMESTIC ECONOMY**

#### **(1.0) MONETARY DEVELOPMENTS**

Monetary policy in Q4, 2005 continued to focus primarily on preserving macroeconomic stability and without prejudice to the price stability objective supporting Government's economic policy of sustained economic growth and poverty reduction.

#### **(1.1) DETERMINANTS OF MONEY SUPPLY**

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

The net foreign assets (NFA) of the banking system declined slightly to D3.2 billion, or 0.7 per cent from the preceding year. This was mainly on account of the decline in the NFA of the deposit money banks by 25.1 per cent to D1.1 billion. Although foreign liabilities fell by 53.4 per cent, this was offset by 26.6 per cent decrease in foreign assets.

In contrast, the NFA of the Central Bank rose to D2.1 billion, or 19.1 per cent. Gross official reserves increase to D2.7 billion, or 9.9 per cent while foreign liabilities decrease to D639.4 million, or 12.2 per cent.

The NFA of the banking system increased by only 2.0 per cent from Q3, 2005. The 5.2 per cent increase in the NFA of the Central Bank was partly offset by 3.9 per cent contraction of the NFA of deposit money banks.

**Table1: Monetary Survey in (D'millions)**

	Dec-04	Per cent Δ	Dec-05	per cent Δ
<b>Net Foreign Assets</b>	3195.41	70.0	3174.28	-0.7
<b>Monetary Authorities</b>	1768.69	104.3	2105.93	19.1
Foreign assets	2497.06	29.1	2745.34	9.9
Foreign liabilities	728.37	-31.9	639.41	12.2
<b>Commercial banks</b>	1426.72	40.7	1068.36	-25.1
<b>Net Domestic Assets</b>	2236.55	-17.6	2970.91	32.8
<b>Domestic Credit</b>	2869.53	-22.6	3510.39	22.33
Claims on Government, net	1008.77	-32.5	1348.35	33.7
Claims on Public Entities	223.37	-34.8	259.76	16.3
Claims on Private Sector	1637.39	-12.5	1902.28	16.2
<b>Other items, net</b>	-632.98	163.6	-539.48	16.2
o/w Revaluation account	-442.19	17.5	324.16	173.3
<b>Broad Money</b>	5431.96	18.3	6145.19	13.1
Narrow Money	3107.62	8.2	3320.60	6.9
Quasi-Money	2324.34	35.1	2824.59	21.1

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

The NDA of the banking system rose to D3.0 billion, or 32.8 per cent from the previous year. This was on account of 22.3 per cent and 16.2 per cent increase in domestic credit and other items (net) respectively. Credit to private sector rose to D1.9 billion, or 16.2 per cent. Claims on public entities and net claims on Government also increased by 16.3 per cent and 33.7 per cent to D259.8 million and D1.3 billion respectively.

From Q3, 2005, the NDA of the banking system increased by 10.2 per cent. Domestic credit rose by 5.5 per cent reflecting in the main strong growth of claims on public entities (2.8 per cent) and Government (8.1 per cent).

## **(1.2) Factors Affecting Money Supply**

Money supply grew by 13.1 per cent in 2005 compared to 18.3 per cent a year earlier. However, the growth rate in money supply was higher than the end-December 2005 programmed target of 9.4 per cent. 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 D3.3 billion, or 6.9 per cent. Currency outside banks and demand deposits rose by 0.6 per cent and 12.1 per cent respectively. The ratio of narrow money (M1) to broad money (M2), however, declined from 57.2 per cent at end-December 2004 to 54.0 per cent in December 2005.

Quasi-money (time and savings deposits) rose to D2.8 billion, or 21.5 per cent. Savings and time deposits increased by 9.5 per cent and 61.4 per cent respectively. Correspondingly, the share of quasi-money to broad money rose from 42.8 per cent at end-December 2004 to 46.0 percent in December 2005.

Compared to Q3, 2005, broad money increased by 5.8 per cent. Both narrow money and quasi money rose by 4.8 per cent and 7.0 per cent respectively.

## **(1.3) Reserve Money**

During the year under review, policies were directed at preventing excessive liquidity that might result to a build up in inflationary pressures while at the same time providing enough liquidity to ensure sustained economic activity.

Reserve money grew by 11.9 per cent, slightly higher than 11.0 per cent in the previous year. However, reserve money growth was lower than the end-December programmed target of 14.7 per cent.

Reserve money increased by a modest 5.2 per cent over Q3, 2005. While currency in circulation rose strongly by 16.2 per cent, reserves of deposit money banks contracted by 11.7 per cent.

**Table 2: Summary Accounts of the Central Bank of The Gambia (D'millions)**

	Dec-04	per cent	Δ Dec-05	per cent Δ
<b>Net Foreign Assets</b>	1768.69	104.3	2105.93	19.1
<b>Foreign assets</b>	2497.06	29.1	2745.34	9.9
<b>Foreign liabilities</b>	728.37	-31.9	639.41	-12.2
<b>Net Domestic Assets</b>	292.04	-70.5	200.66	-31.3
<b>Domestic Credit</b>	195.86	-84.1	-29.24	-114.9
Claims on Government, net	-186.78	-122.2	-413.83	-121.6
Gross claims	1376.38	10.0	1270.76	-7.7
less Government deposits	1563.16	286.4	1684.59	7.8
Claims on Public Entities	136.91	0.0	136.91	0.0
Claims on Private Sector	212.11	-19.1	214.06	0.9
Claims on Deposit Money Banks, net	33.62	427.7	33.62	0.0
<b>Other items, net</b>	96.18	29.7	157.41	337.6
o/w Revaluation account	-442.19	17.5	324.16	173.3
<b>Reserve Money</b>	2060.73	11.0	2306.59	11.9
Currency in circulation (i.e issued)	1485.57	18.8	1537.55	3.5
Reserves of the commercial banks	575.16	-4.9	769.04	33.7

#### **(1.4) LIQUIDITY POSITION OF COMMERCIAL BANKS**

Total liquid assets of the commercial banks decreased to D2.1 billion, or 2.6 per cent from the previous quarter. The reserves of commercial banks, accounting for 68.3 per cent of total liquid assets, declined to D1.4 billion, or 3.7 per cent. While foreign cash holdings rose to D179.5 million, or 151.8 per cent, foreign bank balances fell to D415.5 million, or 16.3 per cent. On an annualized basis, liquid assets decreased, albeit by a marginal 0.6 per cent.

The required liquid assets of commercial banks, based on a statutory requirement of 30.0 per cent of total liabilities to the public, stood at D1.3 billion, same as in the previous quarter. Banks continued to maintain liquidity levels in excess of the statutory requirement. Excess liquidity amounted to D818.0 million, or 61.0 per cent of the requirement.

#### **(1.5) Sectoral Distribution of Deposit Money Banks' Credit**

Total outstanding commercial bank loans and advances decreased to D1.98 billion, or 1.5 per cent from the previous quarter. Lending to all sectors of the economy with the exception of distributive trade, personal loans and tourism increased.

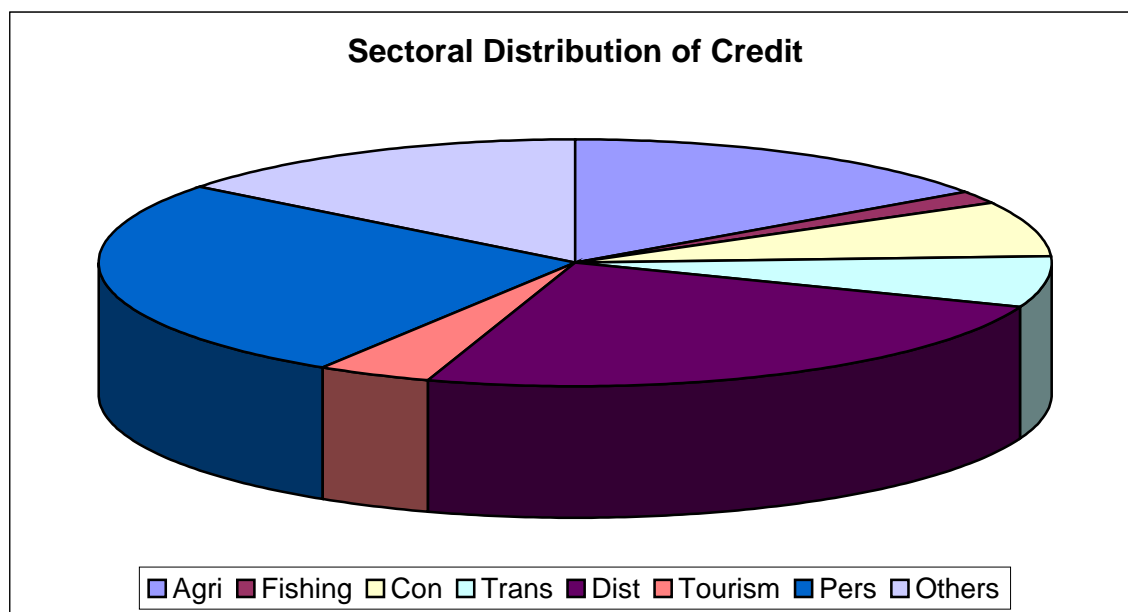
Credit to agriculture, fishing, construction and transportation and other (unclassified) sectors rose by 5.7 per cent, 90.0 per cent, 18.2 per cent, 9.7 per cent and 12.5 per cent to D301.0 million, D32.0 million, D144.4 million and D133.4 million respectively. In contrast, credit to distributive trade, tourism and personal loans decreased by 2.5 per cent, 41.3 per cent and 10.3 per cent to D478.7 million, D75.4 million and D533.9 million respectively.



**Table 3: Deposit Money Banks' Credit by Sector**

Sector	<i>Outstanding Credit (D'millions)</i>	Percentage Share	Percentage Quarterly Change	Percentage Annual Change
Agriculture	300.98	15.2	5.7	65.9
Fishing	31.97	1.6	90.0	91.9
Construction	144.38	7.3	18.2	62.1
Transportation	133.41	6.7	9.7	4.2
Distributive Trade	478.70	24.1	-2.5	-4.1
Tourism	75.44	3.8	-41.3	-26.7
Personal Loans	533.90	26.9	-10.3	45.3
Others	283.85	14.3	12.5	24.0
<b>Total</b>	<b>1982.63</b>	<b>100.0</b>	<b>-1.5</b>	<b>22.8</b>

**Chart 1: Sectoral Distribution of Credit**



Personal loans, distributive trade and agriculture constituted the largest share of total credit of 26.9 per cent, 24.1 per cent and 15.2 per cent respectively.

Relative to Q4, 2004 loans and advances increased by 22.8 per cent. Credit to all the sectors increased with the exception of distributive trade and tourism, which fell by 4.1 per cent and 26.7 per cent respectively.

## **(2.0) FOREIGN EXCHANGE DEVELOPMENTS**

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

### **(1.0) Volume of Transactions**

Volume of transactions, that is, total purchases and sales of foreign currencies in the inter-bank market amounted to D6.7 billion in the quarter under review compared to D4.5 billion in the previous quarter. Central Bank combined purchases amounted to D0.15 billion and there were no sales. For the year as a whole, trading volume increased to D22.6 billion, or 22.5 per cent from 2004, with Central Bank intervention totaling D0.92 billion.

**Table 4: Volume of Transactions in the Inter-bank market in (millions of Dalasis)**

	<b>2004</b>	<b>2005</b>			
	<b>Q4</b>	<b>Q1</b>	<b>Q2</b>	<b>Q3</b>	<b>Q4</b>
<b>Purchases</b>	2570.55	3364.81	2318.08	2293.04	3200.1
<b>Sales</b>	2364.2	3169.75	2670.01	2162.19	3471.1
<b>Total</b>	4934.75	6534.56	4988.09	4455.23	6671.2

### **(2.2) MARKET SHARE OF KEY CURRENCIES**

The Dollar continues to be the most traded currency in the inter-bank market; however, its market share decreased to 56.3 per cent in Q4, 2005 from 60.6 per cent in the previous quarter. The Pound Sterling's market share rose to 19.8 per cent from 14.3 per

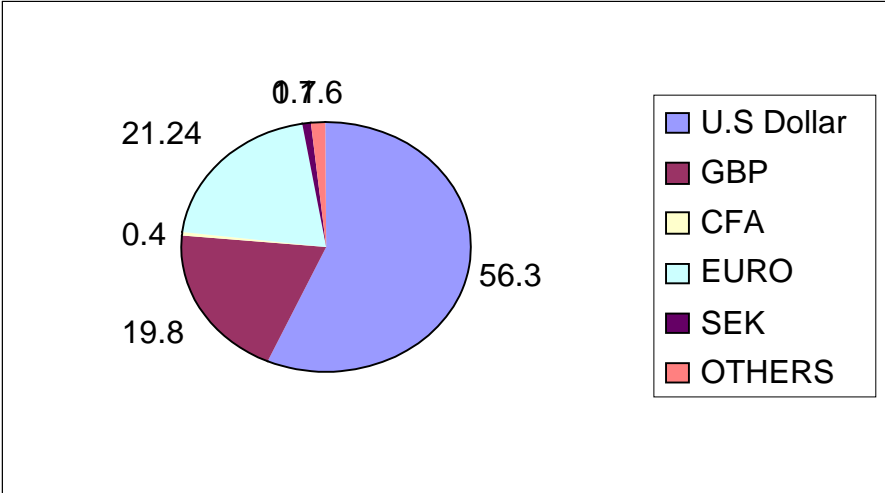
cent in the previous quarter. The Euro recorded a market share of 21.2 per cent, higher than 19.7 per cent in Q3, 2005. The CFA, SEK, and other currencies recorded market shares of 0.4 per cent, 0.7 per cent and 1.5 per cent against 0.6 per cent, 0.2 per cent and 1.4 per cent respectively in the previous quarter. Compared to the same quarter in 2004, the market share of the Pound Sterling and Euro increased, while that of the Dollar, CFA, SEK and other currencies declined.

*Table 5: Market share of Major Currencies Traded in the Inter-Bank*

*Market (Quarterly)*

	2004		2005			
	Q4	Q1	Q2	Q3	Q4	
USD	57.8	56.8	60.3	60.6	56.3	
Pound	19.1	17.5	18.9	14.3	19.8	
CFA	2.3	0.4	0.9	0.6	0.4	
EURO	18.9	22.3	18.1	19.7	21.2	
SEK	1.1	1.1	0.5	0.2	0.7	
Others	2.4	1.7	1.2	1.4	1.5	

**Figure 9: Average market share of key currencies in the inter-bank Market as at end December 2005 (per cent)**



### **(2.3) Exchange Rate Movements**

In 2005, the dalasi appreciated against all the major currencies in the inter-bank market relative to 2004. The Dalasi strengthened against the GBP, USD and Euro by 0.8 per cent, 0.2 per cent, and 1.3 per cent respectively, but depreciated slightly by 0.9 per cent against the CFA.

### **(3.0) INFLATION**

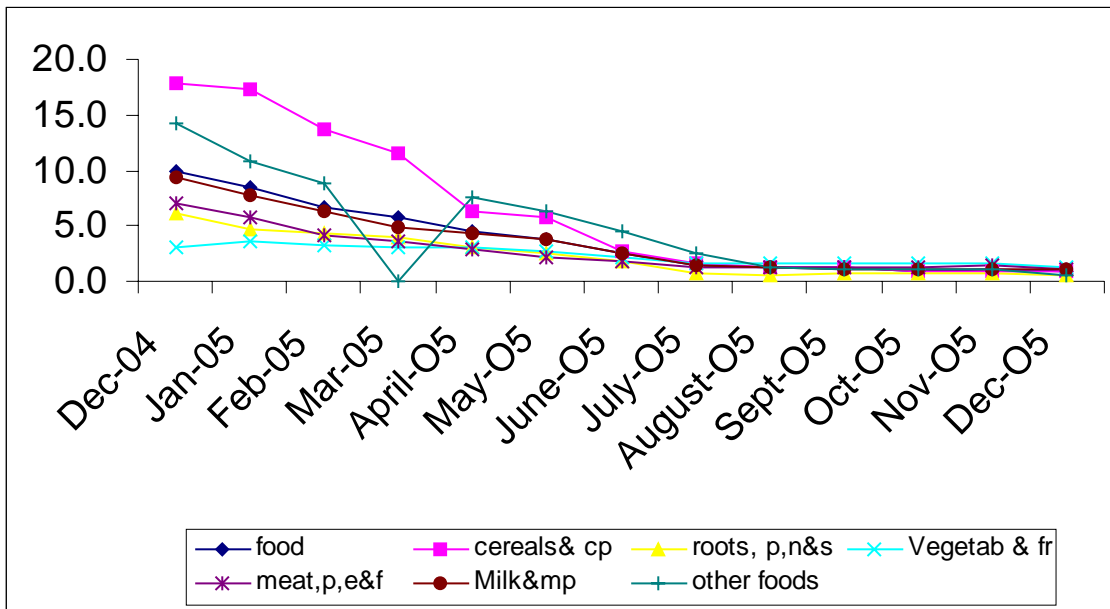
#### **(3.1) CONSUMER PRICE INDEX (CPI)**

End-period inflation, measured by the consumer price index of low income population of Banjul and Kombo St Mary area, declined from 8.0 per cent in December 2004 to 1.8 per cent at end-December 2005. Average inflation rate (12 month moving average) was 3.2 per cent compared to 14.2 per cent a year earlier.

#### **(3.2) FOOD CONSUMER PRICE INFLATION**

Food consumer price inflation declined to 0.9 per cent compared to 9.9 per cent in December 2004. Prices of all food sub-groups declined. "Cereals and cereal products", " roots, pulses, nuts and seeds", " vegetables and fruits", "meat, poultry, eggs and fish", "milk and milk products" and other foods consumer price inflation decelerated to 0.8 per cent, 0.6 per cent, 1.3 per cent, 1.1 per cent, 1.1 per cent and 0.6 per cent compared to 17.8 per cent, 6.1 per cent, 3.1 per cent, 7.1 per cent, 9.3 per cent and 14.3 per cent respectively in the previous year.

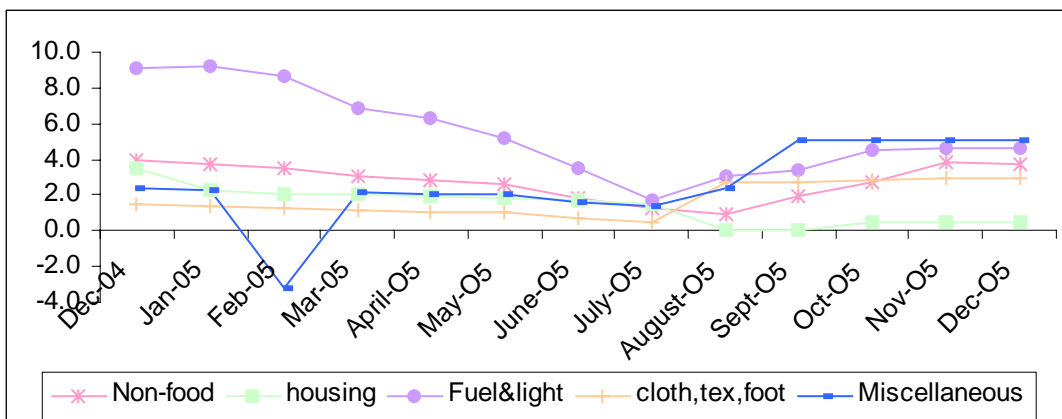
Chart 2: Food Inflation December 04– December 05



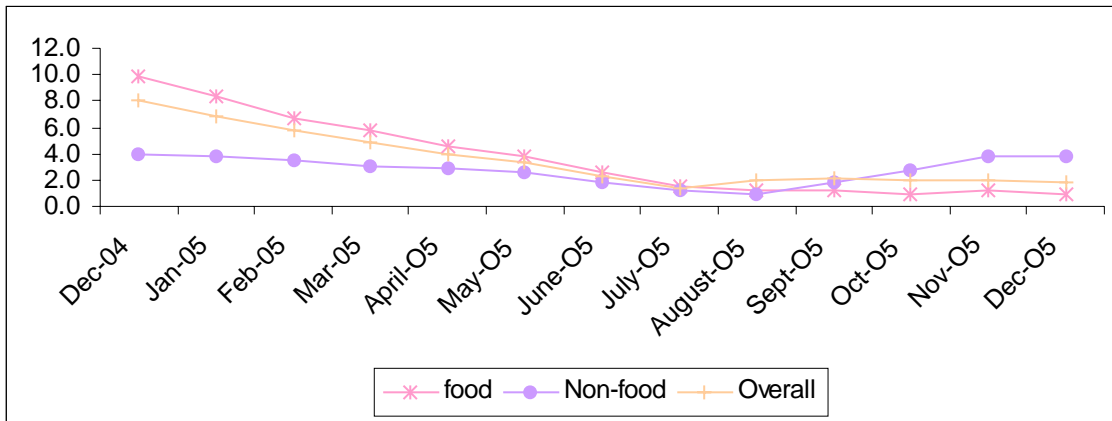
### (3.3) NON-FOOD CONSUMER PRICE INFLATION

Non-food consumer price inflation also decelerated to 3.8 per cent compared to 3.9 per cent at end-December 2004 as a result of the significant decline in the prices of ‘‘housing’’, and ‘‘fuel and light’’, to 0.5 per cent and 4.6 per cent compared to 3.4 per cent and 9.1 per cent respectively in December 2004. On the other hand, prices of ‘‘clothing, textiles and footwear’’ and ‘‘miscellaneous items’’ rose to 2.9 per cent and 5.0 per cent from 1.5 per cent and 2.4 per cent in December 2004.

Chart 3: Non-Food Inflation December 04-December 05



**Chart 4: Inflation December 04- December 05**



**(3.4) Core Measures of Inflation**

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

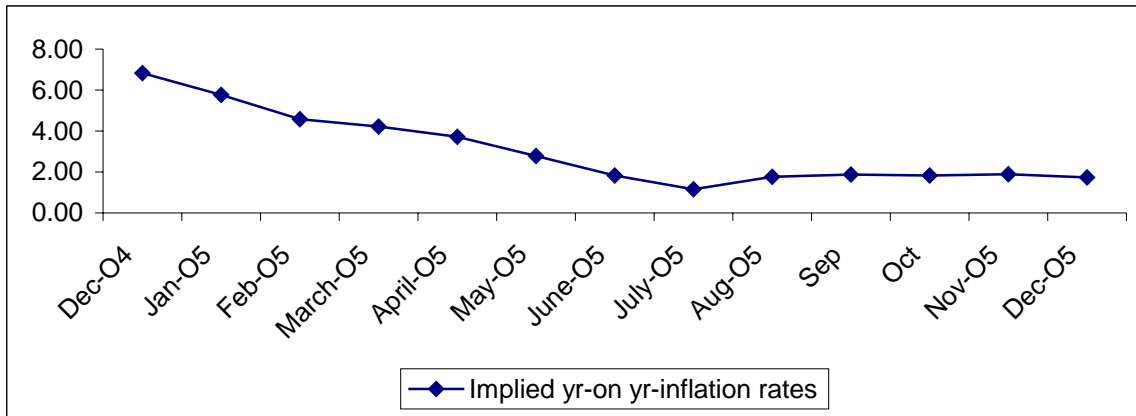
The so-called noise in headline inflation is striped out by excluding prices of energy and utilities (fuel, light and transportation) and volatile food items.

The first measure of core inflation (Core 1), which excludes energy prices, declined from 6.8 per cent in December 2004 to 1.7 per cent in December 2005.

**Table 1: Core1 (excluding energy and transportation)**

	Dec-04	Jan-05	Feb-05	Mar-05	April-05	May-05	Jun-05	Jul-05	Aug-05	Sep-05	Oct-05	Nov-05	Dec-05
Estimated core CPI	2261	2263	2264	2265	2266	2267	2268	2270	2273	2296	2271	2300	2300
Yr.-on yr.-inflation rat	6.8	5.8	4.6	4.2	3.7	2.8	1.8	1.2	0.9	1.9	0.7	1.9	1.7

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

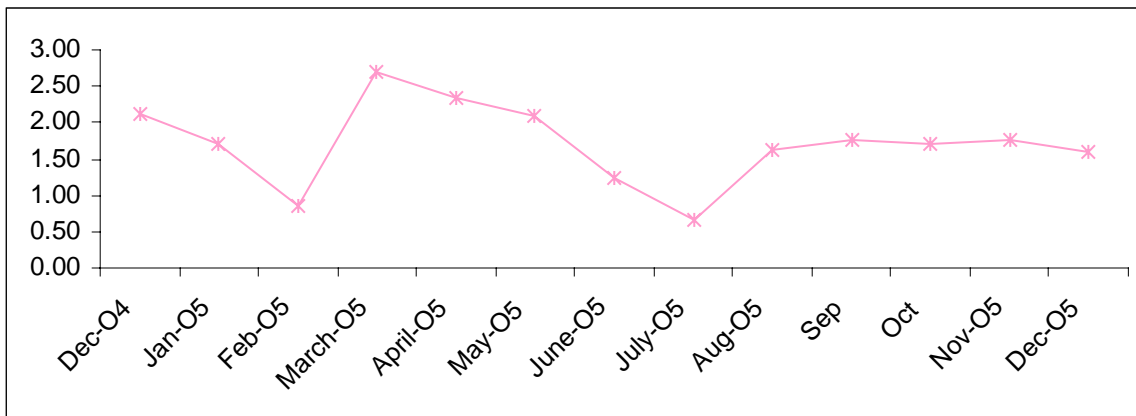


Core 2 which strips out prices of energy and volatile food items ("meat, poultry, eggs and fish", "tobacco and tobacco products", "cereals and cereal products", and "processed foods") also decelerated from 2.1 per cent in December 2004 to 1.6 per cent in December 2005.

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

	Dec-04	Jan-05	Feb-05	Mar-05	Apr-05	may-05	June-05	Jul-05	Aug-05	Sep-05	Oct-05	Nov-05	Dec-05
Estimated core CPI	1095	1096	1096	1097	1097	1097	1098	1098	1099	1111	1099	1112.5	1112.4
yr-on-yr inflation	2.1	1.7	0.9	2.7	2.4	2.1	1.3	0.7	0.7	1.7	0.5	1.8	1.6

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



## **(4.0) PUBLIC DEBT**

### **(4.1) DOMESTIC DEBT**

Total domestic debt increased to D3.8 billion, or 3.2 per cent from the preceding quarter. On an annualized basis, the domestic debt rose by 20.4 per cent.

Short-term debt comprising mainly Treasury bills increased to D3.8 billion, or 3.3 per cent from the previous quarter. However, the stock of long-term debt, which accounts for 0.3 per cent of the domestic debt, remained unchanged from the previous quarter.

Central Bank and deposit money bank holdings of short-term debt increased to D110.3 million and D1.8 billion, or by 38.1 per cent and 12.3 per cent respectively from the third quarter. Debt held by deposit money banks accounted for 46.3 per cent of the stock.

Short-term debt held by the non-bank sector decreased to D1.9 billion, or 6.7 per cent and accounted for 50.8 per cent of the stock. Of the non-bank holdings, public enterprises held D1.2 billion, or 30.4 per cent of the stock.

### **(4.2) External Debt**

The external debt stock decreased to D17.6 billion at end-December 2005, or 0.6 per cent from end-September 2005. However, the stock of external debt increased by 8.1 per cent in the year to end-December 2005. About D9.9 billion, or 56.0 per cent of the debt stock was owed to multilateral creditors and the remainder (44.0 per cent) to bilateral creditors.



Scheduled debt service payments amounted to D165.4 million compared to D218.1 million in the previous quarter. Interest payments totalled D56.4 million and principal payments (D109.0 million). Debt service payments to multilateral creditors amounted to D94.0 million while D71.4 million accrued to bilateral creditors.

## **(5.0) FISCAL DEVELOPMENTS**

### **(5.1) Domestic Revenue and Grants**

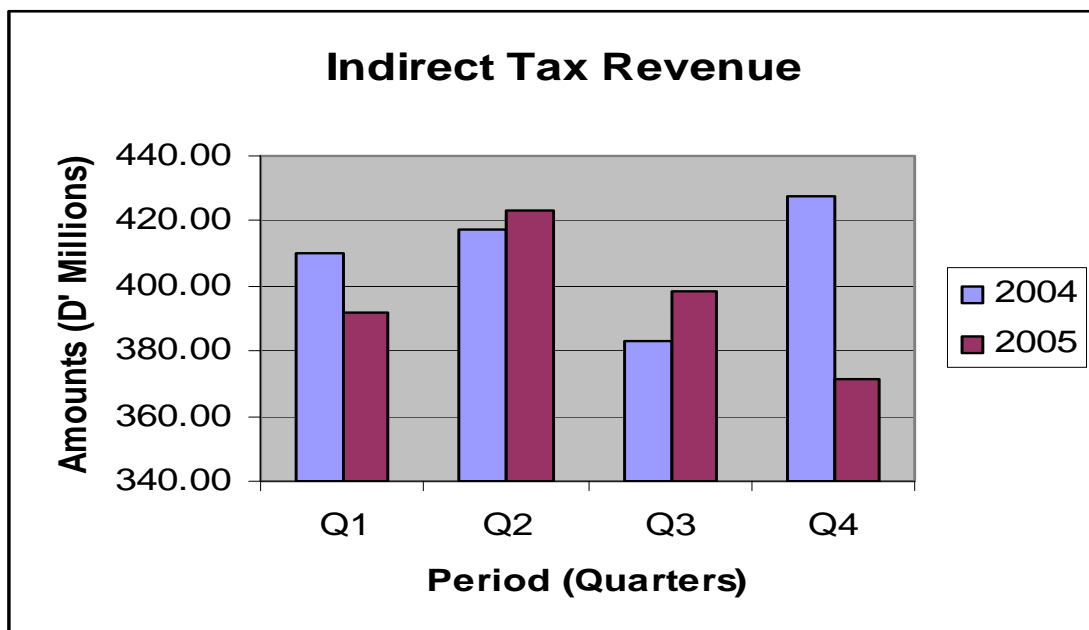
Domestic revenue and grants totaled D680.6 million in quarter 4, 2005 compared to D647.7 million in quarter 3, 2005. Direct and indirect taxes rose to D173.0 million and D367.4 million respectively. Non-tax revenue amounted to D115.9 million compared to D62.2 million in the previous quarter.

Expenditure and net lending was D840.4 million relative to D852.1 million in the preceding quarter. Current and capital expenditure fell by 1.6 per cent and 7.1 per cent to D540.3 million and D281.1 million respectively. Net lending was negative D16.9 million compared to negative D23.6 million in quarter 3, 2005.

On an annualized basis, domestic revenue outturn totaled D2.6 billion in 2005, 7.9 per cent lower than the budget estimate of D2.8 billion.

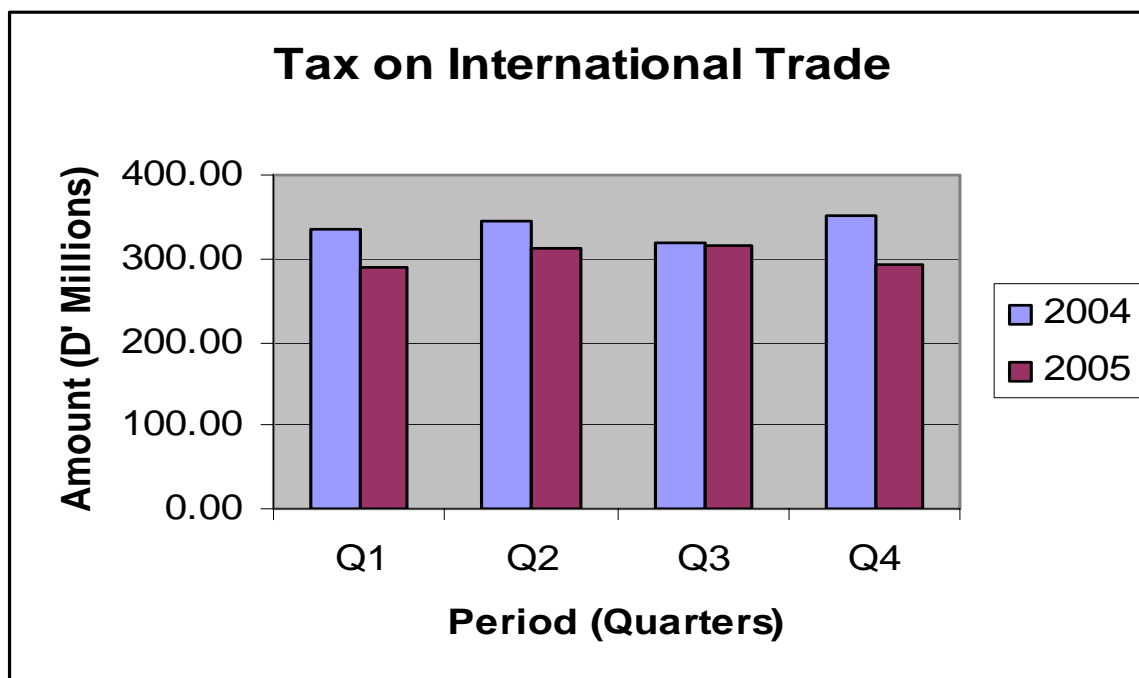
Direct tax revenue totalled D682.5million, D5.8 million (0.9 per cent) above the budgeted figure of D676.7 million. Revenue from indirect taxes amounting to D1580.8 million was, however, lower than the budgeted amount of D1731.8 million by D151 million (8.7 per cent) Taxes on international trade registered a marked shortfall of D190.5 million (14.0 per cent). More specially, the impressive gains of non-fuel customs duties in 2004 largely dissipated during 2005. This item recorded the largest shortfall relative to the budget than any other tax item attributed in large part to duty exemptions.

Chart 6: Indirect Tax Revenue



Source: DOSFEA

Chart 7: Tax on International Trade



Source: DOSFEA

Non-tax revenue amounted to D346.5 million compared to the budget estimate of D408.7 million attributable mainly to the failure of certain public enterprises to meet

their debt service obligations to Government. Over D200.0 million was disbursed from the budget to service the external loans of public enterprises in 2005. Revenue from telecommunication licenses amounted to D28.1 million, lower than the projected figures of D57.0 million.

Grants totaled D220.1 million, below the budgeted figure of D246.2 million attributable to the fact that HIPC grants provided under the Interim Debt Relief were exhausted in the first quarter of 2005.

## **(5.2) EXPENDITURE AND NET LENDING**

Total expenditure and net lending at D3,721.3 million was only D34.0 million higher than the budgeted figure of D3,687.3 million. However, the aggregate total masks large deviations in several categories of expenditure vis-a-vis 2005 budget estimates.

In particular, interest payments at D1130.9 million exceeded the budget estimate by D181.2 million (19.1 per cent), largely on account of the higher than budgeted domestic interest payments. Domestic interest payments amounted to D890.1, compared to the budget figure of D722.8 million. To offset the overspending on these items, severe restrictions were put on cash releases for departmental discretionary spending from the start of the second quarter of 2005. Releases for discretionary expenditure were cut by 22.0 per cent on average. As a result, expenditure on other charges and GLF capital expenditure fell by D157 million and D87.0 million respectively.

**Table 3: INTEREST PAYMENTS**

<b>(In D' millions)</b>			
	<b>Outturn</b>	<b>Budget</b>	<b>Deficit/surplus</b>
<b>Expenditure and Net Lending</b>	3,721.30	3,687.30	( 34.00)
<b>Personal Emoluments</b>	549.50	547.50	( 2.00)
<b>Interest</b>	1,130.90	949.70	(181.20)
<b>GLF BTL Project Accounts</b>	106.00	198.80	92.80
<b>Extra budgetary Expenditure</b>	135.00	-	(135.00)
<b>Other charges</b>			166.6

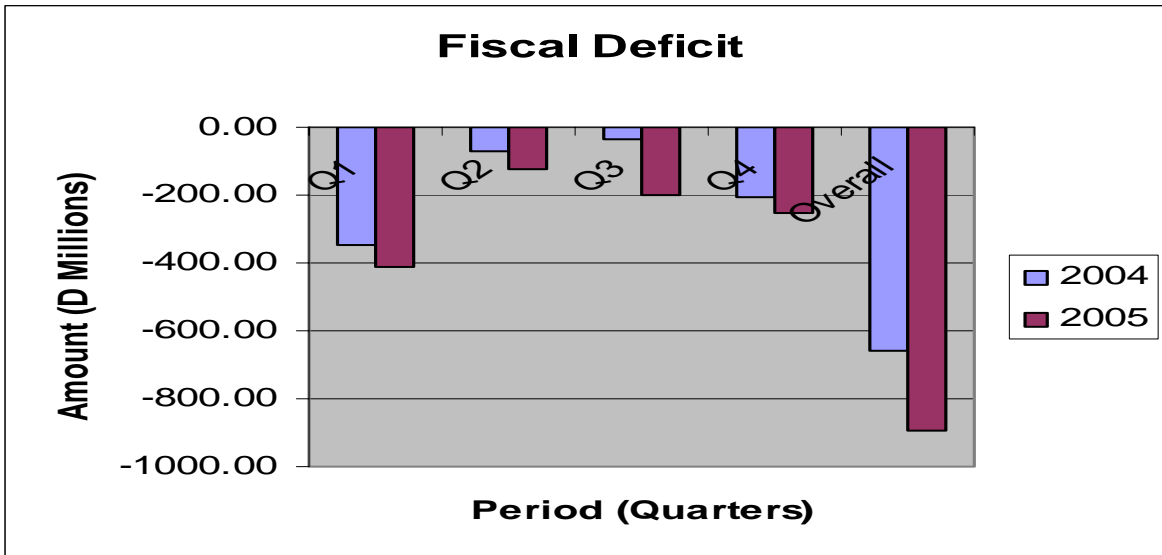
Outturn on personal emoluments (i.e. wages and salaries) was slightly (D2.0 million) below what was budgeted. Other charges were also below budget by D166.6 million.

### **(5.3) THE BUDGET DEFICIT AND FINANCING**

The overall budget deficit including grants amounted to D891.4 million, equivalent to 6.5 per cent of GDP, higher than the 2005 budget estimate of D662.6 million, or 4.5 per cent of GDP. However, the budget deficit excluding grants, and without HIPC assistance amounted to D667.1 million or 5.4 per cent of GDP.

The fiscal deficit was financed with net external borrowing (D457.5 million), privatization proceeds (D54.0 million) and domestic borrowing (D379.9 million). The latter is D187.0 million higher than the domestic borrowing requirement of D271.0 million.

### **Chart 8: Fiscal Deficit**



Source: DOSFEA

OTHER DEVELOPMENTS.....

## **PART II**

### **DEVELOPMENTS IN THE INTERNATIONAL ECONOMY**

In 2005, the global economy is estimated to have grown by 4.0 per cent underpinned by rising corporate profitability, buoyant equity markets, and very strong growth in China. The strong growth is expected to continue relatively unimpeded through to 2006. However, uncertainties exist pertaining to global current account imbalances, and rising oil prices.

#### **(1) WORLD ECONOMIC ACTIVITY**

Japan's GDP unexpectedly accelerated in the last quarter of 2005 after a slow third quarter. Gross domestic product grew at an annualised rate of 5.5 per cent in December 2005 reflecting in the main strong domestic spending. Growth in the US was estimated at 1.1 per cent in the fourth quarter compared to 4.1 per cent in the previous quarter despite oil price increases and destruction caused by the hurricanes. Although housing prices may have peaked, consumer spending remains strong.

China's economy grew by 9.9 per cent in 2005. Strong domestic investment and export growth helped gross domestic product to increase to \$2,262 billion in 2005. China's economy is expected to have passed France, and possibly the United Kingdom, to become the world's fourth largest economy after the US, Japan, and Germany.

The Euro zone economy has been trapped on a sluggish growth path for the past five years, thanks in the main to slow growth in Germany, the biggest economy in the Euro area. In the three months to December 2005, Germany's economy stagnated causing the Zone to grow by only 1.2 per cent in 2005.

The United Kingdom's economy grew by 0.6 per cent in the quarter under review compared to 0.5 percent the previous quarter. On the whole, GDP rose by 1.8 per cent in 2005. The biggest driver of growth was the services sector, which grew by 0.9 per cent

## **(2) INTEREST RATES**

The Federal Reserve, the European Central Bank, and the Bank of Japan, indicated intentions to proactively tighten of monetary policy at least in the short-term to rein in inflation. The Federal Reserve raised the benchmark rate to 4.25 in December 2005.

The European Central Bank, in early December, increased the policy rate for the first time in half a decade to 2.25 per cent, and appears likely to raise it again soon. However, there are fears that further increases in rates could choke off Europe's still fragile economic growth.

The Bank of Japan is also expected to embark on a cautious tightening of policy - not necessarily by raising rates, but by cutting back on its purchases of government bonds from Japanese banks, which pump yen into the market.

## **(3) COMMODITY PRICES**

Oil prices were significantly higher in the fourth quarter than a year ago reflecting increased global demand and fears of supply disruption from major crude oil producers (Iraq, Venezuela and Nigeria). Prices of Brent crude averaged of 57 USD/bbl in Q4, 2005 compared to 44 USD/bbl in Q4 2004.

Rising oil prices have led to the deterioration in the terms of trade of most non-oil producing countries, although this was partly been offset by higher world prices for non-oil commodities particularly beverages and metals.