

**WEST AFRICAN MONETARY AGENCY  
(WAMA)**



**ECOWAS MONETARY COOPERATION PROGRAMME**

**MACROECONOMIC CONVERGENCE REPORT  
2007 GAMBIA**

**FREETOWN, JUNE 2008**

The Government of The Gambia adopted a new economic and financial programme under a three-year Poverty Reduction and Growth Facility (PRGF) arrangement with the International Monetary Fund (IMF) in February 2007. This programme aims at consolidating macroeconomic stability achieved in recent years as well as fostering conditions for sustaining high economic growth and poverty-reduction. In this regard, the government initiated a number of policy measures to enhance revenue, ensure fiscal prudence, and strengthen monetary policy.

The provisional indicators show that the authorities sustained the growth momentum with a high real GDP growth rate of 7.0 percent. Macroeconomic performance was characterized by a relatively unstable exchange rates and mild inflationary pressures, albeit, within the single-digit range. Nominal interest rates generally remained unchanged.

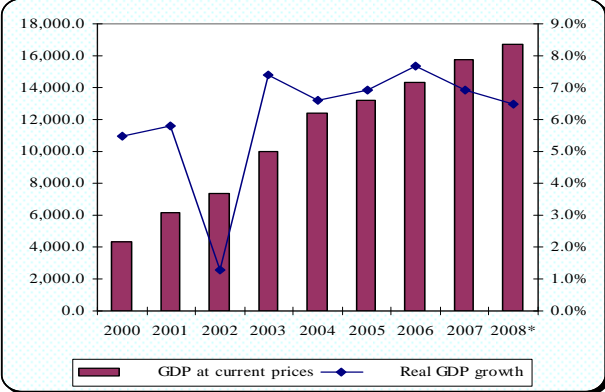
**1 Sector Analyses**

**1.1 Real Sector**

Although economic activity slowed down marginally, it remained robust recording a real GDP growth rate of 7.0 percent in 2007 compared to 7.7 percent in the preceding year and against a programmed rate of 3.5 percent. The marginal deceleration was attributed to budding constraints in the agricultural, industrial and construction sectors, albeit growth in the telecommunication and tourism sectors remained strong.

The growth rate in the agricultural sector plummeted from 6.5 percent in 2006 to 1.3 percent, owing to inadequate rainfall and rising cost of agricultural inputs. Against the backdrop of the high growth rate of 8.8 percent recorded in 2006, the construction sector stunted due to an acute shortage in cement. The high crude oil prices influenced the performance of the manufacturing and industrial sectors, which had hitherto been the main driving force behind the boost in output recorded in recent years. However, vibrant investment activities in tourism and the energy sectors contributed to a significant growth rate of 11.3 percent in the services sector, compared to 2.0 percent in 2006.

Graph 3.33: Trends in Nominal GDP and Real Growth Rate

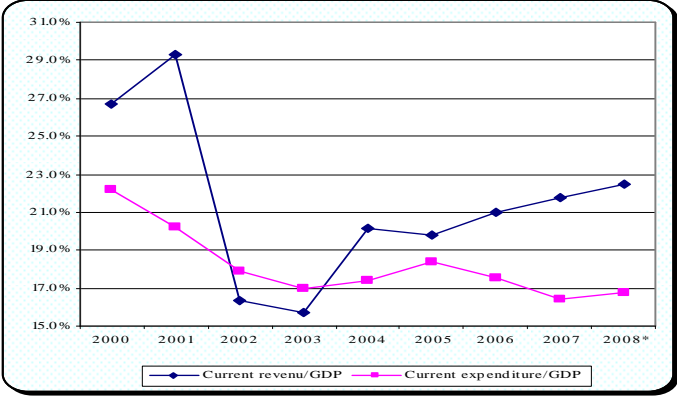


**1.2 Public Finances**

The government introduced a number of reforms in 2007 intended to minimize tax evasion and operational costs. These measures included the introduction of taxpayer identification numbers, automation of tax collection, valuation mechanisms, increases in sales tax, customs tariffs and telecommunication license fees. In addition, the government had introduced a cash management system in 2006 in an attempt to control expenditure overruns. The government programmed an overall budget deficit of 1.5 percent of GDP for 2007.

The reforms yielded positive results during the year under review as fiscal performance improved significantly. The provisional data indicates that fiscal operations resulted in an overall budget surplus (on commitment basis including grants) of 0.1 percent of GDP compared to a deficit balance of 2.2 percent in 2006.<sup>1</sup> Excluding grants, the turnout was an overall deficit balance of 1.0 percent. The positive primary balance also enhanced from 4.2 percent to 5.3 percent of GDP in 2007.

**Graph. 3.34 : Trends in Current Revenue and Expenditure**



The government fiscal operations resulted in a borrowing requirement of ₪926.9 million, of which 71.4 percent was financed from external sources, particularly, from project grants whilst the rest was financed from the banking system.

Total revenue (excluding grants) during the review period increased by 13.7 percent to ₪3,427.3 million, representing 21.8 percent of GDP. Tax revenue augmented marginally from 18.8 percent of GDP to 19.3 percent, driven mainly by an enhancement in indirect taxes on international trade, petroleum and goods and services, reflecting the policy increases in customs rates. Non-tax revenue rose by 21.6 percent against the 7.0 percent reduction recorded in 2006.

Total expenditure (including net-lending) was 22.3 percent of GDP compared to 23.7 percent in the preceding year. Pursuance of the fiscal restraint policy measures adopted in recent years resulted in a reduction in the level of recurrent expenditure from 17.6 percent to 16.4 percent of GDP in 2007. A reduction in interest payments owing to relief granted under the multilateral debt relief initiative also accounted for this development. The demand for higher expenditure on public sector salaries and wages and on goods and services also reduced during the period. Transfers (including subsidies) to public institutions increased by 22.0 percent to ₪434.3 million. However, outlays on capital expenditure continued to decline from 6.2 percent to 5.8 percent of GDP, noting that outlays on this item had shown a downward trend since 2004.

**1.3 External Sector**

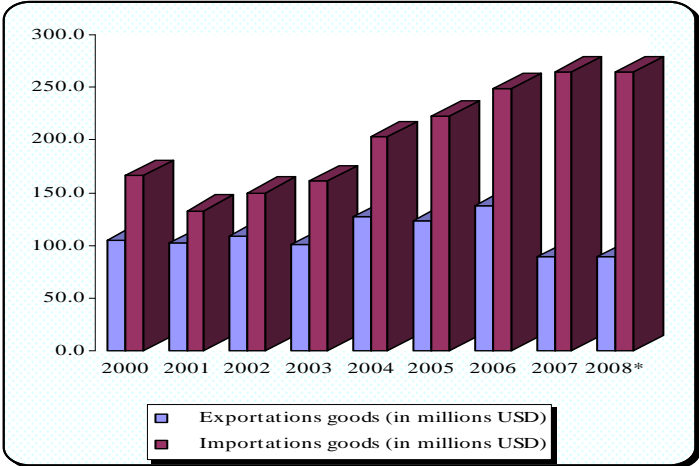
The provisional data show that the balance of payments remained viable in 2007 in spite of certain constraints in the merchandise trade account. The overall balance enhanced from a surplus of US\$ 7.4 million to US\$ 10.8 million, representing 1.9 percent of GDP.

Conversely, the deficit balance on the current account (excluding official transfers) widened by 20.1 percent to US\$ 111.1 million, equivalent to 14.8 percent of GDP. The deficit trade balance further

<sup>1</sup> The overall balance on commitment basis excluding grants declined from 2.7% in 2006 to 1.0% in 2007.

increased by 14.8 percent compared to 12.1 percent in 2006. Total exports declined by 3.0 percent due to unfavourable climatic conditions which adversely affected output of the country's primary export commodities, particularly, groundnuts and related products. On the other hand, domestic imports increased by 4.9 percent to US\$ 261.2 million, driven mainly by the rising costs of fuel and lubricants and higher demand for consumer, intermediate and capital goods. The country's re-export trade also underperformed in 2007 as the level of economic activity in this area has not fully recovered following the border crisis experienced between Senegal and the Gambia in 2005 and 2006. However, the services account was favourable, increasing moderately on account of continued enhancements in private remittances and travel income.

**Graph 3.35** :Trends in Imports and Exports



The capital account remained resilient with a positive balance of US\$ 70.5 million, albeit, marking a relative 13.9 percent decline due to net outflows in respect of portfolio investment in other countries. However, the capital account was dominated by foreign direct investment in the tourism, banking communication and construction sectors. Project-related official loans also enhanced moderately by 38.1 percent.

Transactions on the balance of payments resulted in an enhancement in gross external reserves, increasing by 18.4 percent to US\$ 120.2 million at end-2007. The level of gross external reserves was equivalent to 5.5 months of imports cover compared to 4.9 months in the preceding year.

Notwithstanding the resilience of the balance of payments in 2007, the domestic currency (the dalasi) lost its relative stability against the major international currencies. It appreciated by 21.2 percent, 24.5 percent and 10.4 percent against the pound sterling, euro and US dollar respectively.<sup>2</sup> This appreciation was attributed to the substantial foreign exchange inflows (private transfers, official loans and foreign direct investment), some of which were held by the private sector.

The external debt position of the Gambia firmed up by 3.7 percent to US\$ 676.4 million, representing 90.3 percent of GDP. The external debt position relative to exports of goods and non-factor services increased further from 546.2 percent to 566.5 percent. The proportion of debt service to exports also

<sup>2</sup> In 2006, depreciated by 7.6 percent against the pound sterling, appreciated marginally by 0.3 percent against the US dollar and depreciated by 6.9 percent against the euro.

enhanced, representing 162.1 percent of total exports. These data indicate that the external debt position of the Gambia is currently unsustainable.<sup>3</sup>

#### THE GAMBIA: EXTERNAL DEBT SUSTAINABILITY DATA

	2002	2003	2004	2005	2006	2007
External debt position (millions of US\$)	460.4	513.1	581.8	611.8	652.2	676.4
External debt /GDP (%)	147.3	159.2	139.9	130.2	127.5	90.3
External debt/exports of goods and non-factor services (%)	385.6	429.7	487.3	512.4	546.2	566.5
External debt service/GDP (%)	24.0	33.5	31.1	31.6	30.5	25.8
External debt service/export of goods and non-factor services (%)	62.8	90.3	108.2	124.5	130.6	162.1

SOURCE: CBG

#### 1.4 Monetary Sector

In order to sustain its single-digit inflation objective and maintain exchange rate stability, the Central Bank of The Gambia designed a strategy to enhance liquidity management, and consequently, adopted a restrictive monetary policy stance with occasional intervention in the exchange rate market.

#### THE GAMBIA: GROWTH IN KEY MONETARY AGGREGATES

AGGREGATE	2001	2002	2003	2004	2005	2006	2007
Reserve Money	21.1	34.1	62.7	11.0	11.9	24.3	-4.3
Broad Money (M <sub>2+</sub> )	22.2	32.2	43.4	18.3	13.1	26.2	6.7
Narrow Money (M <sub>1</sub> )	20.0	48.8	63.5	8.2	6.9	26.0	0.6
Currency In Circulation	21.4	21.6	48.4	19.7	0.6	36.0	-12.8
Demand Deposits	18.4	82.9	76.2	0.1	12.1	18.5	12.1
Quasi Money	24.3	16.4	19.0	35.1	21.5	26.5	13.8

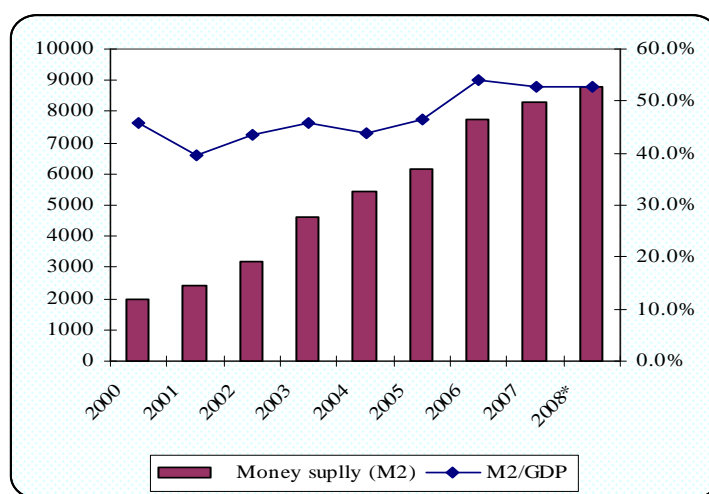
Source: CBG

The data in the above table indicates that monetary policy was restrictive, in line with the policy objective specified for the year. Reserve money, the operating target of the Central Bank, declined by 4.3 percent against a growth rate of 24.3 percent in the preceding period. Broad money supply rose by 6.7 percent compared to the high growth rate of 26.2 percent recorded in 2006. The strict liquidity management regime led to a 12.8 percent decline in currency in circulation. However, demand deposits and quasi money (comprising savings, time and foreign currency deposits) increased moderately, albeit at rates relatively lower than that recorded in 2006.

The deceleration in the money supply growth rate was mainly fuelled by a decline in Net Foreign Assets (NFA) of the banking system, especially, that of the Deposit Money Banks which decreased by 33.5 percent relative to the position as at end-2006. On the other hand, even though Net Domestic Assets (NDA) increased by 23.9 percent against the growth rate of 15.4 percent recorded in 2006, its impact was more-than-outweighed by the reduction in NFA. An analysis of total credits showed that the banking system retrieved a significant proportion of its claims on central government and public institutions. However, the level of credits extended to the private sector enhanced by 15.4 percent to ₪ 2,783.3 million.

<sup>3</sup> A country's external debt position is generally considered sustainable if the scheduled debt service payment is below 25 % of goods and non-factor services and if the net ratio of debt to exports is below 250.0%.

**Graph 3.36 : Trends in Money Supply**



In spite of the slowdown in the growth rate in broad money supply, inflation accelerated moderately from 0.4 percent by end-2006, peaking at 6.6 percent in May 2007, before declining during the second half of the year to 6.0 percent. In addition to the pass-through effect of the rising prices of petroleum products, the inflationary pressures experienced during the year was attributed to supply rigidities (especially, disruptions in the supply of foodstuffs from Guinea and Guinea-Bissau) and increases in import duties on essential consumer commodities.

In line with the inflationary trends observed during the year, the Central Bank of the Gambia signalled the need for an upward adjustment in interest rates by increasing the rediscount rate by 100.0 basis points to 15.0 percent.<sup>4</sup> The 91-day Treasury bill rate also increased from 12.8 percent to 13.7 percent, reflecting its use as a major instrument for liquidity management in 2007. Whilst the average savings rate was maintained at 6.0 percent, the average lending rate declined by 50.0 basis points to 22.5 percent thus, explaining the relative increase in credits extended by the banking system to the private sector.

## **2 PERFORMANCE UNDER MACROECONOMIC CONVERGENCE**

Gambia's performance under the convergence criteria remained encouraging in 2007 as the country sustained six out of the seven targets met in 2006, having lost compliance on inflation. The achievement comprised two primary and four secondary benchmarks. Performance on each of the primary and secondary criteria follows.

### **2.1 Performance under the Primary Criteria**

The Gambia sustained the budget deficit below the required maximum limit of 4.0 percent of GDP. Among other measures, the establishment of the Gambia Revenue Authority, automation of tax collection and valuation mechanisms and introduction of the cash management system in 2006 contributed to the relative improvement in fiscal performance.

Inflation, which had been contained in 2005 and 2006, began to accelerate during the year under review from 1.4 percent in December 2006 to 6.0 percent by end-2007, thereby, missing the required target by 1.0 percentage point. As already indicated, the rising petroleum prices as well as supply rigidities

<sup>4</sup> Interest rates followed a downward trend in recent years.

contributed to this phenomenon, noting as well that the authorities extended the CPI coverage to all urban and sub-urban centres.

### THE GAMBIA: STATUS OF CONVERGENCE

	target	2001	2002	2003	2004	2005	2006	2007	2008
<b>Primary Criteria:</b>									
i) Budget Deficit/GDP	≤4%	9.8	9.1	7.2	10.2	5.1	2.7	1.0	3.9
ii) Inflation Rate	≤5	8.1	13.0	17.6	8.0	1.8	1.4	6.0	2.6
iii) Budget Deficit Financing	≤10%	80.7	22.0	63.1	0.0	0.0	0.0	0.0	0.0
iv) Gross External Reserves	≥6m	8.2	5.2	4.6	5.0	5.2	4.9	5.5	5.4
<b>Secondary Criteria:</b>									
i) Domestic Arrears	=0	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
ii) Tax Revenue/GDP	≥20%	13.9	14.1	13.8	18.1	19.8	21.0	21.8	22.5
iii) Salary Mass/Tax Revenue	≤35%	40.1	38.0	33.3	23.1	24.3	24.2	22.4	27.3
iv) P. Invest/Tax Receipts	≥20%	7.1	5.5	3.2	4.0	6.3	2.9	6.0	10.0
v) Real Interest Rate	≥0	1.9	-3.0	-0.6	6.0	3.2	3.6	3.3	2.4
vi) Real Exchange Rate**	±5%	3.3	3.7	-27.8	-1.2	4.5	-1.1	-1.1	0.3
<b>Total No. Of Criteria Met</b>		3	1	1	4	5	7	6	7

Source: WAMA, Central Bank of The Gambia

\*projected end-2008 data

The central bank did not finance the budget deficit in 2007, reflecting the strong fiscal performance. Improvement in revenue mobilization and restrained spending arising from a commitment to avoid expenditure overruns under the strict cash budget system contributed to the sustainability of this fiscal non-accommodation objective of the central bank.

Gross external reserves continued to improve from 4.9 months of imports cover to 5.5 months by end-2007. Thus, the country narrowly missed the required minimum target of 6.0 months. The performance of Gambia on this criterion has been aided by increasing foreign exchange inflows accruing from its traditional exports and transactions on the capital account.

## 2.2 Performance under the Secondary Criteria

With regard to the domestic arrears criterion, member States are required to prohibit and liquidate all existing arrears. The importance of this criterion lies on the fact that it strengthens the credibility of the primary budget deficit indicator. However, this criterion could not be assessed owing to inadequate data. Evidence of the stock of arrears as at end-2007 was not available, albeit, the fiscal data showed that the government liquidated ₮134.6 million and ₮82.0 million in 2006 and 2007 respectively.

Having met the tax revenue/GDP target for the first time in 2006, The Gambia sustained its performance during the year under review. This feat marked a consistent progress since 2004, indicating the efficient revenue mobilization mechanism introduced in recent years.

Gambia's performance on the salary mass/tax revenue benchmark is also very encouraging as the country has consistently met the required maximum target of 35.0 percent in recent years.

The increasing tax revenue returns also impacted positively on the public sector wage burden relative to tax revenue, remaining favourably below the maximum limit of 35.0 percent. The Gambia needs to deepen its private sector-led development strategy in order to sustain its performance on this criterion.

However, the level of investments remained abysmally low regardless of the increasing revenue. The outturn, which has consistently been below 8.0 percent in recent years, increased from 2.9 percent to 6.0 percent in 2007.

Real interest rates remained positive in 2007, thus, sustaining the favourable performance realized since 2004. Gambia needs to contain inflationary pressures in order to maintain its performance on this criterion, given the low average savings rate.

Using a fluctuation band of  $\pm 5.0$  percent, the real exchange rate remained stable, appreciating by 1.1 percent in each of the two consecutive years of 2006 and 2007. Gambia has consistently met this target in recent years.

### **3 PROSPECTS FOR 2008**

For 2008, the government has outlined a programme under the IMF Poverty Reduction and Growth Facility (PRGF)-supported programme to maintain prudent macroeconomic policies, consolidate the gains of recent achievements on macroeconomic stability and foster reforms conducive to higher growth. In this regard, the economy has been projected to grow by about 6.5 percent. Other policy targets include:

- contain end-year inflation below 5 percent;
- maintain a basic fiscal balance surplus of between 1.0-2.0 percent of GDP;
- reduce the ratio of domestic debt to GDP;
- maintain an external current account deficit (including official transfers) of about 12.0 percent of GDP; and
- maintain a level of international reserves equivalent to about four months of imports.

Given the prudent macroeconomic policies, massive investment in the tourism and energy sectors as well as government commitments to address the constraints in the agricultural, industrial and construction sectors, the growth rate of 6.5 percent projected for 2008 appears reasonable. The slower growth in broad money supply recorded in 2007 and expectations for improvement in supply conditions on the commodities market following termination of the recent border crisis with neighboring Senegal suggest that inflationary pressures would ease during the outlook year.

On the other hand, the continued appreciation of the domestic currency would adversely affect the country's competitiveness with its trading partners. It may therefore be necessary for the government to sterilize the foreign exchange injections into the economy to help control aggregate demand and further appreciation of the dalasi. In addition, the large spread between the savings and lending rates remains a downside risk that may adversely affect the budding investment drive, and thus, the growth prospects.

Ceteris paribus, the projections for 2008 indicate that the Gambia will improve its performance under the macroeconomic convergence criteria. The country would meet the target on inflation in addition to the six targets realized in 2007. The budget deficit target would be realized on the margin owing to projected increases in both recurrent and capital expenditure. Inflation would recede from 6.0 percent to 2.6 percent by end-2008 in view of the restrictive monetary policy currently being pursued. Performance on central bank budget deficit financing and gross external reserves would be expected to be favourable. A likely boost in tax revenue would help sustain performance on salary mass, albeit, the level of public investment would remain low. As in recent years, the country would also meet the targets on real interest rates and real exchange rate stability.

#### **4 Conclusion and Policy Recommendations**

In conclusion, the Gambian economy remained robust despite certain constraints in agriculture, industry and construction. Macroeconomic stability, which has been preserved in recent years, deteriorated slightly in 2007. However, the economy faced certain constraints that need to be addressed as soon as possible. These included: an increasing aggregate demand arising from massive foreign exchange injections into the economy, the continued appreciation of the domestic currency, the widening current account deficit arising from growing constraints in merchandise trade, the large spread between the savings and lending rates and inadequate supply conditions.

Nevertheless, the prospects for 2008 are optimistic. The government's macroeconomic policies outlined for 2008 are intended to consolidate the gains of recent achievements and foster reforms conducive to higher growth and poverty reduction. The proposed policy measures appear adequate and realizable and the stated targets are largely in line with the ECOWAS convergence requirements.

In the light of the above developments, the government needs to adhere to the prudent fiscal and monetary policies adopted in recent years in order to sustain the level of economic activity and macroeconomic stability. In particular, the government needs to avoid the fiscal slippages observed in recent years. There is also room for the government to put in place relevant structures to help boost revenue. The central bank also needs to sustain the restrictive monetary policy stance. In addition, the real sector lacks adequate infrastructure such as irrigation dams, storage facilities and other inputs to encourage higher production for both domestic use and exports. It is also necessary for The Gambia to accelerate its policy harmonization initiatives, particularly, in the areas of payments system development and trade liberalization.

Consequently, the Authorities may consider the following recommendations:

1. enhance tax revenue further by introducing value added tax (VAT), continue to strengthen the tax collection apparatus and widen the tax base to cover identifiable professions in the informal sector;
2. facilitate private sector development by enhancing access to capital and upgrading infrastructural development in roads, utilities, and telecommunications;
3. make conscious efforts to increase the level of public investments financed from domestic sources;
4. rationalize the public sector and consolidate the relatively moderate public sector wage bill;
5. diversify the production base to address the country's over-reliance on a few primary commodity export products (groundnuts and cashew nuts);
6. improve foreign exchange earning capacity through exports promotion;
7. develop a workable agreement with the Government of Senegal to facilitate cross-border trade and accelerate implementation of all aspects of the ETLs and CET;