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Central Bank of Bahrain

Financial Stability Directorate

Balance of Payments Report 2007

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Preface

Bahrain is the leading financial centre in the Gulf and is one of the most open economies in the region. International transactions are therefore vital to the development of Bahrain's economy. Against this background, the Central Bank of Bahrain (CBB) regularly monitors Bahrain's external sector performance. The *Balance of Payments Report* (BOP Report) is one of the key instruments used for this purpose.

Produced annually by the Financial Stability Directorate (FSD), the BOP Report summarizes the economic transactions between residents of Bahrain and the rest of the world during a particular calendar year. It presents developments in various accounts of the Balance of Payments, highlighting key macroeconomic developments in both the global and domestic economy that have affected the balance of payment accounts during the review period. It also discusses movements in Bahrain's International Investment Position (IIP).

This edition of the BOP Report reviews Bahrain's international transactions during 2007. It is organized as follows: Section 1 focuses on the current account, discussing trends in the trade in goods and services, as well as developments in the income and current transfers accounts. Section 2 discusses the capital and financial account, covering changes in capital transfers, direct investment, portfolio investment, other investments and movements in reserve assets. Section 3 briefly examines the size and implication of the statistical discrepancy (errors and omissions) while Section 4 examines movements in Bahrain's International Investment Position (IIP). Section 5 presents an outlook for Bahrain's balance of payments.

Please note that unless indicated otherwise, 2007 BOP and IIP data analyzed in this report are "provisional". Also, please note that 2006 data cited in this report are "revised" numbers and may differ from the provisional data analyzed in the 2006 Balance of Payments Report.

Overview

In 2007, against a background of high international oil prices, Bahrain's *current account surplus* widened by 33% to reach BD1092.9 million (14.6% of GDP). The expansion in the surplus was attributable to favorable developments on all transactions in the current account, including: i) an increase in surpluses on both the *goods and services* accounts; ii) a reduction in net outflows on the *income account*; and iii) a reduction in *current transfers to foreigners*.

Although the import bill increased by around 10% during the year, this was more than offset by the growth in oil export receipts. The buoyant oil earnings also helped to compensate for the drop in non-oil export earnings. The fall in non-oil export receipts resulted mainly from a reduction in earnings from aluminum exports, as the price of aluminum on international markets experienced a downward trend.

As in previous years, oil also featured prominently on the import side, accounting for 54% of total imports in 2007, influenced by the import of Saudi crude as feedstock for the Bahrain refinery.

Although Saudi Arabia remains Bahrain's principal partner for trade in non-oil items (accounting for 14.9% of total non-oil merchandise trade), Australia has displaced Japan as Bahrain's second largest trading partner. On a regional basis, an increased amount of Bahrain's non-oil exports (49.6%) went to Arab countries, compared to 41% in 2006. Most of the non-oil imports came from Asian countries (33%).

Non-oil trade with other GCC is increasing, especially on the export side. In 2007, Bahrain's exports to GCC countries represented 41% of total non-oil exports (up from 35% in 2006) while imports from GCC countries accounted for 18% of total non-oil imports.

The *surplus on services* expanded to BD685.6 million in 2007, from BD645.6 million in 2006. The expansion was driven largely by the 15% increase in receipts from "other business services" and the 9.4% rise in receipts from "financial services" (including insurance).

Although the *income account* still showed a net outflow in 2007, the size of the outflow shrank further to BD112.3 million, compared to an outflow of BD144.7 million the previous year. Net current transfers to foreigners fell to BD557.5 million during the year (from BD575.6 million in 2006), due to a reduction in remittances by expatriate workers resident in Bahrain.

Net outflows on the *capital and financial account* increased to BD1096.6 million, on the back of an outflow of BD3218.5 million in "portfolio investments" as the acquisition of foreign stocks and bonds by Bahraini residents surpassed similar investments in Bahrain by non-residents.

The statistical discrepancy--*errors and omissions in recorded transactions*--was a positive BD3.7 million in 2007, slightly down from BD4.2 million the previous year. The discrepancy was equivalent to 0.04% of the combined value of exports and imports of goods, well within the internationally accepted benchmark of 5%.

At year-end 2007, Bahrain's *net international investment position* (net IIP) showed a surplus of BD4773.5 million, demonstrating that Bahrain continues to be a net creditor to the rest of the world. In 2006, the net IIP was BD 3649.9 million, indicating that the net creditor position of Bahrain widened by BD1123.6 million during the year under review. Underlying this trend was an expansion in assets of BD19,355 million, driven primarily by an increase of BD14,475 million in the "other investments" category, which covers movements in currency, deposits and loans.

Regarding the *balance of payments outlook for 2008*, Bahrain's current account balance is likely to expand further, buoyed by elevated levels of oil prices and increased receipts on the "travel" account. However, this could be countered by a possible slowdown in the world economy as well as the dampening effect of lower international prices for aluminum. The weakness of the dollar may also raise import bills. Overall, we expect the expansion in the current account surplus to be modest.

On the capital and financial account, acquisition of portfolio investments abroad is expected to continue although at a slower pace, given the volatility in international financial markets. Further inflows of foreign direct investment are also expected.

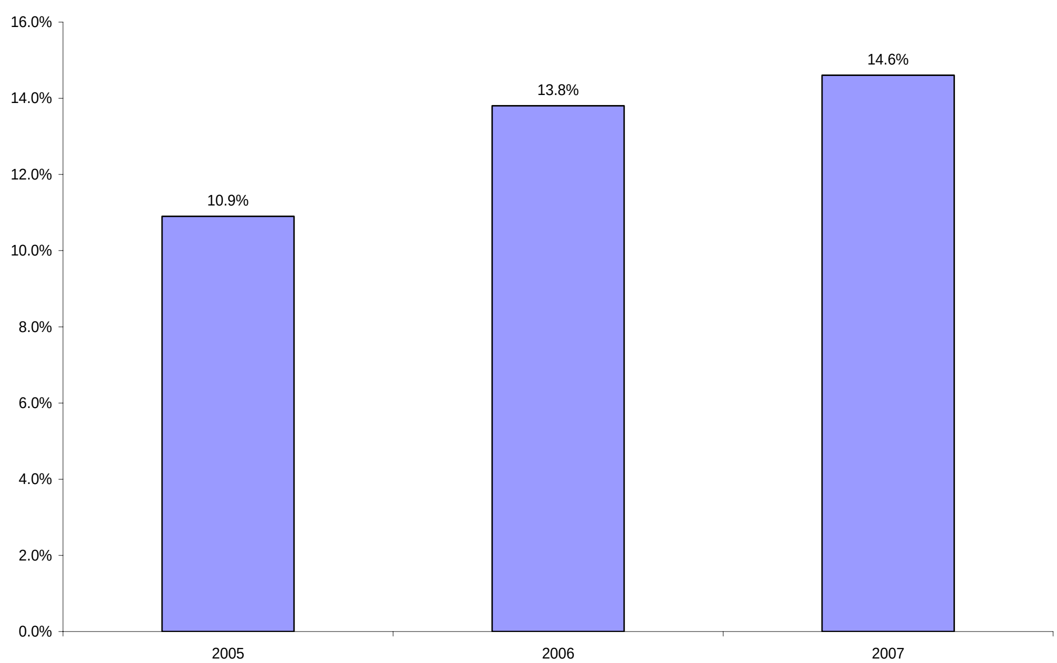
1. The Current Account

Current account surplus expands

Reflecting the ongoing boom in the international oil markets, Bahrain's current account surplus widened further in 2007, reaching an estimated BD1092.9 million (14.6% of projected GDP) (see Chart 1.1 and Table 1). The size of the surplus was 32.8% higher than the BD822.5 million surplus recorded in 2006 (13.8% of GDP).

The expansion was driven by favorable developments on all transactions in the current account. There were increased surpluses in both the goods and services accounts as well as a 22% reduction in the net outflows on the *income account*. Also, *current transfers to foreigners* (workers' remittances) fell from BD575.6 million in 2006 to BD557.5 million, further boosting the size of the current account surplus.

Chart 1.1: Bahrain's Current Account Balance (2005-2007; % of GDP)**



Source: Central Informatics Organisation
*** 2007 GDP figures are IMF projections.*

Table 1: Summary of Bahrain's Balance of Payments—2005-2007 (BD Million)

Items	2005	2006**	2007***
1. Current Account (a+b+c+d)	**554.3**	**822.5**	**1092.9**
a. Goods	**555.7**	**897.2**	**1077.2**
General Merchandise	**515.6**	**844.6**	**1018.2**
Exports (fob)	3851.0	4587.2	5126.2
- Oil	2926.6	3465.8	4059.3
- Non-Oil	924.2	1121.4	1066.9
Imports (fob)	-3335.4	-3742.6	-4108.0
- Oil	-1567.8	-1843.0	-2204.9
- Non-Oil	-1767.6	-1899.6	-1903.1
Repairs on goods	**40.1**	**52.6**	**58.9**
b. Services (net)	**613.6**	**645.6**	**685.6**
- Transportation	19.8	18.1	19.1
- Travel	190.2	222.7	235.5
- Communication services	235.5	232.4	241.7
- Financial services (incl. insurance)	158.3	160.6	175.7
- Other Business Services	9.8	11.8	13.6
c. Income (net)	**-155.0**	**-144.7**	**-112.3**
Investment Income	-155.0	-144.7	-112.3
- Direct Investment Income	-258.4	-315.4	-447.6
- Portfolio Income	386.4	598.1	772.4
- Other Investment Income	-283.0	-427.4	-437.2
d. Current Transfers (net)	**-460.0**	**-575.6**	**-557.5**
- Workers' Remittances	-460.0	-575.6	-557.5
2. Capital and Financial Account (net) (A+B)	**-610.7**	**-826.7**	**-1096.6**
A. Capital Account (net)	**18.8**	**28.2**	**18.8**
- Capital Transfers	18.8	28.2	18.8
B. Financial Account (1+2+3+4)*	**-629.5**	**-854.9**	**-1115.4**
1. Direct Investment	**-32.6**	**727.5**	**32.7**
- Abroad	-426.9	-368.5	-627.6
- In Bahrain	394.3	1096.0	660.3
2. Portfolio Investment (net)	**-1735.0**	**-3320.5**	**-3218.5**
- Assets	-2645.6	-3958.2	-3718.7
- Liabilities	910.6	637.7	500.2
3. Other Investment (net)	**1248.7**	**2047.2**	**2602.3**
- Assets	-4347.5	-11368.3	-14477.8
- Liabilities	5596.2	13415.5	17080.1
4. Reserve Assets (net)	**-110.6**	**-309.1**	**-531.9**
3. Errors and Omissions	**56.4**	**4.2**	**3.7**

**Financial transactions. A negative sign means net outflows/increases in external assets*
***Revised data; ***Provisional Data*
Sources: Central Informatics Organisation and National Oil and Gas Authority

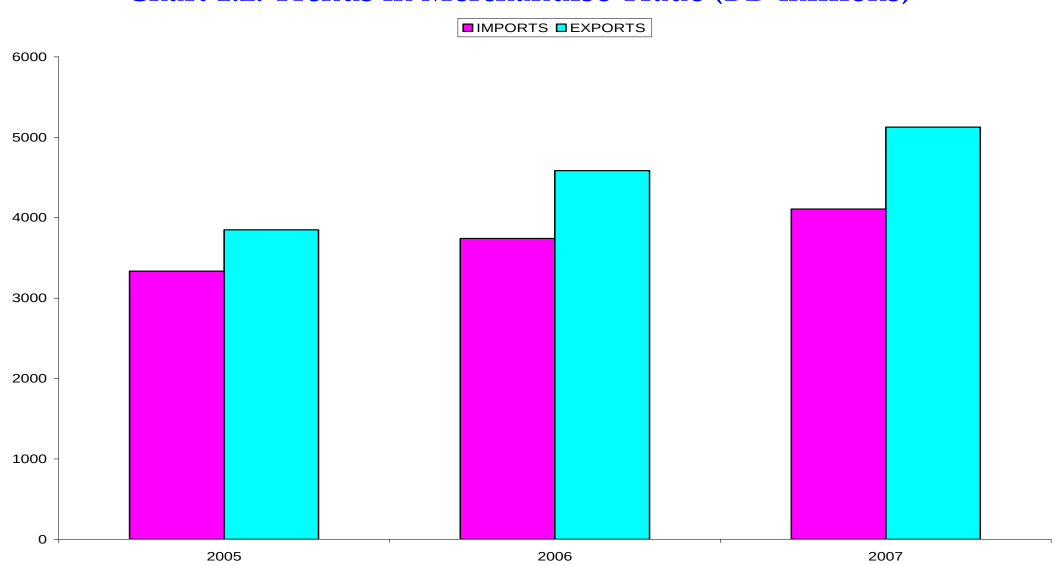
1.1. Trade in Goods

Increased imports offset by higher earnings from oil exports

Propelled by a 17% growth in oil export receipts, total earnings from *merchandise exports* (f.o.b) increased from BD4587.2 million in 2006 to BD5126.2 million in 2007, a 11.7% increase (Table 1). In a reversal of the trend in recent years, non-oil exports earnings *fell* by 4.8% in 2007, due largely to a 21% drop in earnings from the export of "base metals and articles thereof" (principally aluminum).

Payments for *merchandise imports* (f.o.b) increased from BD3742.6 million in 2006 to BD4108 million in 2007, an overall growth of 9.7%. Again, oil imports provided the driving force, with a 19.6% growth, compared to a 0.2% growth in non-oil imports. Against the background of high earnings from oil, *the overall surplus on goods* grew by 20% from BD897.2 million in 2006 to BD1077.2 million in 2007, contributing significantly to the aggregate expansion of the current account surplus.

Chart 1.2: Trends in Merchandise Trade (BD millions)



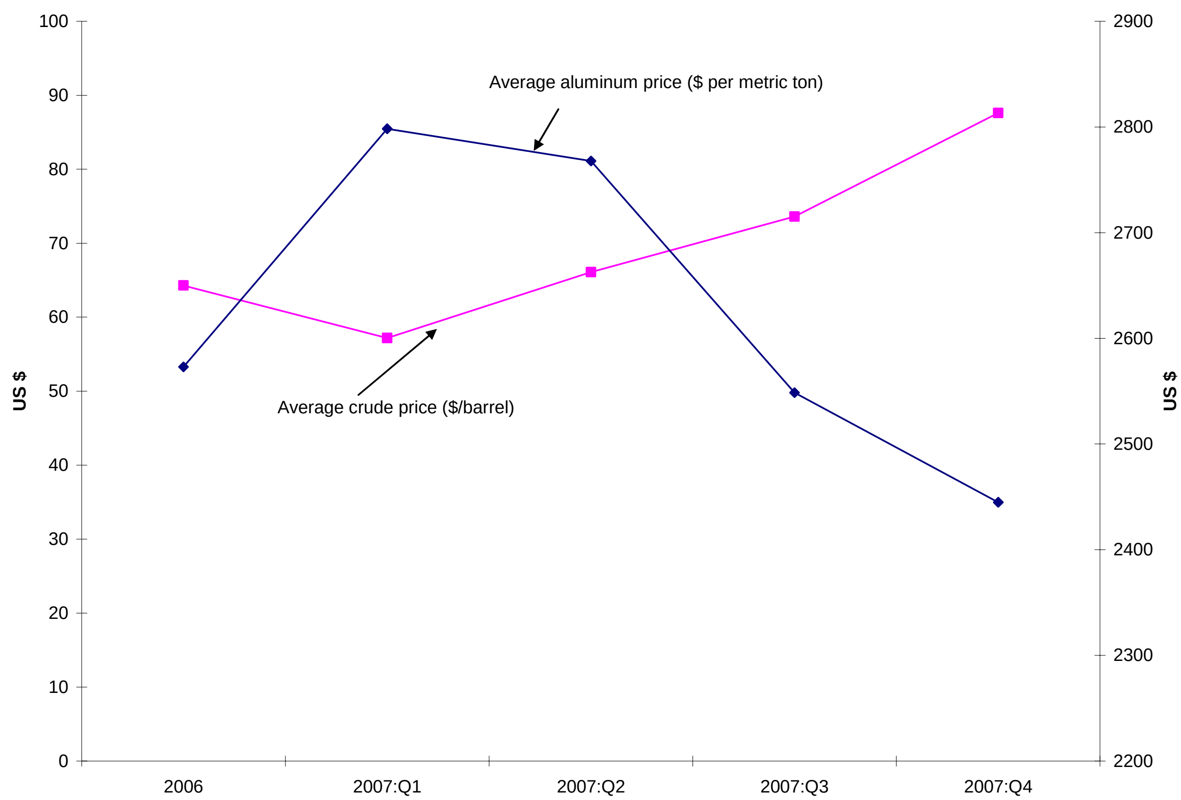
Sources: Central Informatics Organisation and National Oil and Gas Authority

Mixed picture for prices of major exports

Developments in the "goods" account were strongly influenced by movements in *international commodity prices.* Earnings from oil exports were boosted by the record high levels of crude on the international markets, with average spot market prices for petroleum reaching a high of US$87.6 per barrel at the end of 2007:Q4, compared to US$64.3 per barrel in 2006 (see Chart 1.3).

However, prices for aluminum (Bahrain's other main export item), did not fare so well. Average market prices for aluminum have been on a downward trend since peaking in 2007:Q1, falling to US$2444.8 per metric ton by the end of the fourth quarter (compared to US$2798.4 per ton in 2007:Q1).

Chart 1.3: Trends in Aluminum and Crude Oil Prices (2006-2007)

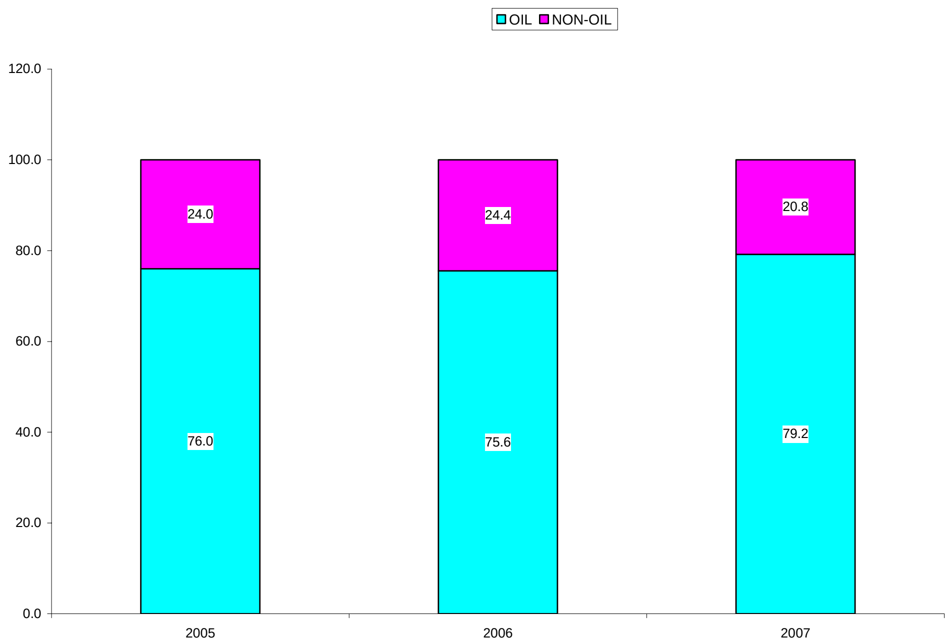


Source: IMF, International Financial Statistics, February 2008

Dominance of oil in both merchandise exports and imports

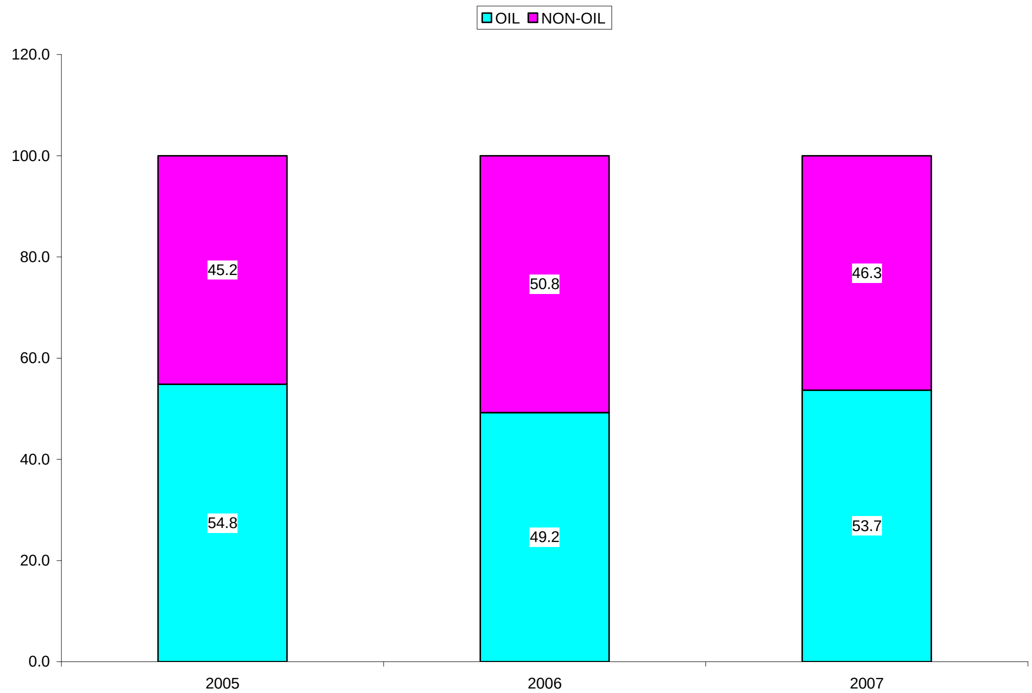
Bahrain's exports continue to be dominated by oil-related items, which accounted for roughly 79% of total export earnings in 2007 (up from 75.5% in 2006) (see Chart 1.4). Due to the reliance on Saudi crude as feedstock for Bahrain's refinery, imports were also dominated by oil, which accounted for 53.7% of the import bill (Chart 1.5).

Chart 1.4: Composition of Exports—Oil vs. Non-Oil (% shares)



Sources: Central Informatics Organisation and National Oil and Gas Authority

Chart 1.5: Composition of Imports—Oil vs. Non-Oil (% shares)



Sources: Central Informatics Organisation and National Oil and Gas Authority

Growth in trade of selected non-oil categories

Despite the fall in overall non-oil exports, some commodity groups recorded respectable growth in exports during 2007 (Table 2). For instance, exports from "chemical and allied industries" more than doubled, in addition to double-digit growth rates in shipments of "animals and animal products", "textile and textile articles", "articles of stone, plaster and cement", as well as "pearls, precious stones and metals".

On the import side, there was a 33% increase in the import of "wood and articles of wood", alongside double-digit increases in the import of "plastic and rubber articles" as well as "products of chemical and allied industries" (Table 3).

Table 2: Exports Classified by Sections of Commodities (BD Million)

	2005	2006	2007	2007 growth (%)
Animals and Animal products	7.3	8.8	10.8	22.7%
Vegetable products	1.6	2.6	1.9	-26.9%
Animal and Vegetable Fats and Oils	0.0	0.1	0.0	-100%
Prepared Foodstuffs, Beverages and Tobacco	11.8	12.1	11.6	-4.1%
Mineral products (including oil)	2993.1	3566.3	4134.7	15.9%
Products of Chemical and Allied Industries	97.7	108.7	219.4	101.8%
Plastic and Rubber articles	19.0	21.2	22.7	7.1%
Raw hides and skins, leather and others	0.1	0.6	0.5	-16.7%
Wood and articles of wood	0.2	0.2	0.1	-50.0%
Wood pulp and paper	14.6	14.6	11.5	-21.2%
Textile and Textile articles	42.8	38.5	45.4	17.9%
Footwear, Headgear and others	0.0	0.1	0.0	-100%
Articles of stone, plaster, cement and others	1.5	2.6	3.8	46.2%
Pearls, precious stones and metals	2.6	1.4	2.5	78.6%
Base metals and articles thereof	487.6	685	542.2	-20.9%
Machinery and appliances, electrical equipment	31.7	36.1	44.9	24.4%
Transport equipment	44.5	72.7	55.2	-24.1%
Optical, photographic, medical, precision equipment and others	2.4	3.7	4.4	18.9%
Other	10.7	11.9	14.6	22.7%
Total	**3769.2**	**4587.2**	**5126.2**	**11.8%**

Sources: Central Informatics Organisation and National Oil and Gas Authority

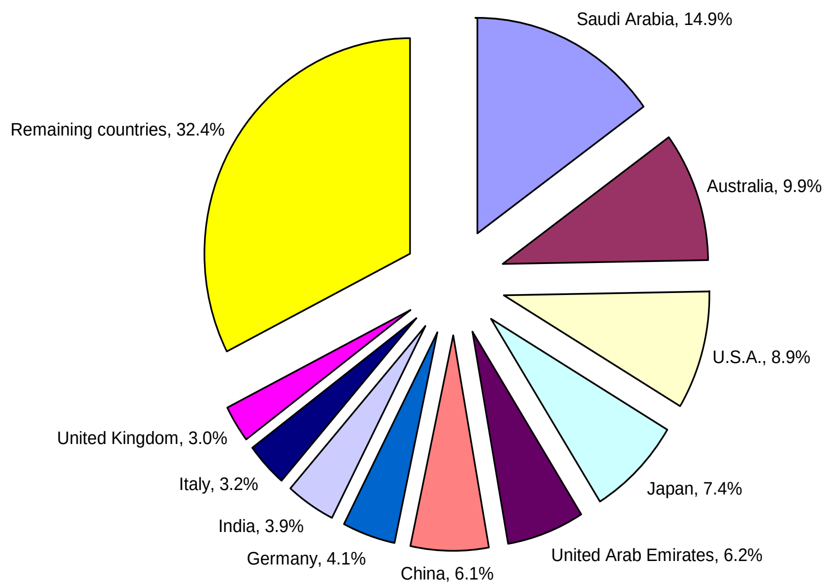
Table 3: Imports Classified by Sections of Commodities (BD Million)**

	2005	2006	2007	2007 growth (%)
Animals and Animal products	56.7	65.8	59.5	-9.6%
Vegetable products	43.7	52.6	49	-6.8%
Animal and Vegetable Fats and Oils	5.9	7.1	8	12.7%
Prepared Foodstuffs, Beverages and Tobacco	82.2	103.9	107.8	3.8%
Mineral products (including oil)	1708.4	1975.4	2295.2	16.2%
Products of Chemical and Allied Industries	189.9	337.5	377	11.7%
Plastic and Rubber articles	47.3	58.8	76.2	29.6%
Raw hides and skins, leather and others	2.7	5.4	4.9	-9.3%
Wood and articles of wood	15.2	23	30.6	33.0%
Wood pulp and paper	24.5	33.9	36.3	7.1%
Textile and Textile articles	62.4	75.6	64.3	-15%
Footwear, Headgear and others	5.2	7.9	7.0	-11.4%
Articles of stone, plaster, cement and others	33.9	51.9	56.7	9.3%
Pearls, precious stones and metals	11.3	18.1	16.7	-7.7%
Base metals and articles thereof	159.9	234	261.8	11.9%
Machinery and appliances, electrical equipment	270.9	479.5	426.2	-11.1%
Transport equipment	218.7	333.6	370.9	11.1%
Optical, photographic, medical, precision equipment and others	18.8	41.4	26.5	-36%
Other	30.2	48.3	44.8	-7.3%
Total	**2987.8**	**3953.7**	**4319.4**	**9.2%**

Sources: Central Informatics Organisation and National Oil and Gas Authority

*** Import figures above include cost, insurance and freight (cif). These do not directly match import numbers in Table 1 which are shown at cost only.*

Chart 1.6: Bahrain's Top 10 Trading Partners in 2007—Non-Oil Exports + Imports
(% shares)



Sources: Central Informatics Organisation and National Oil and Gas Authority

Changes in the composition of top trading partners[1]

As in previous years, Saudi Arabia was Bahrain's largest trading partner during 2007, accounting for 14.9% of total *non-oil* merchandise trade (Chart 1.6). However, Australia displaced Japan as Bahrain's second largest trading partner, with Japan falling to fourth in the rankings. Another notable development was the emergence of Italy as the 9th largest trading partner at the expense of the United Kingdom (which moved to 10th) and of South Korea, which did not make the Top 10 list in 2007.

[1] The breakdown of oil trade by country is not available.

Direction of non-oil exports by region

In 2007, the bulk of Bahrain's *non-oil exports* (49.6%) went to Arab countries (including GCC)(see Table 4). This represented an 8.7 percentage point increase over the 2006 figures. Over the same period, exports to Asia fell substantially from 35.2% of the total to 19.6% and exports to Europe, the Americas and Oceania recorded gains.

Table 4: Regional Direction of Non-Oil Exports (% shares)

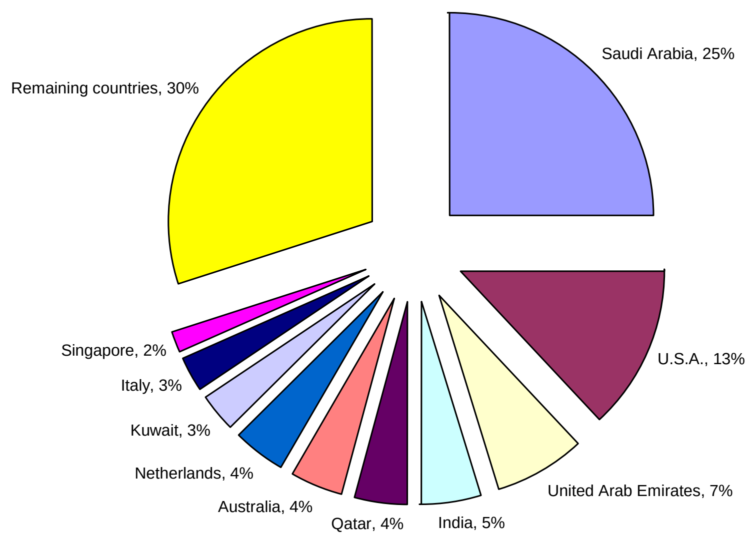
	2005	2006	2007
Arab countries	47.6	40.9	49.6
African countries	0.2	0.4	0.4
Asian countries	31.2	35.2	19.6
European countries	8.2	11.0	12.3
The Americas	10.1	9.8	13.3
Oceanic countries	2.3	2.2	4.4
Other	0.5	0.5	0.4

Source: Central Informatics Organisation

Direction of non-oil exports by country

Chart 1.7 below presents the relative shares of Bahrain's Top Ten trading partners in the total value of non-oil exports. Not surprisingly, Saudi Arabia is the single largest market for Bahrain's non-oil exports, accounting for 25% of total export earnings (up from 21% in 2006). The USA comes next with 13% (up from 9.3%), followed by the UAE (7%), India (5%), Qatar (4%) and Australia (4%). Notable developments include the emergence of the UAE in the 3rd position (displacing India), the fall of Singapore to 10th (from 4th) and the rise of Qatar to 5th position (from 6th).

Chart 1.7: Bahrain's Top Ten Export Markets---2007 (Non-oil only; % shares)



Source: Central Informatics Organisation

Sources of non-oil imports by region

A look at the *sources of non-oil imports* by region shows that most of Bahrain's imports in 2007 came from Asian countries (32.8%), followed by European countries (25.5%), and Arab countries (19.2%)(including GCC) (Table 5). There was a significant rise in imports from Oceania from 8.5% of the total in 2006 to 13.1% in 2007. Imports from the Americas remained modest at 9% of the total.

Table 5: Sources of Non-Oil Imports by Region (% shares)

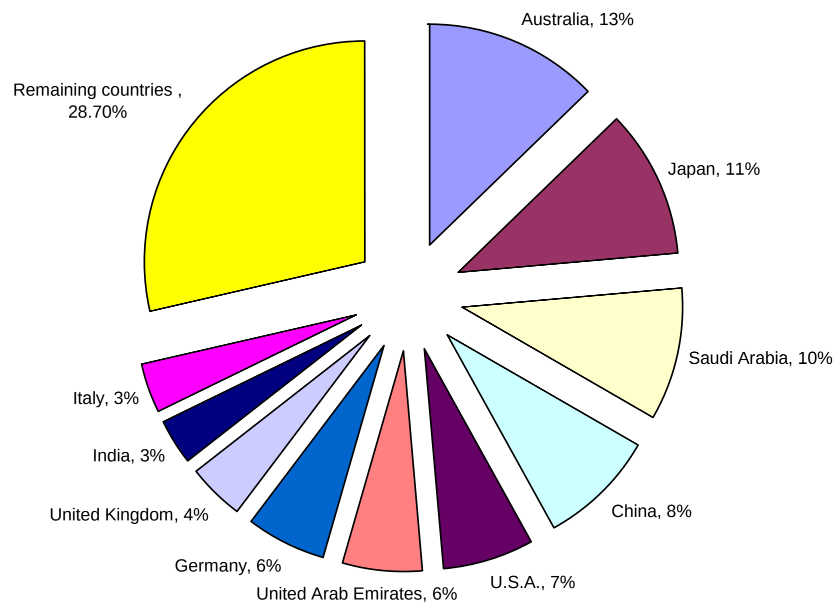
	2005	2006	2007
Arab countries	17.6	20.6	19.2
African countries	0.3	0.3	0.4
Asian countries	32.2	34.0	32.8
European countries	29.5	25.8	25.5
The Americas	11.2	10.7	9
Oceanic countries	9.1	8.5	13.1
Other	0.0	0.1	0.1

Source: Central Informatics Organisation

Sources of non-oil imports by country

Chart 1.8 presents the relative shares of Bahrain's Top Ten sources of non-oil imports. Displacing Japan into 2nd place, Australia emerges as the single largest source of Bahrain's non-oil imports in 2007, accounting for 13% of total import payments. Saudi Arabia falls to third with 10%, followed by China (8%), the United States (7%), and the UAE (6%).

Chart 1.8: Bahrain's Top Ten Sources of Non-Oil Imports—2007 (% shares)



Source: Central Informatics Organisation

Substantial non-oil trade with other GCC countries

Bahrain's trade with other GCC countries (Kuwait, Oman, Qatar, Saudi Arabia, and UAE) continues to be significant, especially on the export side. In 2007, Bahrain's non-oil imports from other GCC countries accounted for 18% of total imports while exports to GCC countries represented 41% of total non-oil exports (up from 35% in 2006) (Table 6). Imports from GCC countries increased from BD293.8 million in 2006 to BD380.3 million in 2007 (a 29.4% rise), while exports also increased by 42.6% from BD306.3 million to BD437 million, reversing the fall experienced during 2006.

If we examine the data on a country-by-country basis, trade with Saudi Arabia continues to account for the bulk of Bahrain's GCC trading activities, both on the import and export sides (Table 7).

Table 6: Bahrain—Total Trade vs. Trade with GCC Countries (Non-oil)

	IMPORTS			EXPORTS		
	2005	2006	2007	2005	2006	2007
All countries (BD million)	1420	1520.7	2114.5	842.6	881.8	1066.9
GCC only (BD million)	230.2	293.8	380.3	369.1	306.3	437.0
% share of GCC	16.2%	19.3%	18%	43.8%	34.7%	41%

Source: Central Informatics Organisation

Table 7: Bahrain's Trade with GCC Countries (Non-oil) (% shares)

	IMPORTS			EXPORTS		
	2005	2006	2007	2005	2006	2007
Saudi Arabia	57.6	60.2	54.6	62.9	60.2	60.8
United Arab Emirates	31.1	28.1	32.3	14.7	17.3	17.3
Kuwait	5.1	3.6	6.2	7.7	8.6	7.7
Oman	2.9	3.0	3.1	3.8	2.6	3.6
Qatar	3.3	5.0	3.9	10.9	11.3	10.7

Source: Central Informatics Organisation

1.2. Trade in Services

Surplus on services widens

Bahrain's surplus on "services" increased to BD 685.6 million in 2007, from BD645.6 million in 2006 (Table 1). Underlying this increase was the 15.2% expansion in receipts from "other business services", and the 9.4% rise in receipts from "financial services" (including insurance). Positive contributions also came from increases in the surpluses from "transportation", "travel" and "communication services".

1.3. Income Account

Net outflows on income account shrink further

Although the income account still showed a net outflow in 2007, the size of the net outflow continues to shrink. During the year, foreigners' income from their investments in Bahrain amounted to BD4012.8 million, compared to receipts of BD3900.5 million on Bahraini assets abroad. This resulted in a *net outflow* of BD112.3 million on the income account (see Table 1). However, this is much smaller than the net outflows of BD144.7 million and BD155 million recorded in 2006 and 2005 respectively.

The reduction in the size of the outflows was driven primarily by a substantial increase in receipts from Bahraini portfolio investments abroad (stocks and bonds), resulting in an expansion in the surplus on "portfolio income" from BD598.1 million to BD772.4 million.

1.4. Current Transfers (net)

Reduced deficit on current transfers account

Net current transfers to foreigners fell to BD557.5 million in 2007 from BD575.6 million in 2006, due to a reduction in remittances by expatriate workers currently resident in Bahrain. This is contrary to expectations, as one would expect an increase in the absolute value of remittances, given the declining value of the dinar against non-US dollar currencies (a declining value means more dinars are needed to maintain the same real level of remittances to home countries). An alternative explanation could be that expatriates have reduced the real value of remittances, probably in expectation of a recovery in the value of the dollar (and dinar) in the coming months[2].

2. Capital and Financial Account

Increased net outflows on the capital and financial account

Net outflows on the capital and financial account expanded to BD1096.6 million in 2007 (from BD826.7 million in 2006), as Bahrain continues to be a net exporter of capital to the rest of the world (Table 1). While the *capital account* showed a net inflow of BD18.8 million (following a net inflow of BD28.2 million in 2006), this was overwhelmed by the increased deficit on the *financial account,* which showed a net outflow of BD1115.4 million (compared to a net outflow of BD854.9 million in 2006).

Significant increase in Bahraini portfolio investments abroad

The net outflow on the financial account is attributable mainly to the outflow of BD 3218.5 million in "portfolio investments" as the acquisition of foreign stocks and bonds by Bahraini residents surpassed similar investments in Bahrain by non-residents. On the asset side of the portfolio account, acquisition of foreign equities by Bahraini residents increased by BD1266.4 million in 2007 (vs. BD827.4 million in 2006) (Table 8). Banks were the major investors in foreign equities, accounting for 65% of total Bahraini investments in foreign equities.

Acquisition of debt securities increased by BD2452.3 million (vs. BD3130.8 million in 2006), again driven by the increased investment of Bahraini banks in bonds and notes. There were no recorded transactions in financial derivatives.

[2] Data on current transfers are usually subject to revisions. The picture should become clearer when revised figures become available.

Table 8: Details of the Financial Account—2005-2007

Items	2005**	2006**	2007***
Overall Financial Account (1+2+3+4)*	**-629.5**	**-854.9**	**-1115.4**
1. Direct Investment (net)	**-32.6**	**727.5**	**32.7**
(A) Abroad	***-426.9***	***-368.5***	***-627.6***
- Equity capital	-320.7	-231.6	-464.1
- Reinvested earnings	-106.2	-136.9	-163.5
(B) In Bahrain	***394.3***	***1096.0***	***660.3***
- Equity capital	129.3	793.2	251
- Reinvested earnings	264.9	302.8	409.3
2. Portfolio Investment (net)	**-1,735.0**	**-3320.5**	**-3218.5**
(A) Assets	-2645.6	-3958.2	-3718.7
- Equity securities	-834.6	-827.4	-1266.4
Banks	*-415.0*	*-504.6*	*-821.0*
Other sectors	*-419.6*	*-322.9*	*-445.4*
- Debt securities	-1811.0	-3130.8	-2452.3
Bonds and Notes	-1811.0	-3130.8	-2452.3
Banks	*-1706.6*	*-3050.5*	*-2341.3*
Other sectors	*-104.4*	*-80.3*	*-110.9*
(B) Liabilities	910.6	637.7	500.2
- Equity securities	677.2	50.3	52.2
Banks	*0*	*0*	*0*
Mutual Funds	*677.2*	*50.3*	*52.2*
- Debt securities	233.4	587.4	448.0
Bonds and Notes	233.4	587.4	448.0
Banks	*233.4*	*587.4*	*448.0*
3. Other Investment (net)	**1248.7**	**2047.2**	**2602.3**
(A) Assets	-4347.5	-11,368.3	-14,477.8
- Trade Credits	*0*	*0*	*0*
- Loans	-3162.0	-5882.4	-9228.7
Banks	*-3162.0*	*-5882.4*	*-9228.7*
- Currency and deposits	-1185.3	-5482.8	-5246.3
Banks	*-1185.3*	*-5482.8*	*-5246.3*
- Other assets	-0.1	-3.1	-2.8
(B) Liabilities	5,596.2	13,415.5	17,080.1
- Trade Credits	-4.2	-2.1	-2.9
- Loans	36.8	30.4	41.3
Government	*14.9*	*8.5*	*17.4*
Long term	*14.9*	*8.5*	*17.4*
Short term	*0*	*0*	*0*
Other sectors	*21.9*	*21.9*	*23.9*
Long term	*21.9*	*21.9*	*23.9*
Short term	*0*	*0*	*0*
- Currency and deposits	5563.8	13390.4	17044.9
Banks	*5563.8*	*13390.4*	*17044.9*
- Other liabilities	-0.2	-3.2	-3.2
4. Reserve Assets	**-110.6**	**-309.1**	**-531.9**

**Financial transactions. A negative sign means net outflows/increases in external assets*
***Revised data; *** Provisional data*
Source: Central Informatics Organisation

On the liability side, inflow of portfolio investments into Bahrain from non-residents amounted to BD500.2 million, smaller than the BD637.7 million inflow recorded in 2006. This slowdown was principally influenced by a slowdown in debt securities which recorded an inflow of BD448 million in 2007, compared to an inflow of BD587.4 million in 2006.

Fall in inflows of foreign direct investment

The "direct investment" account shows a net inflow of BD32.7 million in 2007, significantly down from the BD727.5 million inflow of 2006. This is largely explained by the reduced inflow of BD660.3 million in "foreign direct investment in Bahrain" (compared to an inflow of BD1096 million in 2006), coupled with in increased outflow of BD627.6 million in Bahrain's "direct investment abroad" (compared to a BD 368.5 million outflow in 2006)[3].

Underlying this trend was the recorded increase in Bahraini equity capital investments abroad alongside a reduction in equity capital investments in Bahrain by nonresidents.

Other investments and reserve assets

The "other investment" category (including loans, currency and deposits) also showed a net inflow of BD2602.3, higher than the net inflow of BD2047.2 million recorded in 2006. Trends in this category were driven principally by the increased inflow of nonresident deposits into Bahraini banks.

Lastly, Bahrain's "official reserve assets" (gold, SDR, IMF reserve position and foreign exchange) swelled by BD531.9 million in 2007, following an increase of BD 309.1 million in 2006.

[3] Further investigation revealed that FDI numbers for 2006 were influenced substantially by a particularly large investment in the financial services sector. 2007 numbers may therefore indicate a return to more normal levels of inflows.

3. Errors and Omissions

The statistical discrepancy--*errors and omissions in recorded transactions*--was a positive BD3.7 million in 2007, compared with a positive BD4.2 million in 2006. This discrepancy is equivalent to 0.04% of the combined value of exports and imports of goods, well within the internationally accepted benchmark of 5%. However, the consistent positive value of the discrepancy over the past three years points to the possible omission of some credit entries or overstatement of debit entries[4].

4. International Investment Position (IIP)

Bahrain continues to be a net creditor to the rest of the world

At year-end 2007, Bahrain's net international investment position (net IIP) showed a surplus of BD4949.4 million, indicating that Bahrain is a net creditor to the rest of the world (i.e. the value of Bahraini investments abroad exceeded the value of foreign investments in Bahrain) (Table 9).

Table 9: Bahrain's Net International Investment Position (BD millions)

	2005	2006	2007	2007 Change (BD million)
Foreign Assets	46,882.4	62,890.0	82,234.5	**19,344.5**
Foreign Liabilities	43,933.9	59,057.6	77,285.1	**18,227.5**
Net Investment Position	2,948.5	3,832.4	4,949.4	**1,117.0**

Source: Central Informatics Organisation

In 2006, the net IIP was BD3832.4 million, indicating that the net creditor position of Bahrain widened by BD1,117.0 million during 2007. Underlying this trend was an expansion in foreign assets of BD19,344.5 million, fuelled by an increase of BD14,473.8 million in "other assets"[5]

[4] See IMF (2007), *Draft Balance of Payments and International Investment Position Manual,* Chapter 2, Section 4.

[5] "Other investments" of Bahraini residents consisted mainly of bank loans and deposits abroad.

(Table 10). However, increases were also registered in portfolio assets (by BD3709.7 million), and direct investment abroad (by BD627.6 million).

Foreign liabilities increased by BD18,227.5 million, due principally to an increase of BD17, 067 million in "other investments" by foreigners in Bahrain (Tables 9 and 10). Smaller increases were recorded in "direct investment in Bahrain" (by BD660.4 million), and portfolio investments in Bahrain (by BD 500.1 million) (Table 10).

Table 10: Components of Bahrain's Investment Position (BD millions)

	2005	2006	2007	2007 Change (BD million)
Direct Investment Position				
Direct Investment Abroad	1,906.5	2,275.0	2,902.6	**627.6**
Direct Investment in Bahrain	3,111.8	4,207.7	4,868.1	**660.4**
Net Position	-1205.3	-1932.8	-1965.5	**-32.7**
Portfolio Investment Position				
Portfolio Assets	12,532.7	16,500.0	20,209.7	**3709.7**
Portfolio Liabilities	1,879.4	2,517.2	3,017.3	**500.1**
Net Position	10,653.3	13,982.8	17,192.4	**3209.6**
Other Investment Position				
Other Assets	31,693.8	43,057.8	57,531.6	**14473.8**
Other Liabilities	38,942.7	52,332.7	69,399.7	**17067**
Net Position	-7248.9	-9274.9	-11868.1	**-2593.2**

*** Provisional Data*
Source: Central Informatics Organisation

5. Balance of Payments Outlook for 2008

We envisage that Bahrain's current account balance will expand further in 2008, buoyed by elevated levels of oil prices. However, the possible slowdown in world output due to the ongoing crisis in international financial markets and the slowdown in the US economy will most likely dampen non-oil exports (especially aluminum). Higher import prices due to the weakening dollar will also increase the import bill somewhat. Overall, we expect the expansion in the current account surplus to be modest.

In addition, the enduring attraction of Bahrain as a tourist destination, for visitors from within and outside the GCC will help ensure high levels of receipts on the services account. The Formula One racing event which took place in April 2008 is expected to contribute substantially to receipts on the "travel" account. Various exhibitions and conferences taking place during 2008 should also contribute to an increased surplus on the "services" account.

Workers' remittances will continue to register net outflows, given the large number of expatriate workers in Bahrain relative to Bahrainis working abroad.

On the capital and financial account, acquisition of portfolio investments abroad is expected to continue although at a slower pace, given the volatility in international financial markets. Further inflows of foreign direct investment into Bahrain are also envisaged, given the favourable investment climate in the Kingdom.

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