



Financial Stability Directorate

Balance of Payments Report 2008

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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. Therefore, international transactions are 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 2008. 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, 2008 BOP and IIP data analyzed in this report are "provisional".

Overview

During 2008, the global financial crisis worsened and began to have dramatic effects on real economies across the globe. Commodity prices collapsed and many industrial economies slid into recession. World trade contracted. In this unfavorable environment, Bahrain's external accounts came under pressure, resulting in a contraction of the current account surplus. Nonetheless, the amount of foreign direct investment still increased during the year and the net International Investment Position (IIP) widened further.

The *current account surplus* contracted to BD848.6 million, a decrease of 22.4% when compared to 2007. This situation was due mainly to a 210% increase in net payments on the *income account* as Bahraini residents saw a substantial fall in receipts from portfolio investments abroad. Although oil prices fell dramatically during the final quarter of the year, there was no discernible impact on overall oil export receipts which were 28% higher compared to 2007.

Mirroring the overall direction of the current account balance, the surplus on *services* decreased to BD643 million in 2008 (from BD685.6 million in 2007), influenced largely by the negative net position on the "transportation" account. Net receipts on "travel", "communications", "financial", and "other business services" were positive.

In contrast to the downward trend of the past three years, there was an increase in the size of net payments on the *income account* during 2008. Also, *current transfers* rose to BD667.2 million due to increased remittances by expatriate workers currently resident in Bahrain.

Net outflows on the *capital and financial account* dropped to BD837.2 million in 2008 (compared to BD1,096.6 million in 2007), as Bahraini residents lost the appetite for portfolio investments abroad in the wake of the global financial crisis.

The statistical discrepancy--*errors and omissions in recorded transactions*--was a negative BD11.4 million in 2008, equivalent to 0.09% of the

combined value of exports and imports of goods, well within the internationally accepted benchmark of 5%.

At year-end 2008, Bahrain's *net international investment position* (net IIP) showed a surplus of BD5,774.9 million, demonstrating Bahrain's position as a net creditor to the rest of the world. In 2007, the net IIP was BD4,949.4 million, indicating that the net creditor position of Bahrain widened by BD825.5 million during 2008.

In terms of the *future outlook for the balance of payments*, we envisage that Bahrain's current account balance will shrink further in 2009 if oil prices remain soft and economic activity stays depressed in major export markets. However, lower oil prices should also lower Bahrain's import bill, thus helping to mitigate the extent of the contraction.

On the capital and financial account, the appetite for portfolio investments abroad is expected to remain dampened as residents await signs of a full turnaround in global financial markets. Further inflows of foreign direct investment are also expected, albeit at a slower pace.

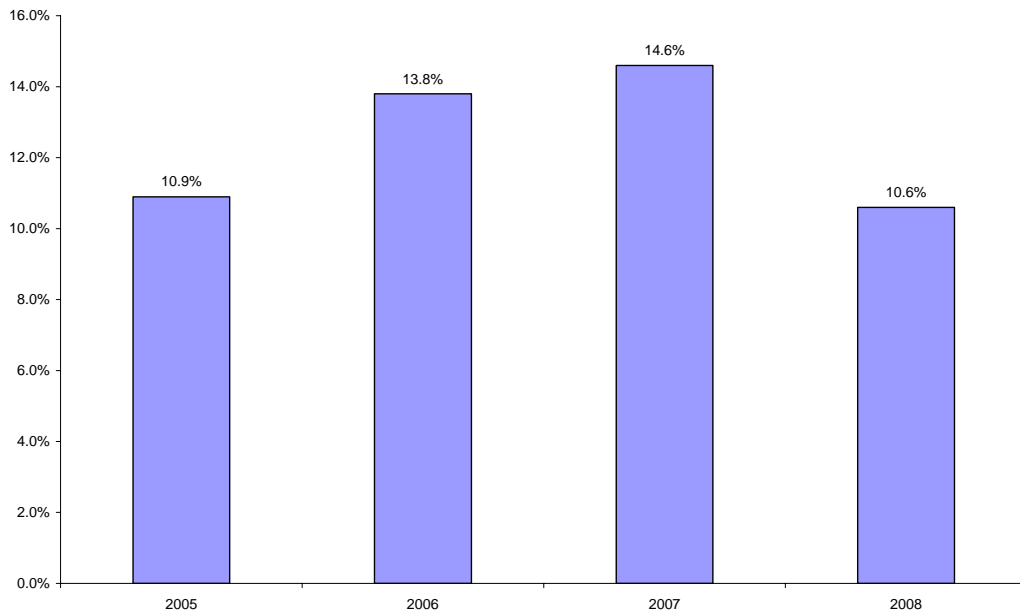
1. The Current Account

Current account surplus contracts

Against a background of a worsening global financial crisis, Bahrain's current account surplus shrank in 2008, to an estimated BD848.6 million (10.6% of projected GDP). This was 22.4% lower than the BD1,092.9 million surplus attained in 2007 (see Chart 1.1 and Table 1).

The contraction in the current account surplus position stemmed principally from a 210% increase in the *deficit on income*, as the global financial crisis intensified during the year. Also, there was a reduced surplus on the *services account* and *current transfers to foreigners* (workers' remittances) rose from BD557.5 million in 2007 to BD667.2 million in 2008, putting additional downward pressure on the current account surplus. The only positive trend was recorded in the *goods account*, which showed a surplus of BD1,220.1 million, 13.3% higher than the 2007 surplus.

Chart 1.1: Bahrain's Current Account Balance (2005-2008; % of GDP)**



Source: Central Bank of Bahrain

** 2008 GDP figures are IMF projections.

Table 1: Summary of Bahrain's Balance of Payments—2005-2008 (BD Million)

| Items | 2005 | 2006** | 2007** | 2008** |
|---|----------------|----------------|----------------|-----------------|
| 1. Current Account (a+b+c+d) | 554.3 | 822.5 | 1092.9 | 848.6 |
| a. Goods | 555.7 | 897.2 | 1077.2 | 1,220.1 |
| General Merchandise | 515.6 | 844.6 | 1018.2 | 1154.1 |
| Exports (fob) | 3851.0 | 4587.2 | 5126.2 | 6,510.7 |
| - Oil | 2926.6 | 3465.8 | 4059.3 | 5184.6 |
| - Non-Oil | 924.4 | 1121.4 | 1066.9 | 1326.1 |
| Imports (fob) | -3335.4 | -3742.6 | -4108.0 | -5,356.6 |
| - Oil | -1567.8 | -1843.0 | -2204.9 | -2708.8 |
| - Non-Oil | -1767.6 | -1899.6 | -1903.1 | -2647.8 |
| Repairs on goods | 40.1 | 52.6 | 58.9 | 66.0 |
| b. Services (net) | 613.6 | 645.6 | 685.6 | 643.0 |
| - Transportation | 19.8 | 18.1 | 19.1 | -54.2 |
| - Travel | 190.2 | 222.7 | 235.5 | 249.2 |
| - Communication services | 235.5 | 232.4 | 241.7 | 250.1 |
| - Financial services (incl. insurance) | 158.3 | 160.6 | 175.7 | 183.0 |
| - Other Business Services | 9.8 | 11.8 | 13.6 | 14.9 |
| c. Income (net) | -155.0 | -144.7 | -112.3 | -347.3 |
| Investment Income | -155.0 | -144.7 | -112.3 | -347.3 |
| - Direct Investment Income | -258.4 | -315.4 | -447.6 | -479.0 |
| - Portfolio Income | 386.4 | 598.1 | 772.4 | 408.7 |
| - Other Investment Income | -283.0 | -427.4 | -437.2 | -277.0 |
| d. Current Transfers (net) | -460.0 | -575.6 | -557.5 | -667.2 |
| - Workers' Remittances | -460.0 | -575.6 | -557.5 | -667.2 |
| 2. Capital and Financial Account (net) (A+B) | -610.7 | -826.7 | -1096.6 | -837.2 |
| A. Capital Account (net) | 18.8 | 28.2 | 18.8 | 18.8 |
| - Capital Transfers | 18.8 | 28.2 | 18.8 | 18.8 |
| B. Financial Account (1+2+3+4)* | -629.5 | -854.9 | -1115.4 | -856.0 |
| 1. Direct Investment | -32.6 | 727.5 | 32.7 | 65.2 |
| - Abroad | -426.9 | -368.5 | -627.6 | -609.3 |
| - In Bahrain | 394.3 | 1096.0 | 660.3 | 674.5 |
| 2. Portfolio Investment (net) | -1735.0 | -3320.5 | -3218.5 | 3,488.1 |
| - Assets | -2645.6 | -3958.2 | -3718.7 | 2,363.8 |
| - Liabilities | 910.6 | 637.7 | 500.2 | 1,124.3 |
| 3. Other Investment (net) | 1248.7 | 2047.2 | 2602.3 | -4,519.9 |
| - Assets | -4347.5 | -11368.3 | -14477.8 | -1,227.5 |
| - Liabilities | 5596.2 | 13415.5 | 17080.1 | -3,292.4 |
| 4. Reserve Assets (net) | -110.6 | -309.1 | -531.9 | 110.6 |
| 3. Errors and Omissions | 56.4 | 4.2 | 3.7 | -11.4 |

**Provisional Data

*Financial transactions. A negative sign means net outflows/increases in external assets

Sources: Central Bank of Bahrain

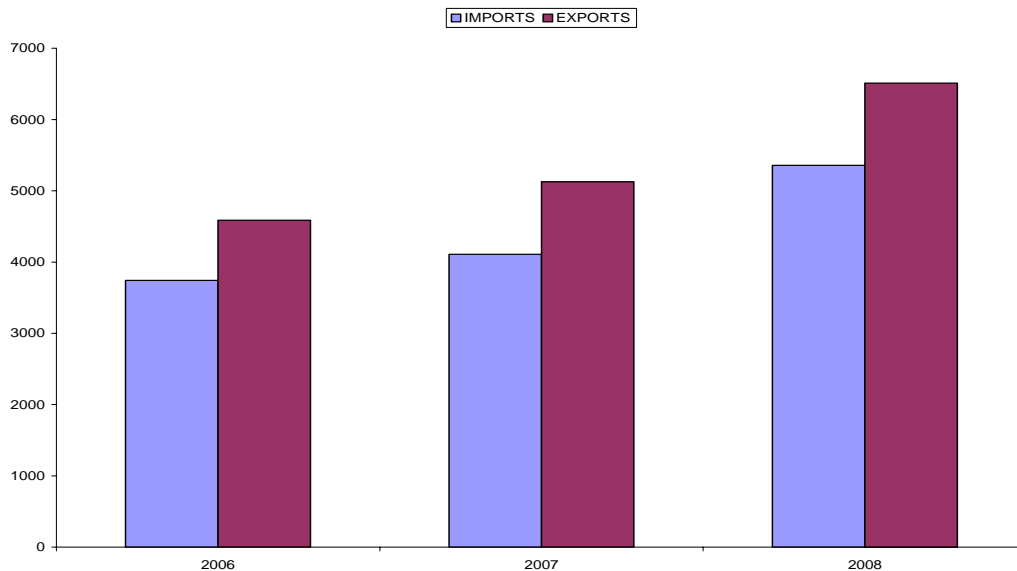
1.1. Trade in Goods

Higher export earnings contribute to goods account surplus

Although oil prices fell substantially during the fourth quarter of 2008, this came too late to have any negative impact on Bahrain's overall earnings from oil exports, with a 28% increase in oil export receipts recorded for 2008 (Table 1). Non-oil export earnings were also up by 24.3%, reversing the decline shown for 2007. Hence, total earnings from *merchandise exports* (f.o.b) increased from BD5,126.2 million in 2007 to BD6,510.7 million in 2008 (a 27% increase).

Payments for *merchandise imports* (f.o.b) increased from BD4108 million in 2007 to BD5,356.6 million in 2008, an overall growth of 30.4%. Unlike in previous years, non-oil imports provided the impetus, with a 39% expansion, compared to a 23% growth in oil imports. With export earnings managing to outstrip import payments, *the overall surplus on goods* grew by 13.3% between 2007 and 2008. Although respectable, this was lower than the 20% expansion recorded during the previous year.

Chart 1.2: Trends in Merchandise Trade (BD millions)

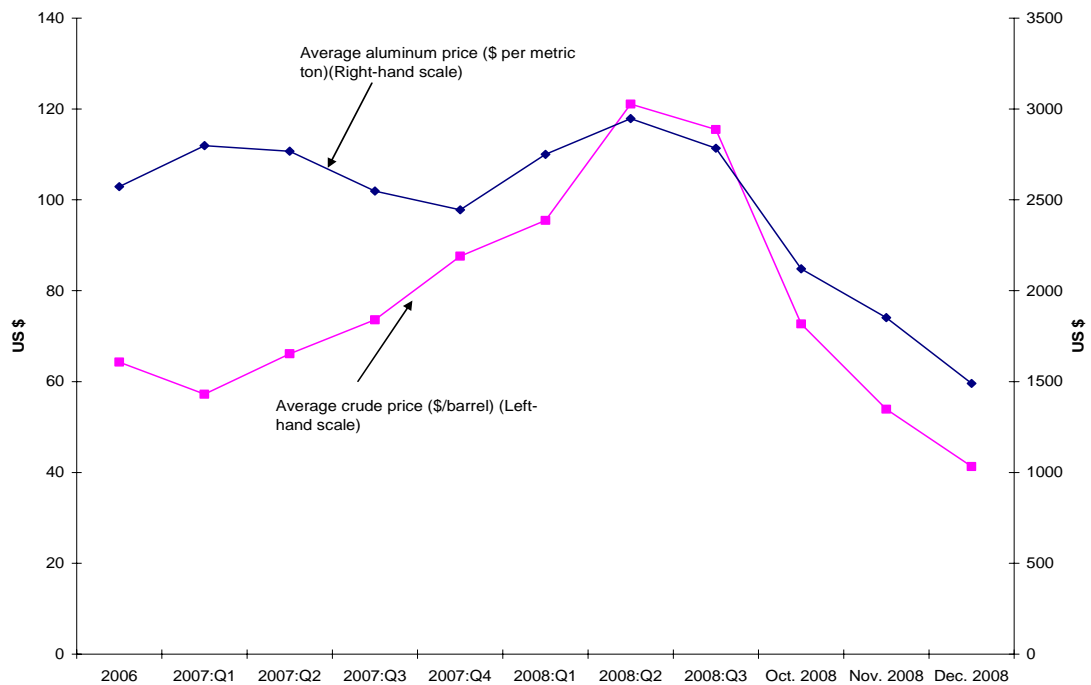


Sources: Central Informatics Organisation and National Oil and Gas Authority

Downward trend in prices of major exports

During the year under review, there was a sharp turnaround in commodity prices. Focusing on two commodities of importance to Bahrain (oil and aluminium), *average crude prices* peaked at \$121 per barrel in the second quarter of 2008 before falling sharply to \$72 per barrel in October 2008 (Chart 1.3)¹ At some point in July 2008, oil was trading at the record level of \$145 per barrel. By end-December 2008, oil prices averaged only \$41 per barrel, a 66% fall from its peak.

Chart 1.3: Trends in Aluminum and Crude Oil Prices (2006-2008)



Sources: IMF, International Financial Statistics and World Bank Commodity Prices Database

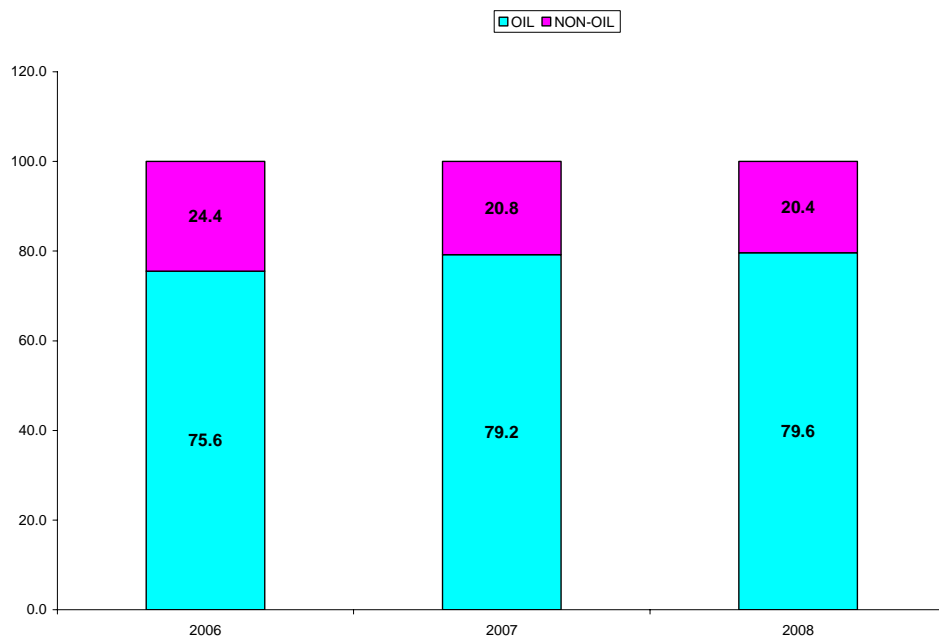
Aluminium prices have similarly taken a downward path, falling from a peak of \$2948 per metric ton in 2008:Q2 to stand at \$1490 per metric ton in December 2008, a fall of 49%.

¹ Please note that these are average prices over the period (quarter or month).

Dominance of oil in both merchandise exports and imports

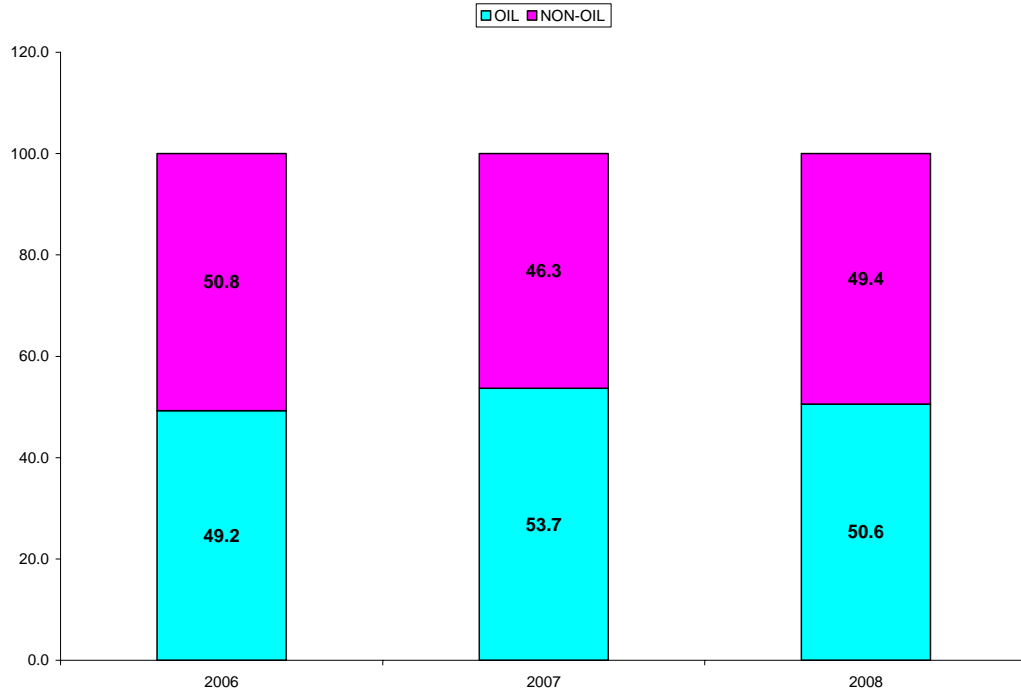
Bahrain's exports continue to be dominated by oil-related items, which accounted for roughly 80% of total export earnings in 2008 (see Chart 1.4). On the import side, although oil imports still outweigh non-oil imports, the respective shares are much closer. While oil accounted for 51% of the import bill in 2008, non-oil payments represented 49% of the total (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

1.2 Trade in Services

Smaller surplus on services

Bahrain's surplus on "services" dropped to BD643 million in 2008, from BD685.6 million in 2007 (Table 1). The primary reason for the decline was the "transportation" account, which showed a *negative* net position to the tune of BD54 million. Net receipts from the other sub-accounts (travel, communications, financial and other business services) were positive.

1.3. *Income Account*

Significant increase in net payments on income account

As in previous years, Bahrain's income account showed a negative net payment position for 2008. However, in sharp contrast to the downward trend of the past three years, the size of the net payments expanded substantially to BD347.3 million, 210% higher than the BD112.3 million recorded in 2007 (see Table 1).

The expansion in the size of the deficit was due principally to a substantial fall in receipts from Bahraini portfolio investments abroad (stocks and bonds), as the global financial crisis hit various asset classes around the world.

1.4. *Current Transfers (net)*

Increase in current transfers

Net current transfers to foreigners rose to BD667.2 million in 2008, compared to BD557.5 million the previous year. As the economic situation deteriorated across the globe, many expatriate workers in Bahrain increased the amount of remittances to their home countries, in order to compensate for the negative impact on relatives and other dependents. We also saw an increase in the absolute number of expatriate workers in Bahrain, which rose from 277,790 in 2007 to 354,017 by the end of 2008 (an increase of 27.4%)².

² Data from General Organization for Social Insurance (GOSI) and Civil Service Bureau.

2. Capital and Financial Account

Fall in net outflows on the capital and financial account

Although Bahrain continues to be a net exporter of capital to the rest of the world, net outflows on the capital and financial account fell to BD837.2 million in 2008 (from BD1096.6 million in 2007) (Table 1). While the net outflow of BD18.8 million on the *capital account* was the same as in 2007, a reduction in the net outflow on the *financial account* to BD856 million (from BD1115.4 million in 2007), helped to reduce the overall net position on the capital and financial account.

Net positive position on portfolio investments

During 2008, the “portfolio investment” component of the financial account registered a net inflow of BD3,488.1 million as Bahrainis lost the appetite for portfolio investments abroad. On the asset side of the portfolio account, acquisition of *foreign equities* by Bahraini residents increased by a meager BD298.2 million, compared to BD1,266.4 million in 2007 (Table 2, next page). Underlying this was a sharp reversal in banks’ position in equities, swinging from being net investors in equities in 2007 (amounting to BD821 million) to net sellers of equities in 2008 (to the tune of BD534.4 million). A similar story is repeated on the *debt securities* front, where 2008 saw Bahrain become a net importer of bond capital, due to the reversal of banks’ position in debt securities.

On the liability side, inflow of portfolio investments into Bahrain from non-residents amounted to BD1,124.3 million, 125% higher than the BD500.2 million inflow recorded in 2007. This spike was principally influenced by a sharp increase in debt securities which recorded an inflow of BD1,065.5 million in 2008, compared to an inflow of BD448 million in 2007. The pay-off of an outstanding government bond also contributed.

Table 2: Details of the Financial Account—2006-2008

| Items | 2006 | 2007** | 2008** |
|---|----------------|----------------|-----------------|
| Overall Financial Account (1+2+3+4)* | -854.9 | -1115.4 | -856.0 |
| 1. Direct Investment (net) | 727.5 | 32.7 | 65.2 |
| (A) <i>Abroad</i> | -368.5 | -627.6 | -609.3 |
| - Equity capital | -231.6 | -464.1 | -400.6 |
| - Reinvested earnings | -136.9 | -163.5 | -208.7 |
| (B) <i>In Bahrain</i> | 1096.0 | 660.3 | 674.5 |
| - Equity capital | 793.2 | 251 | 200.6 |
| - Reinvested earnings | 302.8 | 409.3 | 473.9 |
| 2. Portfolio Investment (net) | -3320.5 | -3218.5 | 3,488.1 |
| (A) Assets | -3958.2 | -3718.7 | 2,363.8 |
| - Equity securities | -827.4 | -1266.4 | -298.2 |
| <i>Banks</i> | -504.6 | -821.0 | 534.4 |
| <i>Other sectors</i> | -322.8 | -445.4 | -832.7 |
| - Debt securities | -3130.8 | -2452.3 | 2,662.1 |
| Bonds and Notes | -3130.8 | -2452.3 | 2,662.1 |
| <i>Banks</i> | -3050.5 | -2341.3 | 2,955.9 |
| <i>Other sectors</i> | -80.3 | -111.0 | -293.8 |
| (B) Liabilities | 637.7 | 500.2 | 1,124.3 |
| - Equity securities | 50.3 | 52.2 | 58.8 |
| <i>Banks</i> | 0 | 0 | 0 |
| <i>Other sectors</i> | 50.3 | 52.2 | 58.8 |
| - Debt securities | 587.4 | 448.0 | 1,065.5 |
| Bonds and Notes | 587.4 | 448.0 | 1,065.5 |
| <i>Banks</i> | 587.4 | 448.0 | 1,253.5 |
| <i>Other sectors</i> | 0 | 0 | -188.0 |
| 3. Other Investment (net) | 2047.2 | 2602.3 | -4,519.9 |
| (A) Assets | -11,368.3 | -14,477.8 | -1,227.5 |
| - Trade Credits | 0 | 0 | 0 |
| - Loans | -5882.4 | -9228.7 | -6,154.6 |
| <i>Banks</i> | -5882.4 | -9228.7 | -6,154.6 |
| - Currency and deposits | -5482.8 | -5246.3 | 4,926.9 |
| <i>Banks</i> | -5482.8 | -5246.3 | 4,926.9 |
| - Other assets | -3.1 | -2.8 | 0.2 |
| (B) Liabilities | 13,415.5 | 17,080.1 | -3,292.4 |
| - Trade Credits | -2.1 | -2.9 | -2.9 |
| - Loans | 30.4 | 41.3 | 48.7 |
| <i>Government</i> | 8.5 | 17.4 | 22.6 |
| <i>Long term</i> | 8.5 | 17.4 | 22.6 |
| <i>Short term</i> | 0 | 0 | 0 |
| <i>Other sectors</i> | 21.9 | 23.9 | 26.1 |
| <i>Long term</i> | 21.9 | 23.9 | 26.1 |
| <i>Short term</i> | 0 | 0 | 0 |
| - Currency and deposits | 13390.4 | 17044.9 | -3,335.0 |
| <i>Banks</i> | 13390.4 | 17044.9 | -3,335.0 |
| - Other liabilities | -3.2 | -3.2 | -3.2 |
| 4. Reserve Assets | -309.1 | -531.9 | 110.6 |

** Provisional data

*Financial transactions. A negative sign means net outflows/increases in external assets

Source: Central Bank of Bahrain

Increased inflows of foreign direct investment

The “direct investment” account registered a net inflow of BD65.2 million, up from BD32.7 million in 2007. This was due to the combined effect of a *higher inflow* of BD674.5 million in “foreign direct investment in Bahrain” (compared to an inflow of BD660.3 million in 2007) and a *reduced outflow* of BD609.3 million in Bahrain’s “direct investment abroad” (compared to a BD627.6 million outflow in 2007).

Other investments and reserve assets

The “other investment” category (including loans, currency and deposits) showed a net *outflow* of BD4,519.9 million, compared to a net *inflow* of BD2602.3 in 2007. This largely reflected a sharp reversal in the flow of non-resident deposits, with 2008 showing a net outflow of deposits, in sharp contrast to the net inflow of deposits experienced during the previous year. Again, the impact of the global financial crisis is evident.

Lastly, Bahrain’s “official reserve assets” (gold, SDR, IMF reserve position and foreign exchange) fell by BD110.6 million in 2008, compared to an increase of BD531.9 million in 2007.

3. Errors and Omissions

The statistical discrepancy--*errors and omissions in recorded transactions*--was a negative BD11.4 million in 2008, compared to a positive BD3.7 million in 2007. This discrepancy is equivalent to 0.09% of the combined value of exports and imports of goods, well within the internationally accepted benchmark of 5%.

4. International Investment Position (IIP)

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

At year-end 2008, Bahrain's net international investment position (net IIP) showed a surplus of BD5,774.9 million, demonstrating 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 3).

Table 3: Bahrain's Net International Investment Position (BD millions)

| | 2006 | 2007 | 2008 | 2008 Change (BD million) |
|-------------------------|----------|----------|----------|-----------------------------|
| Foreign Assets | 62,890.0 | 82,234.5 | 81,600.4 | -634.1 |
| Foreign Liabilities | 59,057.6 | 77,285.1 | 75,825.5 | -1,459.6 |
| Net Investment Position | 3,832.4 | 4,949.4 | 5,774.9 | 825.5 |

Source: Central Bank of Bahrain

With the net IIP in 2007 at BD4,949.4 million, the net creditor position of Bahrain widened by BD825.5 million during 2008. Although foreign assets contracted during the year, foreign liabilities shrunk by a much larger amount, thereby maintaining the net creditor position.

A breakdown of foreign assets (Table 4, next page) shows that there were increases in "direct investment abroad" (by BD609.3 million) and "other assets" (by BD1, 227.7 million) while "portfolio assets" fell by BD2,363.4 million. The contraction in foreign liabilities was largely due to the "other liabilities" category, which shrank by BD3,297.2 million.

Table 4: Components of Bahrain's Investment Position (BD millions)

| | 2006* | 2007* | 2008* | 2008 Change (BD million) |
|--------------------------------------|----------|----------|----------|-----------------------------|
| Direct Investment Position | | | | |
| Direct Investment Abroad | 2,275.0 | 2,902.6 | 3,511.9 | 609.3 |
| Direct Investment in Bahrain | 4,207.7 | 4,868.1 | 5,581.3 | 713.2 |
| Net Position | -1932.8 | -1965.5 | -2,069.4 | |
| Portfolio Investment Position | | | | |
| Portfolio Assets | 16,491.0 | 20,209.7 | 17,846.3 | -2,363.4 |
| Portfolio Liabilities | 2,517.2 | 3,017.3 | 4,141.6 | 1,124.3 |
| Net Position | 13,973.8 | 17,192.4 | 13,704.7 | |
| Other Investment Position | | | | |
| Other Assets | 43,057.8 | 57,531.6 | 58,759.3 | 1,227.7 |
| Other Liabilities | 52,332.7 | 69,399.7 | 66,102.5 | -3,297.2 |
| Net Position | -9274.9 | -11868.1 | -7,343.2 | |

* Provisional Data

Source: Central Bank of Bahrain

5. Balance of Payments Outlook for 2009

It is expected that Bahrain's current account balance will shrink further in 2009, as the *goods account* is impacted negatively by lower oil prices and the adverse effects of the global recession. However, lower oil prices will also reduce Bahrain's import bill, thus helping to mitigate the extent of the contraction. Receipts on the *services account* are also expected to be lower, despite the attraction of Bahrain as a tourist destination. The Formula One racing event which took place in May 2009 should provide some support to receipts on the "travel" account, in addition to the continued increase in the number of visitors via the King Fahd Causeway. Various exhibitions and conferences scheduled throughout 2009 should also help limit the contraction on the "services" account.

We project that the pace of workers' remittances may slow down somewhat during 2009 as various economies begin to shake off the worst effects of the global economic crisis.

On the capital and financial account, the appetite for portfolio investments abroad is expected to remain dampened as Bahraini residents wait to see signs of a genuine turnaround in international financial markets and the global economy. Further inflows of foreign direct investment into Bahrain are also envisaged, although the pace will be slower, given the current global economic uncertainties.

END