Central Bank of Bahrain
Financial Stability Directorate

Balance of Payments Report 2006

June 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. With imports accounting for 57% of GDP and exports representing 74%, 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 2006. 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, BOP and IIP data analyzed in this report are provisional.

Overview

In 2006, against a background of favorable domestic and international economic trends, Bahrain recorded double-digit growth in both exports and imports, experienced a widening of the current account surplus, and received large inflows of foreign direct investment. The net International Investment Position (IIP) also widened.

The *current account surplus* expanded to BD721.3 million, an increase of 14% over 2005. The substantial increase in the *surplus on goods* was the major contributor to this increase, influenced by high levels of international oil and aluminum prices. Oil was also dominant on the import side, accounting for 57% of the total import bill, influenced by the import of crude oil from Saudi Arabia for processing at Bahrain's refinery.

With respect to non-oil trade, Saudi Arabia remains Bahrain's principal trading partner, accounting for 15% of total non-oil merchandise trade (exports plus imports). On a regional basis, most of Bahrain's non-oil exports went to Arab countries (41%) while most of its non-oil imports came from Asian countries (34%). Non-oil trade with other GCC countries was substantial, with Bahrain's non-oil imports from other GCC countries accounting for 19.3% of total imports in 2006 while exports to GCC countries represented 35% of total non-oil exports.

The surplus on services expanded to BD262 million in 2006, influenced largely by the 17% increase in net "travel" receipts. The increase in the travel surplus sufficiently offset the combined effects of a decrease in net transportation receipts, and the increases in net payments on "insurance services" and "other business services".

While the *balance on income* showed a net outflow in 2006, the size of the deficit was smaller, compared to 2005. Net outflows on current transfers rose to BD 575.6 million due to increased remittances by expatriate workers currently resident in Bahrain.

Net outflows on the *capital and financial account* increased to BD724.3 million, driven primarily by the record outflow of BD3218.2 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 million in 2006, compared with a positive BD17.9 million in 2005. 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 2006, Bahrain's *net international investment position* (net IIP) showed a surplus of BD3301.3 million (56% of estimated GDP), indicating that Bahrain is a net creditor to the rest of the world. In 2005, the net IIP was BD 2793.2 million, indicating that the net creditor position of Bahrain widened by BD508.1 million during 2006. Underlying this trend was an expansion in assets of BD15, 899 million, driven primarily by an increase of BD11, 366.4 million in the "other investments" category, which covers movements in currency, deposits and loans.

In terms of the *future outlook for the balance of payments*, Bahrain's current account balance in 2007 is likely to expand further, positively influenced by the continued expansion of the domestic non-oil economy, high international commodity prices, favorable economic performance in major export markets, as well as increased tourist arrivals in the country.

On the capital and financial account, acquisition of portfolio investments abroad is expected to continue apace, and further inflows of foreign direct investment into Bahrain are expected, given the stable macroeconomic environment, continued growth of the financial sector, ongoing economic reforms and the Government's commitment to expanding investments in infrastructure.

Balance of Payments Concepts

The Balance of Payments is a summary of all international transactions by the Government, businesses and private residents of Bahrain occurring during a specified period of time (usually a year). Transactions are grouped into the following categories:

(1) The Current Account (a+b+c+d)

(a) *Goods:* This category covers exports and imports of physical goods that cross Bahraini borders.

(b) *Services:* Exports and imports of services, including transportation (e.g. shipment of merchandise), travel (expenditures by tourists and other travelers), insurance (associated with movement of merchandise) and other business services (not included in any of the categories above).

(c) *Income (net):* The receipt of earnings on financial investments of Bahraini residents abroad (credit) set against the payments of earnings on foreign financial investments in Bahrain (debit). Investment income is further broken down into income from direct investment, portfolio investment (stocks and bonds) and "other" investment income.

(d) *Current transfers:* This covers private transfer payments which are gifts and similar payments by Bahraini residents to foreign residents and by foreign residents to Bahraini residents. The main category of transfers is workers' remittances.

(2) The Capital Account

This covers capital transfers receivable and payable by government and other sectors as well as the acquisition and disposal of non-produced, non-financial assets (e.g. natural resources, contracts, leases and licenses).

(3) The Financial Account (i+ii+iii+iv)

The financial account records transactions that involve financial assets and liabilities, occurring between residents and non-residents of Bahrain. Assets are actual claims on non-residents and liabilities are actual indebtedness to non-residents.

(i) *Direct investment:* Investment by an investor resident in one economy that give control or significant influence over management of an enterprise in another economy.

(ii) *Portfolio investment:* This covers investment in long-term bonds and corporate equities other than "direct investment" and "reserves".

(iii) *Reserve assets:* This covers those assets that are available to Bahraini authorities in meeting balance of payment needs (e.g. gold, SDR, foreign exchange, etc).

(iv) *Other investment:* This covers transactions in other categories of financial assets including currency, deposits and loans.

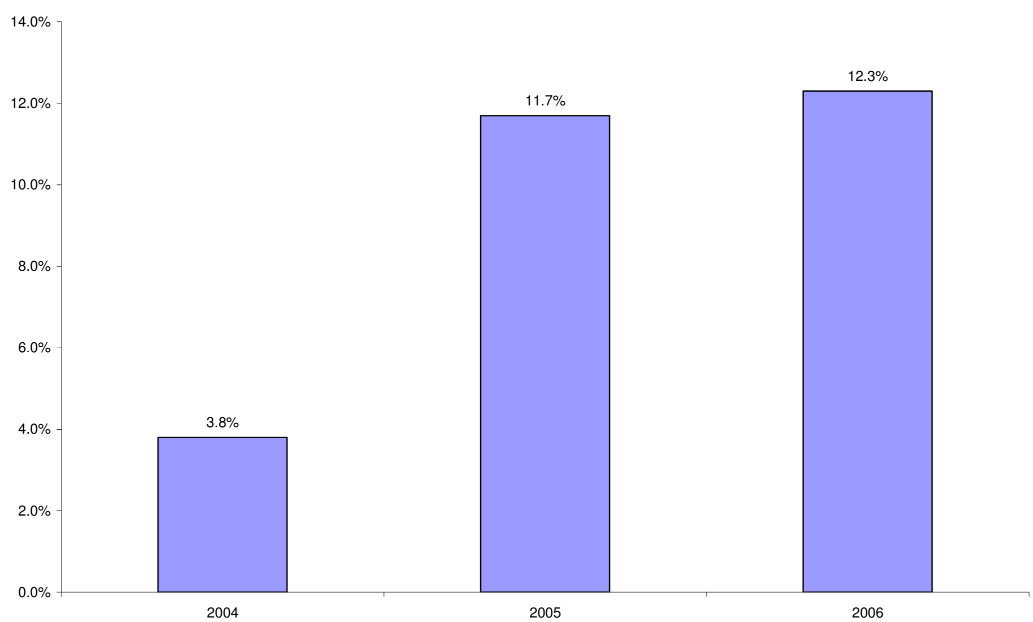
1. The Current Account

Strong export growth boosts current account surplus

In 2006, Bahrain's current account surplus widened to BD721.3 million, representing 12.3% of estimated GDP. The size of the surplus was 21.8% higher than the BD592.2 million surplus recorded in 2005 (11.7% of GDP) (see Chart 1.1 and Table 1). The expansion in the current account surplus was driven largely by the strong growth in the earnings from merchandise exports and the associated surplus on the goods account. Undoubtedly, the historically high level of oil prices in international markets was a major factor behind the increase in export earnings, but high prices of aluminum also contributed.

The current account balance also benefited from an increase in the *surplus on services* and a reduction in the *deficit on income*, but the impact of these factors paled in comparison to the influence of the surplus on goods. Although *current transfers to foreigners* (workers' remittances) increased to BD575.6 million (from BD460 million in 2005), this development was overwhelmed by the trends in the other components of the current account, which combined to expand the current account surplus.

Chart 1.1: Bahrain's Current Account Balance (2004-2006; % of GDP)****



Source: Central Informatics Organisation
*** 2006 GDP figures are estimates*

Table 1: Summary of Bahrain's Balance of Payments—2004-2006 (BD Million)

Items	2004	2005**	2006**
1. Current Account (a+b+c+d)	**156.2**	**592.2**	**721.3**
a. Goods	**558.5**	**949.4**	**1179.7**
General Merchandise	**520.1**	**909.3**	**1127.1**
Exports (fob)	2,827.0	3,769.2	4347.6
- Oil	2,087.3	2,926.6	3465.8
- Non-Oil	739.7	842.6	881.8
Imports (fob)	-2,306.9	-2,859.9	-3220.5
- Oil	-1,039.7	-1,567.8	-1843.0
- Non-Oil	-1,267.2	-1,292.1	-1377.5
Repairs on goods	**38.4**	**40.1**	**52.6**
b. Services (net)	**234.9**	**257.8**	**262.0**
- Transportation	69.5	81.5	80.0
- Travel	179.5	190.2	222.7
- Insurance Services	-13.1	-12.8	-14.2
- Other Business Services	-1.0	-1.1	-26.6
c. Income (net)	**-216.1**	**-155.0**	**-144.7**
Investment Income	-216.1	-155.0	-144.7
- Direct Investment Income	-248.0	-258.4	-315.4
- Portfolio Income	175.3	386.4	598.1
- Other Investment Income	-143.4	-283.0	-427.4
d. Current Transfers (net)	**-421.1**	**-460.0**	**-575.6**
- Workers' Remittances	-421.1	-460.0	-575.6
2. Capital and Financial Account (net) (A+B)	**-187.5**	**-610.1**	**-724.3**
A. Capital Account (net)	**18.8**	**18.8**	**28.2**
- Capital Transfers	18.8	18.8	28.2
B. Financial Account (1+2+3+4)*	**-206.3**	**-628.9**	**-752.5**
1. Direct Investment	**-64.0**	**-28.1**	**727.5**
- Abroad	-389.4	-422.4	-368.5
- In Bahrain	325.4	394.3	1096.0
2. Portfolio Investment (net)	**-1,317.8**	**-1,735.0**	**-3218.2**
- Assets	-1,463.6	-2,645.6	-3855.9
- Liabilities	145.8	910.6	637.7
3. Other Investment (net)	**1234.9**	**1244.8**	**2047.2**
- Assets	-3677.3	-4347.5	-11368.3
- Liabilities	4912.2	5592.3	13415.5
4. Reserve Assets (net)	**-59.4**	**-110.6**	**-309.1**
3. Errors and Omissions	**31.3**	**17.9**	**3.0**

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

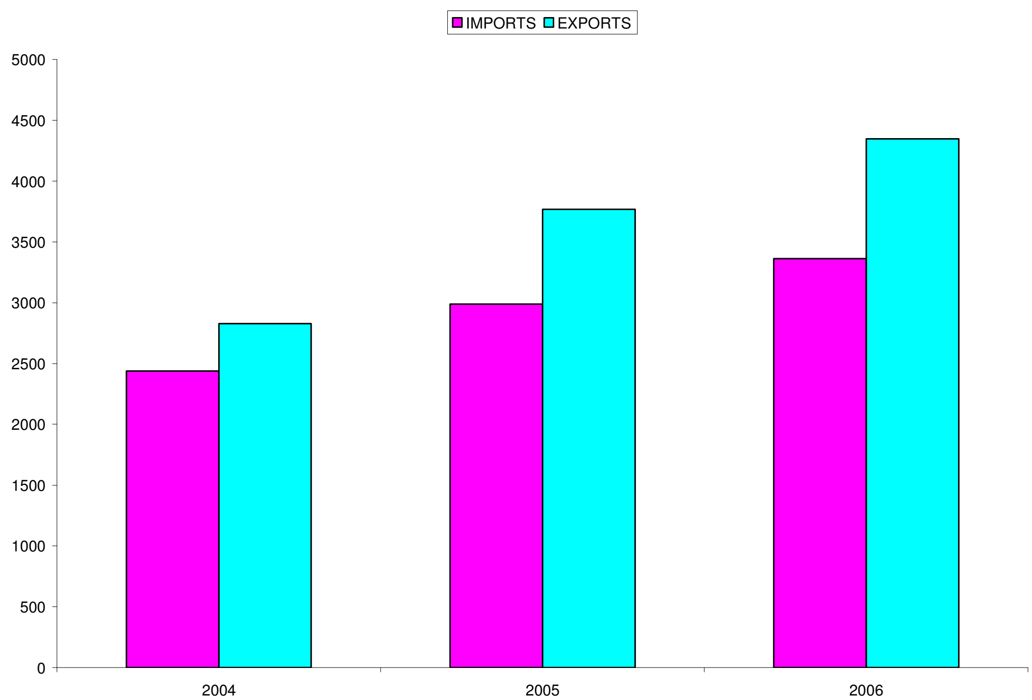
1.1. Trade in Goods

Merchandise exports increased faster than imports

Total earnings from *merchandise exports* (f.o.b) increased from BD3, 769.2 million in 2005 to BD4347.6 million in 2006, a 15.3% increase (Table 1). The 18% growth in oil export receipts was the principal factor behind this surge. In comparison, non-oil exports earnings grew by only 4.6%, largely due to the growth in the export value of "base metals and articles thereof" (principally aluminum)[1].

Payments for *merchandise imports* (f.o.b) increased from BD2859.9 million in 2005 to BD3220.5 million in 2006, an overall growth of 12.6%. Again, oil imports provided the driving force, with a 17.5% growth, compared to a 6.6% growth in non-oil imports for 2005. On the back of a stronger export base, *the overall surplus on goods* grew by 24% from BD949.4 million in 2005 to BD1179.7 million in 2006, helping to enlarge the currency account surplus.

Chart 1.2: Trends in Foreign Trade (BD millions)



Sources: Central Informatics Organisation and National Oil and Gas Authority

[1] Past experience indicates that import numbers are often revised upwards during the course of the year. It therefore likely that the current account surplus will narrow to some extent, upon receipt of revised figures for imports.

Exports benefited from favorable international economic conditions

The 2006 export performance benefited from a confluence of favorable international macroeconomic trends. *World output* expanded by 5.4%, maintaining the healthy global growth rates experienced since 2003 (Table 2). Although the US economy softened during the year, a pickup in growth rates in the Euro area, the resumption of growth in Japan and China's remarkable double-digit growth rates helped to keep world output growth positive.

Table 2: Summary of World Output (% growth rates)

	2003	2004	2005	2006
World	4.1	5.3	4.9	5.4
United States	2.5	3.9	3.2	3.3
Euro area	0.8	2.1	1.3	2.6
Japan	1.8	2.3	2.6	2.2
China	10	10.1	10.2	10.7
Other Asia	8.4	8.8	9.0	8.7
Middle East	6.4	5.5	5.7	5.7
Sub-Saharan Africa	4.1	5.6	5.8	5.7
Latin America	2.2	5.7	4.3	4.8

Source: IMF, World Economic Outlook Database

Trends in *international commodity prices* also benefited Bahrain. The IMF's index of primary commodity prices increased by 22% in 2006, relative to 2005 (Table 3). Focusing on sub-indices directly relevant to Bahrain's foreign trade, the petroleum sub-index increased by 20.4% while the aluminum sub-index increased by 35.3%. Further, average spot market prices for petroleum reached a high of US$64.3 per barrel compared to US$53.4 per barrel in 2005. Average market prices for aluminum also increased to US$2573.1 per metric ton in 2006, relative to US$1900.5 per metric ton in 2005.

Table 3: Trends in Global Commodity Prices (2004-2006)

	2004	2005	2006
Index of all primary commodities (annual percentage change)	26.6	29.2	22
Index of petroleum prices (annual percentage change)	30.7	41.3	20.4
Index of aluminum prices (annual percentage change)	19.9	10.5	35.3
Average market petroleum price (US$/barrel)	37.8	53.4	64.3
Average market aluminum price (US$/metric ton)	1718.5	1900.5	2573.1

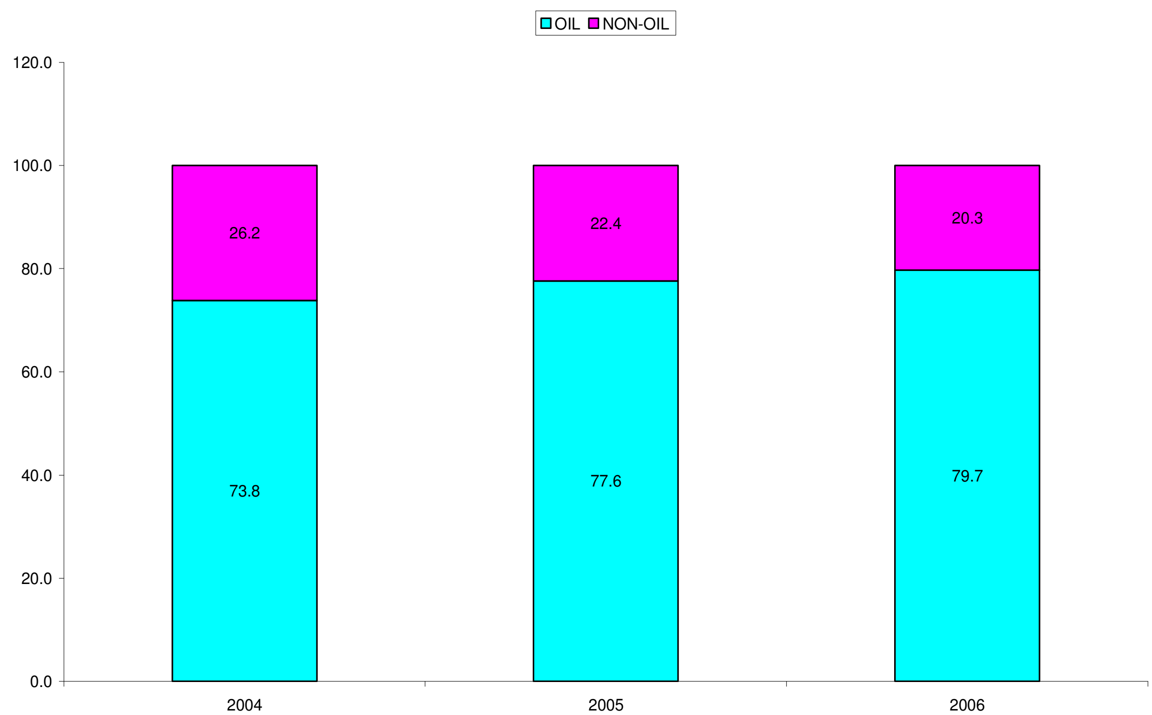
Source: IMF, International Financial Statistics, March 2007

Oil price increases, especially in the first half of 2006, were due to concerns about supply shortages as well as strong demand from major consumer nations, principally the US and China. Although oil prices declined somewhat in August and September 2006 (due to a softening of demand), cuts in production by OPEC countries as well as a recovery in demand raised prices in late 2006. Aluminum prices continued to get boosts due to strong demand from industries in China, India and Russia. This industrial demand contributed to the price increases seen in the metals category. Indeed, metals prices rose by 57% during 2006, the largest increase posted among the main categories in the IMF commodity index[2].

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 2006 (up from 77.6% in 2005) (see Chart 1.3). Base metals (principally aluminum) were the next major single contributor, accounting for 13% of total export earnings (Table 4). Interestingly, oil was also dominant on the import side, accounting for 57% of the total import bill, influenced by the import of crude oil from Saudi Arabia for processing at Bahrain's refinery (Chart 1.4). Non-oil imports accounted for 43% of total imports. Machinery, transport equipment, chemicals and base metals were the main categories of non-oil imports (Table 5).

Chart 1.3: Composition of Exports—Oil vs. Non-Oil (% shares)



Sources: Central Informatics Organisation and National Oil and Gas Authority

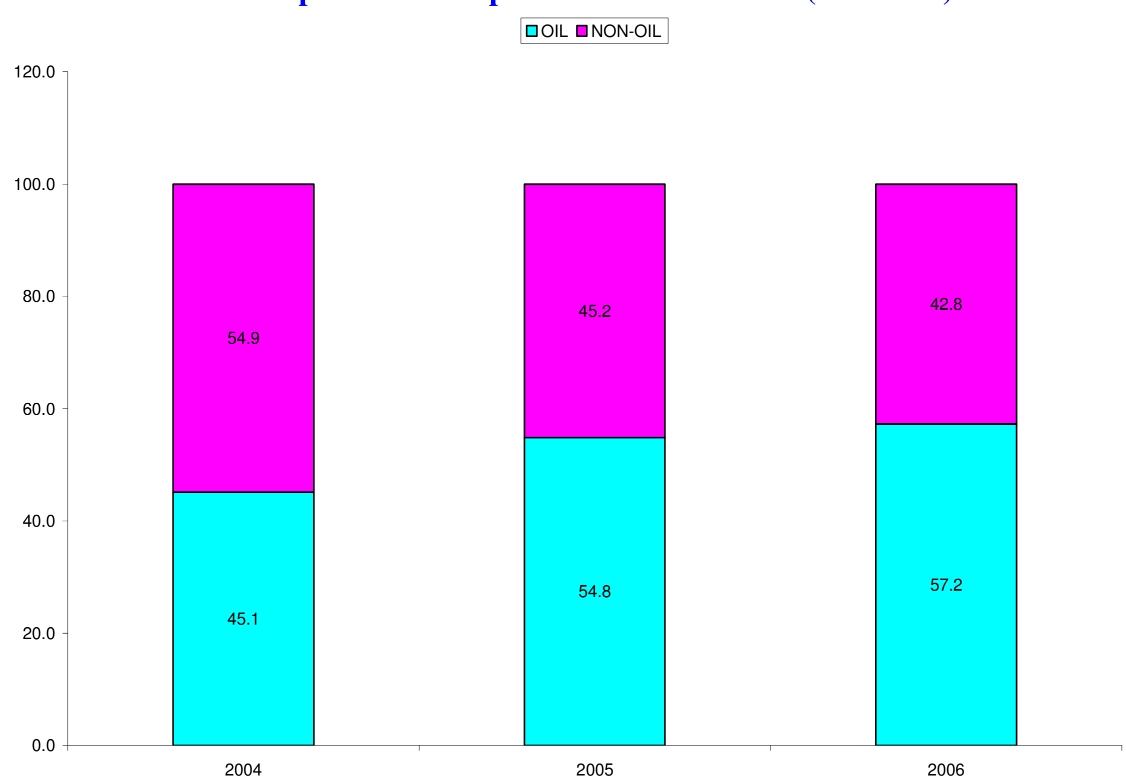
[2] See IMF, *World Economic Outlook*, April, 2007, Appendix 1.1.

Table 4: Exports Classified by Sections of Commodities (% shares)

	2004	2005	2006
Animals and Animal products	0.3	0.2	0.2
Vegetable products	0.1	0.0	0.0
Animal and Vegetable Fats and Oils	0.0	0.0	0.0
Prepared Foodstuffs, Beverages and Tobacco	0.4	0.3	0.2
Mineral products (including oil)	76.5	79.4	80.9
Products of Chemical and Allied Industries	2.9	2.6	2.4
Plastic and Rubber articles	0.5	0.5	0.4
Raw hides and skins, leather and others	0.0	0.0	0.0
Wood and articles of wood	0.0	0.0	0.0
Wood pulp and paper	0.4	0.4	0.3
Textile and Textile articles	3.3	1.1	0.7
Footwear, Headgear and others	0.0	0.0	0.0
Articles of stone, plaster, cement and others	0.0	0.0	0.1
Pearls, precious stones and metals	0.0	0.1	0.0
Base metals and articles thereof	13.0	12.9	12.9
Machinery and appliances, electrical equipment	1.2	0.8	0.6
Transport equipment	1.0	1.2	1.0
Optical, photographic, medical, precision equipment and others	0.1	0.1	0.1
Other	0.3	0.3	0.2
Total	**100.0**	**100.0**	**100.0**

Sources: Central Informatics Organisation and National Oil and Gas Authority

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



Sources: Central Informatics Organisation and National Oil and Gas Authority

Table 5: Imports Classified by Sections of Commodities (% shares)

	2004	2005	2006
Animals and Animal products	2.3	1.9	1.6
Vegetable products	1.8	1.5	1.2
Animal and Vegetable Fats and Oils	0.3	0.2	0.2
Prepared Foodstuffs, Beverages and Tobacco	3.7	2.8	2.7
Mineral products (including oil)	46.1	57.2	57.7
Products of Chemical and Allied Industries	5.9	6.4	6.1
Plastic and Rubber articles	1.7	1.6	1.4
Raw hides and skins, leather and others	0.1	0.1	0.1
Wood and articles of wood	0.7	0.5	0.5
Wood pulp and paper	1.1	0.8	0.8
Textile and Textile articles	3.4	2.1	1.6
Footwear, Headgear and others	0.2	0.2	0.1
Articles of stone, plaster, cement and others	1.7	1.1	1.3
Pearls, precious stones and metals	0.3	0.4	0.3
Base metals and articles thereof	5.8	5.4	5.8
Machinery and appliances, electrical equipment	14.8	9.1	9.2
Transport equipment	7.5	7.3	7.6
Optical, photographic, medical, precision equipment and others	1.0	0.6	0.5
Other	1.4	1.0	1.1
Total	**100.0**	**100.0**	**100.0**

Sources: Central Informatics Organisation and National Oil and Gas Authority

Rapid growth in trade of selected non-oil categories

The relatively slow growth in aggregate non-oil exports (4.6%) masks remarkable growth in selected commodity groups. Albeit from a low base, there were substantial increases in the shipments of commodity groups such as raw hides and skins, articles of stone, plaster and cement, vegetable products, as well as chemicals and allied products (Table 6). The story is similar on the import side where we observe double-digit growth rates in import payments under several commodity categories (Table 7).

Table 6: Exports Classified by Sections of Commodities (BD Million)

	2004	2005	2006	2006 growth (%)
Animals and Animal products	8.0	7.3	7.4	**1.4%**
Vegetable products	2.3	1.6	2.1	**31.3%**
Animal and Vegetable Fats and Oils	0.1	0.0	0.0	**0%**
Prepared Foodstuffs, Beverages and Tobacco	10.5	11.8	10.6	**-10.2%**
Mineral products (including oil)	2163.3	2993.1	3517.5	**17.5%**
Products of Chemical and Allied Industries	81.0	97.7	105.7	**8.2%**
Plastic and Rubber articles	15.1	19.0	18.2	**-4.2%**
Raw hides and skins, leather and others	0.7	0.1	0.5	**400%**
Wood and articles of wood	0.3	0.2	0.1	**-50%**
Wood pulp and paper	11.3	14.6	12.2	**-16.4%**
Textile and Textile articles	93.1	42.8	31.5	**-26.4%**
Footwear, Headgear and others	0.0	0.0	0.0	**0%**
Articles of stone, plaster, cement and others	1.0	1.5	2.4	**60%**
Pearls, precious stones and metals	0.8	2.6	0.7	**-73.1%**
Base metals and articles thereof	368.2	487.6	559.9	**14.8%**
Machinery and appliances, electrical equipment	34.4	31.7	25.2	**-20.5%**
Transport equipment	27.5	44.5	41.8	**-6.1%**
Optical, photographic, medical, precision equipment and others	1.7	2.4	2.5	**4.2%**
Other	7.7	10.7	9.3	**-13.1%**
Total	**2827**	**3769.2**	**4347.6**	**15.3%**

Sources: Central Informatics Organisation and National Oil and Gas Authority

Table 7: Imports Classified by Sections of Commodities (BD Million)**

	2004	2005	2006	2006 growth (%)
Animals and Animal products	55.6	56.7	55.4	-2.3%
Vegetable products	43.8	43.7	40.4	-7.5%
Animal and Vegetable Fats and Oils	6.9	5.9	6.5	10.2%
Prepared Foodstuffs, Beverages and Tobacco	90.5	82.2	92.3	12.3%
Mineral products (including oil)	1125	1708.4	1940	13.6%
Products of Chemical and Allied Industries	143.7	189.9	204.5	7.7%
Plastic and Rubber articles	42	47.3	48.5	2.5%
Raw hides and skins, leather and others	3.3	2.7	3	11.1%
Wood and articles of wood	17.7	15.2	17.4	14.5%
Wood pulp and paper	27.5	24.5	27.7	13.1%
Textile and Textile articles	82.7	62.4	54.1	-13.3%
Footwear, Headgear and others	5.7	5.2	5	-3.9%
Articles of stone, plaster, cement and others	42.3	33.9	43.2	27.4%
Pearls, precious stones and metals	8.5	11.3	11.7	3.54%
Base metals and articles thereof	140.7	159.9	195.8	22.5%
Machinery and appliances, electrical equipment	361	270.9	308.2	13.7%
Transport equipment	182.5	218.7	255.7	17.0%
Optical, photographic, medical, precision equipment and others	24.2	18.8	17.7	-5.8%
Other	34.6	30.2	35.7	18.2%
Total	**2438.2**	**2987.8**	**3362.8**	**12.5%**

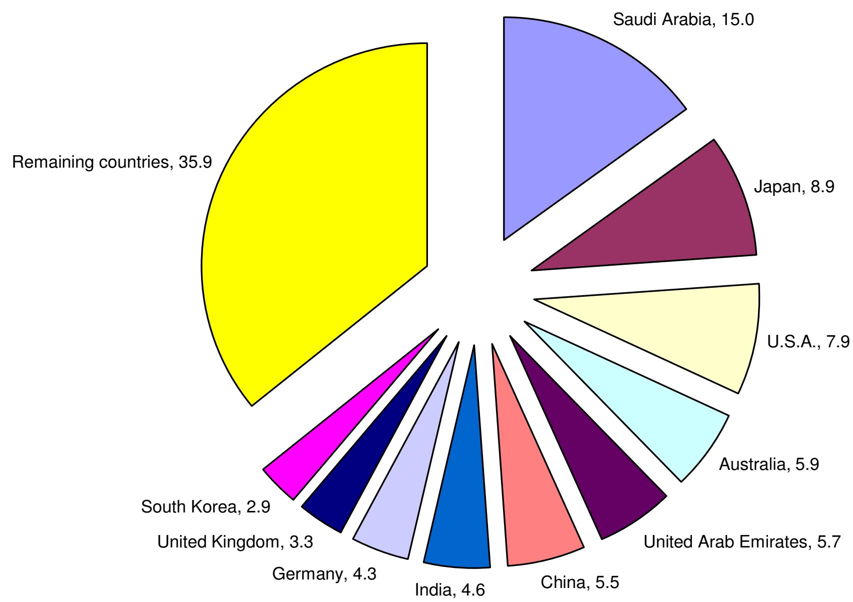
Sources: Central Informatics Organisation and National Oil and Gas Authority

*** 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.*

Saudi Arabia is Bahrain's largest trading partner (non-oil)

Saudi Arabia maintained its position as Bahrain's largest trading partner during 2006, accounting for 15% of total merchandise trade (non-oil), compared with 16.1% in 2005 (Chart 1.5). As in 2005, Saudi Arabia, Japan and the US were Bahrain's top-three trading partners; trade with these countries was valued at BD 765.3 million or 32% of total merchandise trade (including insurance and freight). Together, these countries provided markets for BD298.9 million or 33.8% of Bahrain's total non-oil exports, while supplying BD466.4 million or 30.6% of its imports.

Chart 1.5: Bahrain's Top 10 Trading Partners in 2006—Exports + Imports (% shares)



Sources: Central Informatics Organisation and National Oil and Gas Authority

Table 8: Bahrain's Balance of Trade with Top Ten Trading Partners (Non-oil; BD millions)*

	2004	2005	2006
Saudi Arabia	42.7	99.4	7.6
Japan	-123.6	-121.9	-148.6
USA	10	-10.2	-26.3
Australia	-34.4	-110.6	-108.7
UAE	-30.1	-17.3	-29.6
China	-69.2	-88.6	-115.2
India	-22.2	-24.1	8.7
Germany	-83.5	-97.9	-90.3
U.K.	-81.9	-71.7	-63.3
South Korea	-17.3	3.4	-6.1

Sources: Central Informatics Organisation and National Oil and Gas Authority
**Balance of Trade is defined as value of exports minus value of imports*

Non-oil balance of trade is in deficit with major trading partners

Table 8 above presents data on Bahrain's non-oil merchandise trade balance with its major trading partners. Notable features are as follows:

- In 2006, the trade balance showed a surplus only with two of the ten countries: Saudi Arabia and India. The largest deficits were with Japan, China, and Australia respectively (in order of magnitude).
- There was a substantial shrinkage in the size of the surplus with Saudi Arabia from BD99.4 million in 2005 to BD7.6 million in 2006. This was influenced by an increase of BD44.2 million in spending on Saudi imports as well as a BD47.6 million contraction in export earnings.
- Between 2005 and 2006, trade deficits with Japan, the US, UAE, and China registered significant increases, the largest being the 157% increase in the size of the deficit with the US and the 71% expansion in the deficit with the UAE. In both cases, the trends were influenced by an increase in import payments alongside decreases in export earnings.
- Deficits with Australia, Germany and the UK actually contracted as import payments to those countries declined.
- The balance of trade with India improved significantly, moving to a surplus of BD8.7 million in 2006 from a deficit of BD24.1 million in 2005. This trend was driven by a BD9.7 million fall in import payments coupled with the BD23.1 million increase in export receipts.
- The balance of trade with South Korea recorded a turnaround from a surplus of BD3.4 million in 2005 to a deficit of BD6.1 million in 2006, following a BD3.2 million increase in import payments coupled with a BD 6.3 million decrease in export earnings.

Direction of non-oil exports by region

Examining the direction of trade on a regional basis, most of Bahrain's *non-oil exports* went to Arab countries (41%)(including GCC) and to Asian countries (35.2%) (see Table 9). Exports to Europe and the Americas were modest in comparison, although exports to Europe jumped from 8.2% of total exports in 2005 to 11% in 2006, perhaps as a result of the brisk growth in the Euro area during 2006 as well as the growing strength of the Euro.

Table 9: Regional Direction of Non-Oil Exports (% shares)

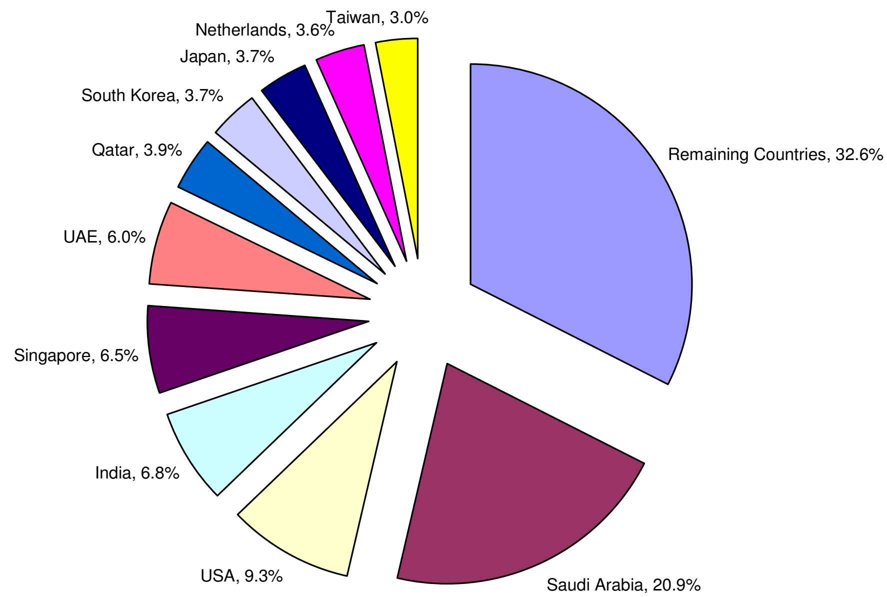
	2004	2005	2006
Arab countries	40.9	47.6	40.9
African countries	0.3	0.2	0.4
Asian countries	32.7	31.2	35.2
European countries	8.2	8.2	11.0
The Americas	12.4	10.1	9.8
Oceanic countries	4.8	2.3	2.2
Other	0.6	0.5	0.5

Source: Central Informatics Organisation

Direction of non-oil exports by country

Looking at country-by-country markets for Bahraini exports, Chart 1.6 presents the relative shares of Bahrain's Top Ten trading partners in the total value of non-oil exports. Saudi Arabia emerges as the single largest market for Bahrain's non-oil exports, accounting for 21% of total export earnings. The USA comes next with 9.3%, followed by India (6.8%), Singapore (6.5%), and UAE (6%).

Chart 1.6: Bahrain's Top Ten Export Markets---2006 (Non-oil only; % shares)



Source: Central Informatics Organisation

Sources of non-oil imports by region

A look at the *sources of imports* by region shows that most of Bahrain's imports in 2006 came from Asian countries (34%), followed by European countries (26%) and Arab countries (21%)(including GCC) (Table 10). Imports from the Americas (10%) and Oceanic countries (8.5%) were more modest in comparison.

Table 10: Sources of Non-Oil Imports by Region (% shares)

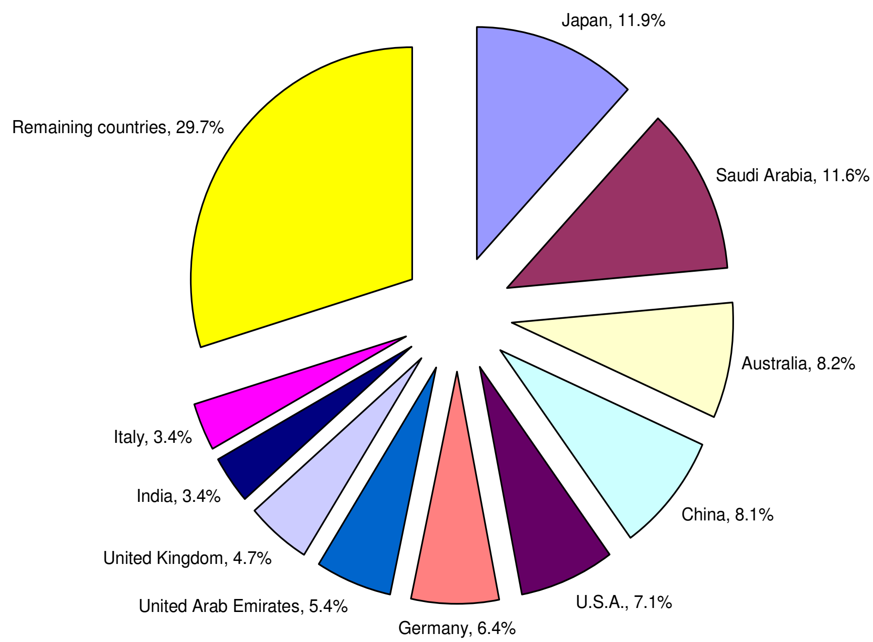
	2004	2005	2006
Arab countries	18.1	17.6	20.6
African countries	0.5	0.3	0.3
Asian countries	32.0	32.2	34.0
European countries	34.3	29.5	25.8
The Americas	9.9	11.2	10.7
Oceanic countries	5.1	9.1	8.5
Other	0.0	0.0	0.1

Source: Central Informatics Organisation

Sources of non-oil imports by country

Looking at country-by-country sources of Bahrain's non-oil imports, Chart 1.7 presents the relative shares of Bahrain's Top Ten sources of non-oil imports. Japan emerges as the single largest source of Bahrain's non-oil imports, accounting for 12% of total import payments. Saudi Arabia comes next with 11.6%, followed by Australia (8.2%), China (8.1%), and the United States (7.1%).

Chart 1.7: Bahrain's Top Ten Sources of Non-Oil Imports—2006 (% 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) is significant. In 2006, Bahrain's non-oil imports from other GCC countries accounted for 19.3% of total imports and exports to GCC countries represented 35% of total non-oil exports (Table 11). While imports from GCC countries increased from BD230.2 million in 2005 to BD293.8 million in 2006 (a 27.6% rise), exports recorded a 17% decline from BD369.1 million to BD306.3 million over the same period.

When broken down country-by-country, trade with Saudi Arabia accounts for the bulk of Bahrain's GCC trading activities, both on the import and export sides (Table 12). UAE and Qatar came next in importance.

Table 11: Bahrain—Total Trade vs. Trade with GCC Countries (Non-oil)

	Imports			Exports		
	2004	2005	2006	2004	2005	2006
All countries (BD million)	1398.5	1420	1520.7	739.7	842.6	881.8
GCC only (BD million)	235.7	230.2	293.8	277.1	369.1	306.3
% share of GCC	16.9	16.2	19.3	37.5	43.8	34.7

Source: Central Informatics Organisation

Table 12: Bahrain's Trade with GCC Countries (Non-oil) (% shares)

Country	Imports			Exports		
	2004	2005	2006	2004	2005	2006
Saudi Arabia	58.3	57.6	60.2	65.0	62.9	60.2
United Arab Emirates	29.4	31.1	28.1	14.1	14.7	17.3
Kuwait	5.6	5.1	3.6	9.5	7.7	8.6
Oman	2.6	2.9	3.0	2.1	3.8	2.6
Qatar	4.2	3.3	5.0	9.4	10.9	11.3

Source: Central Informatics Organisation

1.2. Trade in Services

Surplus on services widens

Bahrain's surplus on "services" increased to BD262 million in 2006 from BD 257.8 million in 2005 (Table 1). This increase was primarily driven by the 17% rise in net "travel" receipts from BD190.2 million in 2005 to BD222.7 million in 2006[3]. This increase in the "travel" surplus was large enough to offset the combined effects of a slight decrease in net receipts on "transportation" and the increases in net payments on "insurance services" and "other business services". The growth in net travel receipts is a reflection of the continued attraction of Bahrain as a tourist destination, as well as its ability to attract an increasing number of high-profile conferences and exhibitions.

[3] An increase in the "travel" surplus indicates that expenditures of tourists visiting Bahrain exceed expenditures of Bahrainis visiting foreign countries.

Table 13: Arrivals in Bahrain (non-Bahrainis only; 2004-2006)

	2004	2005	2006	2006 change
Total	**5, 667, 331**	**8, 350, 703**	**9, 250, 530**	**10.7%**
By air	1, 176, 460	1, 790, 878	1, 834, 158	2.4%
By sea	6, 526	8, 376	13, 381	59.7%
By causeway	4, 484, 345	6, 551, 449	7, 402, 991	13%

Sources: Ministry of Information for 2004, Central Informatics Organisation from 2005.

Table 13 above presents data on foreign arrivals in Bahrain (non-Bahrainis). In 2006, the number of arrivals into Bahrain totaled 9.3 million, compared to 8.3 million in 2005. Arrivals increased across all entry points, but the largest increase related to arrivals via the King Fahd Causeway, which recorded a 13% increase relative to 2005. Indeed, 80 percent of all arrivals came via the causeway, indicating the importance of Saudi and other GCC tourists to the Bahraini economy.

Between 2005 and 2006, net inflows on the "transportation" sub-account slowed slightly from BD81.5 million to BD80 million as an 11.3% increase in net freight payments offset the 8% increase in net receipts on passenger travel services (mainly air transport services). Both "insurance services" and "other business services" registered deficits.

1.3. Income Account

Income account remains in deficit

The balance on income recorded a deficit in 2006 as income payments on foreign-owned assets in Bahrain continue to exceed income receipts from Bahraini-owned assets abroad. Foreigners' income from their investments in Bahrain amounted to BD3015 million, compared to income receipts of BD2870.3 million on Bahraini assets abroad, resulting in a net outflow of BD144.7 million (Table 1). This deficit is slightly smaller than the BD155 million deficit recorded in 2005.

Notably, the surplus on "portfolio income" increased from BD386.4 million in 2005 to BD598.1 million, indicating that receipts from Bahraini portfolio investments abroad (stocks and bonds) exceed payments on foreign-owned portfolio investments in Bahrain. But this was more than offset by net outflows on the "direct investments" and "other investment" accounts, with a combined deficit of BD742.8 million.

The increasing net outflow of investment income is a reflection of the steady growth of foreign direct investment in Bahrain and the high returns realized on business activities in Bahrain. This situation suggests that Bahrain is (and will continue to be) an attractive destination for foreign investors in the coming years.

1.4. Current Transfers (net)

Increased deficit on current transfers account

Net current transfers to foreigners rose to BD575.6 million in 2006 from BD460 million in 2005. This trend was entirely attributable to remittances by expatriate workers currently resident in Bahrain.

2. Capital and Financial Account

Increased net outflows on the capital and financial account

Net outflows on the capital and financial account expanded to BD724.3 million from BD610.1 million in 2005, as Bahrain continues to be a net exporter of capital to the rest of the world. While the *capital account* showed a net inflow of BD28.2 million in 2006 (following a net inflow of BD18.8 million in 2005) [4], this was overwhelmed by the increased deficit on the *financial account,* which showed a net outflow of BD752.5 million (compared to a net outflow of BD628.9 million in 2005).

Significant increase in Bahraini portfolio investments abroad

The net outflow on the financial account was driven primarily by the record outflow of BD 3218.2 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 BD745.5 million in 2006 (vs. BD834.6 million in 2005). Banks were the major investors in foreign equities, accounting for 68% of total Bahraini investments in foreign equities.

Acquisition of debt securities increased by BD3110.4 million (vs. BD1811 million in 2005), again driven by the increased investment of Bahraini banks in bonds and notes. There were no recorded transactions in financial derivatives.

[4] The increased net inflow on the capital account was due entirely to higher capital transfers to the Bahraini government. Capital transfers are usually linked to the acquisition and disposal of fixed assets.

Table 14: Details of the Financial Account

Items	2004	2005**	2006**
Overall Financial Account (1+2+3+4)*	**-206.3**	**-628.9**	**-752.5**
1. Direct Investment (net)	**-64.0**	**-28.1**	**727.5**
(A) Abroad	***-389.4***	***-422.4***	***-368.5***
- Equity capital	-311.2	-316.2	-231.6
- Reinvested earnings	-78.2	-106.2	-136.9
(B) In Bahrain	***325.4***	***394.3***	***1096.0***
- Equity capital	94.9	129.3	793.2
- Reinvested earnings	230.5	264.9	302.8
2. Portfolio Investment (net)	**-1,317.8**	**-1,735.0**	**-3218.2**
(A) Assets	-1,463.6	-2,645.6	-3,855.9
- Equity securities	-751.6	-834.6	-745.5
Banks	*-627.4*	*-415.0*	*-504.6*
Other sectors	*-124.2*	*-419.6*	*-240.9*
- Debt securities	-712.0	-1,811.0	-3,110.4
Bonds and Notes	-712.0	-1,811.0	-3,110.4
Banks	*-681.4*	*-1,706.6*	*-3,050.5*
Other sectors	*-30.6*	*-104.4*	*-59.8*
(B) Liabilities	145.8	910.6	637.7
- Equity securities	7.8	677.2	50.3
Banks	*0*	*0*	*0*
Other sectors	7.8	677.2	50.3
- Debt securities	137.9	233.4	587.4
Bonds and Notes	137.9	233.4	587.4
Banks	*137.9*	*233.4*	*587.4*
Other sectors	*0*	*0*	*0*
3. Other Investment (net)	**1234.9**	**1244.8**	**2047.2**
(A) Assets	-3,677.3	-4,347.5	-11,368.3
- Trade Credits	0.0	0.0	0.0
- Loans	-1,428.1	-3,162.0	-5,882.4
Banks	*-1,428.1*	*-3,162.0*	*-5,882.4*
- Currency and deposits	-2,248.1	-1,185.3	-5,482.8
Banks	*-2,248.1*	*-1,185.3*	*-5,482.8*
- Other assets	-1.0	-0.1	-3.1
(B) Liabilities	4,912.2	5,596.2	13,415.5
- Trade Credits	1.2	-4.2	-2.1
- Loans	21.5	36.8	30.4
Government	9.3	14.9	8.5
Long term	9.3	14.9	8.5
Short term	0	0	0
Other sectors	12.2	21.9	21.9
Long term	12.2	21.9	21.9
Short term	0	0	0
- Currency and deposits	4,889.8	5,563.8	13,390.4
Banks	*4,889.8*	*5,563.8*	*13,390.4*
- Other liabilities	-0.2	-0.2	-3.2
4. Reserve Assets (net)	**1234.9**	**1244.8**	**2047.2**

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

On the liability side, inflow of portfolio investments into Bahrain from non-residents amounted to BD637.7 million, smaller than the BD910.6 million inflow recorded in 2005. This slowdown was principally influenced by a precipitous decline in inflows of equity investments from BD677.2 million to BD50.3 million. Debt liabilities actually increased by BD587.4 million relative to BD233.4 million in 2005, due mainly to increased claims of non-residents on Bahraini banks.

Higher inflows of foreign direct investment

The net inflow of BD727.5 million on the "direct investment" account represented a significant turnaround from the net outflow of BD28.1 million in 2005. This is largely explained by the increased inflow of BD1096 million in "foreign direct investment in Bahrain" which outstripped the outflow of BD368.5 million in Bahrain's "direct investment abroad". This trend resulted chiefly from the higher equity capital investments in Bahrain by nonresidents as well as higher levels of re-invested earnings. This situation is a reflection of the continued confidence of foreign investors in the economy, on the back of strong macroeconomic performance, credible economic reforms, as well as the demonstrated vibrancy of the financial sector.

In contrast, Bahraini direct investments abroad totaled BD368.5 million in 2006 (compared to BD422.4 million in 2005), as equity capital investments decelerated from BD316.2 million to BD231.6 million. This sufficiently outweighed the acceleration in re-invested earnings from BD106.2 million to BD136.9 million.

Other investments and reserve assets

The "other investment" category (including loans, currency and deposits) also showed a net inflow of BD2047.2, higher than the net inflow of BD1244.8 million recorded in 2005. Trends in this category were principally driven by the increased inflow of nonresident deposits into Bahraini banks.

Bahrain's "official reserve assets" (gold, SDR, IMF reserve position and foreign exchange) swelled by BD309.1 million in 2006, following an increase of BD 110.6 million in 2005. The rise in 2006 was almost entirely the result of a BD 307.9 million increase in the Central Bank of Bahrain's foreign exchange holdings. A slight increase in SDR accounted for the rest.

3. Errors and Omissions

The statistical discrepancy--errors and omissions in recorded transactions--was a positive BD3 million in 2006, compared with a positive BD17.9 million in 2005. 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%. 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[5].

4. International Investment Position (IIP)

Definition of IIP[6]

Bahrain's international investment position (IIP) is a statement which shows asset and liability positions at a point in time. On the asset side, it shows the value of Bahraini residents' financial assets that are claims on non-residents or reserve assets holdings. On the liabilities side, it shows the liabilities of Bahraini residents to non-residents (i.e. claims of foreigners on Bahraini residents). The difference between the assets and liabilities is the net position in the IIP and represents either net claims on or net liabilities to the rest of the world.

Bahrain is a net creditor to the rest of the world

At year-end 2006, Bahrain's net international investment position (net IIP) showed a surplus of BD3301.3 million (56% of estimated GDP), 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 15).

Table 15: Bahrain's Net International Investment Position (BD millions)

	2004	2005	2006	2006 Change
Assets	39, 365.6	46, 727.2	62, 626.2	15, 899
Foreign Liabilities	37, 100.2	43, 934.0	59, 324.9	15, 390.9
Net Investment Position	2265.4	2793.2	3301.3	508.1

Source: Central Informatics Organisation

In 2005, the net IIP was BD2793.2 million, indicating that the net creditor position of Bahrain widened by BD508.1 million during 2006. Underlying this

[5] See IMF (2007), *Draft Balance of Payments and International Investment Position Manual,* Chapter 2, Section 4.
[6] The definition below is summarized from IMF (2007).

trend was an expansion in assets of BD15, 899 million, driven primarily by an increase of BD11, 366.4 million in "other investments"[7] (Table 16). However, increases were also registered in portfolio investments (by BD3856 million), direct investment abroad (by BD368.5 million) and foreign exchange assets (by BD307.9 million).

Liabilities increased by BD15, 390.9, linked mainly to an increase of BD13, 577.8 million in "other investments" by foreigners in Bahrain[8] (Table 15). More modest increases were recorded in "direct investment in Bahrain" (by BD1175.4 million), and portfolio investments (by BD 637.8 million) (Table 16).

Table 16: Components of Bahrain's Investment Position (BD millions)

	2004	2005	2006	2006 Change
Direct Investment Position				
Direct Investment Abroad	1,479.6	1,902.0	2,270.5	368.50
Direct Investment in Bahrain	2,765.1	3,111.8	4,287.2	1,175.40
Net Position	-1,285.50	-1,209.80	-2,016.70	-806.90
Portfolio Investment Position				
Portfolio Assets	9,899.2	12,380.2	16,236.5	3,856.30
Portfolio Liabilities	968.8	1,879.4	2,517.2	637.80
Net Position	8,930.40	10,500.80	13,719.30	3,218.50
Other Investment Position				
Other Assets	27,349.8	31,695.5	43,061.9	11,366.40
Other Liabilities	33,366.3	38,942.7	52,520.5	13,577.80
Net Position	-6,016.50	-7,247.20	-9,458.60	-2,211.40

*** Provisional Data*
Source: Central Informatics Organisation

5. Outlook for the Balance of Payments

Bahrain's *current account balance* in 2007 is likely to expand further, positively influenced by the continued expansion of the domestic non-oil economy, high international commodity prices, favorable economic performance in major export markets, as well as increased tourist arrivals in the country.

International oil and aluminum prices are expected to remain high in 2007. Also, world economic growth is expected to remain strong, in spite of continued concerns about the potential impact of the slump in the housing market on the US economy[9]. Economic performance in Saudi Arabia, Bahrain's largest trading partner is also expected to remain strong, with high levels of public expenditure

[7] "Other investments" of Bahraini residents consisted mainly of bank loans and deposits abroad.
[8] "Other investments" of non-residents consisted entirely of deposits in Bahraini banks.
[9] See IMF, *World Economic Outlook*, April, 2007.

boosting domestic consumption and investment[10]. Consequently, Bahraini export receipts are likely to grow faster than import payments in 2007, further expanding the merchandise trade surplus. Bahrain's encouragement of higher value-added exports may also result in higher export receipts.

In addition, the increased attraction of Bahrain as a tourist destination, for visitors from within and outside the GCC will boost receipts on the services account. The recently concluded Formula One racing event in Bahrain will also give a boost to tourist arrival figures and receipts on the "travel" account for 2007. Exhibitions and conferences occurring in 2007 will also contribute. The surplus on the "services" account is therefore projected for expansion in 2007.

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 apace, and further inflows of foreign direct investment into Bahrain are likely, given the stable macroeconomic environment, continued growth of the financial sector, ongoing economic reforms and the Government's commitment to expanding investments in infrastructure.

[10] See Economist Intelligence Unit, *Saudi Arabia: Country Report*, February, 2007.

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