



Financial Stability Directorate

Monetary and Financial Trends

First Quarter 2008

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Monetary and Financial Trends is produced quarterly by the Financial Stability Directorate, Central Bank of Bahrain. This edition focuses on the First Quarter of 2008 and highlights developments in the following monetary and financial indicators: i) monetary aggregates; ii) domestic credit; iii) interest rates; iv) domestic prices; v) domestic public debt; vi) exchange rates; vii) official reserves; and viii) the stock market.

Highlights

Monetary Aggregates

- During 2008:Q1, narrow money (M1) expanded by 17.5%, much faster than the 3.9% recorded in the previous quarter.
- Broad money (M2) rose by 7.7%, a slowdown when compared to the 10.2% expansion registered in 2007:Q4.
- Among the components of the money stock, *demand deposits* expanded most rapidly at 20.1%, with *currency in circulation* rising by 3.5% and *quasi money* (savings and time deposits) growing by 3.9%.
- The growth in money supply during 2008:Q1 was attributable mainly to the 12.3% increase in net domestic assets (NDA).
- The growth of net foreign assets (NFA) was much slower at 2.6%.

Credit Developments

- Total domestic credit increased by 10.4% (to BD4623.1 million), slightly faster than the 8% growth of the previous quarter.
- The growth of domestic credit is explained largely by the 12% growth in credit to the private sector.
- Credit to general government *declined* by 14.5% during the first quarter of 2008, in sharp contrast to the 25.9% *expansion* recorded in 2007:Q4.
- An examination of the components of private sector credit indicates that business loans increased by 14.7%, much faster than the 7.8% registered in 2007:Q4.
- Personal loans rose by 7.6% during the quarter, marginally faster than the 5.8% growth of the previous quarter.
- As at end-2008:Q1, the bulk of business loans outstanding were in the “construction and real estate” segment (33.6% of the total); however, most of the *growth* in business loans during the quarter occurred in the “other” category, which increased by 52.4%.
- Personal loans are dominated by loans “with salary assignment” which represents 47% of personal loans outstanding; however,

most of the growth in personal loans during 2008:Q1 occurred in the “secured by property mortgage” category, which expanded by 20.2%.

- The *year-on-year* growth of private sector credit (43.5%) exceeded the projected growth of nominal GDP for 2007 (26%), reflecting the ongoing boom in lending to the private sector.

Interest Rates

- Short-term interest rates fell further during 2008:Q1, reflecting the reductions in US interest rates.
- The 3-month and 6-month inter-bank rates fell to 2.59% and 2.6% respectively by the end of the quarter, while the average 3-month Treasury bill yield declined to 2.8%.
- The CBB key policy rate was also reduced to 2.25% by the end of the quarter.
- The spread between average deposit (3-12 month) and lending rates has widened further to 5 percentage points (using business loan rates) and 7.4 percentage points (using personal loan rates).

Domestic Prices

- According to available CPI data, domestic prices rose by 0.5% during 2008:Q1, when compared to the index at the end of 2007.
- Annual inflation is currently at 4.9%.
- However, this number is not directly comparable to inflation numbers from previous years, given the change in the underlying basket of commodities.

Domestic Public Debt

- The stock of domestic public debt (securities only) increased marginally during the quarter under review, from BD616.6 million to BD634.6 million.
- The change is due mainly to the increase in the stock of treasury bills from BD90 million to BD108 million.
- Both Islamic leasing securities and Al Salam Islamic securities outstanding remained unchanged at BD508.6 million and BD18 million respectively.

Exchange Rates and Official Reserves

- The Bahraini dinar appreciated slightly against the Pound Sterling but depreciated against other key currencies (Euro, Yen, Swiss Franc).
- The latest available data for end-2007:Q4 indicates that the Real Effective Exchange Rate (REER) is still trending downwards, suggesting continued improvements in Bahrain's international competitive position.
- The level of official reserves rose further during 2008:Q1 to BD1924 million, 78% higher than the level attained during the same period of 2007.

Stock Market

- Total market capitalization stood at BD10.9 billion at the end of the review quarter, compared to the BD10.1 billion attained during the last quarter of 2007. *Year-on-year*, market capitalization was 41.5% higher than the level at the same period of 2007.
- Growth in market capitalization was driven primarily by the 22% increase in the market capitalization of the "commercial banks" segment.
- The BSE All-Share Index rose to 2789.89 points during 2008:Q1 from 2755.27 points in 2007:Q4.
- Liquidity also improved during 2008:Q1, with the turnover ratio rising to 2.8% (compared to 1.7% in the previous quarter).

1. Monetary Aggregates¹

During the first three months of 2008, *narrow money* (M1) increased by 17.5%, much faster than the 3.9% growth recorded during the last quarter of 2007 (Table 1). *Year-on-year*, the level of M1 was 25.6% higher than its level for 2007:Q1. In contrast to the developments in M1, the growth of *broad money* (M2) slowed to 7.7% during 2008:Q1, compared to the 10.2% expansion of the previous quarter. *Year-on-year*, the level of M2 was 40.7% higher than its level for 2007:Q1.

Table 1: Developments in Monetary Aggregates

	2007:Q1	2007:Q2	2007:Q3	2007:Q4	2008:Q1
M1 (BD millions)	1481	1681.4	1525.5	1584.3	1,860.8
<i>M1 Growth (%)</i>	<i>15.2%</i>	<i>13.5%</i>	<i>-9.3%</i>	<i>3.9%</i>	<i>17.5%</i>
M2 (BD millions)	4302.6	4777.7	5099.4	5622.0	6,056.9
<i>M2 Growth (%)</i>	<i>6.6%</i>	<i>11.0%</i>	<i>6.7%</i>	<i>10.2%</i>	<i>7.7%</i>

Source: Central Bank of Bahrain

Table 2 (next page) presents data on the different components of the money supply, providing further insights into the driving forces behind the movements in M1 and M2.

First, it shows that the acceleration in the growth of M1 was driven principally by the 20.1% growth in demand deposits during 2008:Q1, compared to a 2.7% expansion during the previous quarter. The rapid growth of demand deposits more than compensated for the slowdown in the growth rate of currency outside banks.

Further, the observed slowdown in the growth of M2 was influenced largely by a deceleration in the growth of savings and time deposits, from 12.9% in 2007:Q4 to only 3.9% during 2008:Q1.

¹ M1 is the sum of currency and demand deposits. M2 equals M1 plus savings and time deposits.

Table 2: Developments in Components of Money Supply

	2007:Q1	2007:Q2	2007:Q3	2007:Q4	2008:Q1
Currency outside banks (BD millions)	232.7	241.5	233.0	256.2	265.3
<i>Growth Rate (%)</i>	<i>2.2</i>	<i>3.8</i>	<i>-3.5</i>	<i>9.9</i>	<i>3.5</i>
Demand deposits (BD millions)	1248.3	1439.9	1292.5	1328.1	1595.5
<i>Growth Rate (%)</i>	<i>18.0</i>	<i>15.3</i>	<i>-10.2</i>	<i>2.7</i>	<i>20.1</i>
Savings and Time Deposits (BD millions)	2,821.6	3096.3	3573.9	4037.7	4196.1
<i>Growth rate (%)</i>	<i>2.6</i>	<i>9.7</i>	<i>15.4</i>	<i>12.9</i>	<i>3.9</i>

* Central government and the Social Insurance system

Source: Central Bank of Bahrain

Table 3: Contributions to Monetary Growth (% changes)

	2007:Q1	2007:Q2	2007:Q3	2007:Q4	2008:Q1
Growth in M2 (%)	6.6	11.0	6.7	10.2	7.7
Net Foreign Assets (NFA)	23.6	27.6	6.6	-3.5	2.6
<i>Central Bank of Bahrain</i>	<i>2.3</i>	<i>7.4</i>	<i>1.2</i>	<i>36.8</i>	<i>21.5</i>
<i>Retail banks</i>	<i>41.4</i>	<i>39.8</i>	<i>9.1</i>	<i>-20.7</i>	<i>-11.3</i>
Net Domestic Assets (NDA)	-12.8	-11.6	7.7	34.3	12.3
<i>Claims on government</i>	<i>-19.1</i>	<i>21.8</i>	<i>-0.03</i>	<i>6.9</i>	<i>1.9</i>
<i>Claims on private sector</i>	<i>6.7</i>	<i>6.7</i>	<i>12.7</i>	<i>8.2</i>	<i>11.2</i>
<i>Other assets (net)</i>	<i>-42.6</i>	<i>-40.0</i>	<i>-14.2</i>	<i>16.4</i>	<i>-6.6</i>

Source: Central Bank of Bahrain

According to the *sources of monetary expansion* (Table 3), the 12.3% expansion in net domestic assets (NDA) was the principal contributor to the expansion in money supply during 2008:Q1. In turn, the growth in NDA was primarily driven by claims on the private sector, which rose by 11.2% during the period.

Net foreign assets (NFA) increased by 2.6% during the quarter, reversing the 3.5% *decline* witnessed during 2007:Q4. This was caused by a slowdown in the rate at which retail banks reduced their net foreign assets, as speculations about a possible dinar revaluation died down.

2. Credit Developments

During 2008:Q1, total domestic credit increased by 10.4% to BD4623.1 million, slightly faster than the 8% growth of the previous quarter (Table 4). Credit to the private sector continues to be the major driving force behind domestic credit growth as credit to general government actually *declined* during the quarter (by 14.5%), which is remarkable when compared to the 25.9% *expansion* of the previous quarter.

Table 4: Trends in Domestic Credit (BD millions)

	2007:Q1	2007:Q2	2007:Q3	2007:Q4	2008:Q1
Total Domestic Credit	3219.8	3453.6	3877.4	4186.1	4623.1
<i>Growth (%)</i>	<i>6.1%</i>	<i>7.3%</i>	<i>12.3%</i>	<i>8.0%</i>	<i>10.4%</i>
Credit to General Government	152.1	213.0	197.0	248.2	212.1
<i>Growth (%)</i>	<i>-5.9%</i>	<i>40.0%</i>	<i>-7.5%</i>	<i>25.9%</i>	<i>-14.5%</i>
Credit to Private Sector	3067.7	3240.6	3680.4	3937.9	4411
<i>Growth (%)</i>	<i>6.8%</i>	<i>5.6%</i>	<i>13.6%</i>	<i>6.9%</i>	<i>12.0%</i>
Memo Items					
Share of Private Sector Credit	95.3%	93.8%	95%	94.1%	95.4%
Share of Public Sector Credit	4.7%	6.2%	5%	5.9%	4.6%

Source: Central Bank of Bahrain

Year-on-year, total domestic credit expanded by 43.5%, far exceeding the 26% growth rate of nominal GDP projected for 2007. Private sector credit shows a similar pattern, with year-on-year growth of 43.7%.

In terms of composition, the private sector continues to receive the bulk of domestic credit, accounting for 95.4% of the total during 2008:Q1, slightly up from the 94.1% recorded at the end of 2007:Q4. This probably reflects the aforementioned decline in lending to the government.

Table 5 (next page) provides a breakdown of private sector credit by sector. Lending to business grew by 14.7% during the first quarter of 2008, much faster than the 7.8% expansion recorded in the previous quarter. Year-on-year, lending to business expanded by 64.2%. Overall, business loans represented 63.6% of outstanding private sector credit as at end-2008:Q1.

Personal loans also rose during the first quarter, increasing by 7.6% (compared to a growth of 5.8% during 2007:Q4). Year-on-year, personal loans rose by 18.2%. Overall, personal loans accounted for 36.4% of outstanding private sector credit as at end-2008:Q1.

Table 5 also shows a breakdown of lending to the private sector by activity or segment. Loans to the “construction and real estate” segment accounted for the largest share of business loans outstanding (33.6%), with the “trade” segment in second place at 27.8%. Most of the growth in business loans during 2008:Q1 occurred in the “other sector” category, which increased by 52.4% during the quarter.

Personal loans “with salary assignment” represented the largest proportion of personal loans (47%), a marginal increase over the 45.5% share recorded during the previous quarter.

Most of the growth in personal loans during 2008:Q1 occurred in the “secured by property mortgage” category, which expanded by 20.2%. A notable development was the sharp decline in the “credit card receivables” category, which *dropped* by 30.8% during the quarter, compared to the 38.5% *rise* of 2007:Q4. This suggests that banks are beginning to take drastic action to reduce the high levels of credit card receivables.

Table 5: Trends in Retail Private Domestic Credit (BD millions)

	2007:Q1	2007:Q2	2007:Q3	2007:Q4	2008:Q1	2008:Q1 GROWTH (%)
BUSINESS	1708.1	1798.3	2268.6	2444.6	2804.5	14.7%
--Manufacturing	296.4	290.6	369.0	425.4	435.6	2.4%
--Mining and Quarrying	3.2	3.0	16.7	8.0	3.6	-55.0%
--Agriculture, fishing and dairy	6.5	6.0	5.7	6.4	6.5	1.6%
--Construction and real estate	508.8	598.0	711.7	787.8	943.5	19.8%
--Trade	597.2	540.9	650.4	737.7	782.0	6.0%
--Non-bank financial	97.9	102.0	144.8	171.0	209.3	22.4%
--Transport and communication	46.5	60.2	111.8	95.5	114.1	19.5%
--Hotels and restaurants	24.1	35.7	54.4	44.3	53.1	19.9%
--Other sectors	127.5	161.9	204.1	168.5	256.8	52.4%
PERSONAL	1359.6	1442.3	1411.8	1493.3	1606.5	7.6%
--Secured by Property Mortgage	262.6	272.9	273.4	376.0	451.8	20.2%
--Secured by Vehicle Title	93.1	99.7	97.8	113.3	122.1	7.8%
--Secured by deposits	28.2	26.6	28.7	25.7	28.9	12.5%
--With salary assignment	762.4	777.9	721.5	679.3	753.7	11.0%
--Credit card receivables	69.5	69.1	74.6	103.3	71.5	-30.8%
Other	143.8	196.1	215.8	195.7	178.5	-8.8%
TOTAL	3067.7	3240.6	3680.4	3937.9	4411.0	12.0%

Source: Central Bank of Bahrain

3. Interest Rates

Reflecting trends in the United States, short-term interest rates fell during 2008:Q1 (Table 6). The 3-month and 6-month inter-bank rates fell to 2.59% and 2.6% respectively by the end of the quarter, while the 3-month Treasury bill yield declined to 2.8%. With CBB responding to cuts in US interest rates, the CBB key policy rate was down to 2.25% by the end of 2008:Q1.

Table 6: Structure of Interest Rates (%)

	2007:Q1	2007:Q2	2007:Q3	2007:Q4	2008:Q1
3 month money market/inter-bank rate (BHIBOR)*	5.1	5.2	5.2	4.9	2.59
6 month money market/inter-bank rate (BHIBOR)*	5.1	5.2	5.2	4.8	2.60
CBB Key policy rate (end-of-quarter)	5.0	5.0	5.0	4.0	2.25
Average 3 month treasury bill yield	4.7	5.0	5.0	4.0	2.8
Average 6 month treasury bill yield	5.0	5.0	5.0	4.2	2.9
Retail bank lending rate—personal**	9.1	9.0	9.3	9.3	9.0
Retail bank lending rate—business**	7.6	8.0	7.6	6.9	6.6
Retail bank deposit rate (3-12 mths)**	5.2	5.1	4.2	3.5	1.6

*BHIBOR was introduced in December 2006

** Weighted averages of rates during the last month of each quarter

Source: Central Bank of Bahrain

Corresponding to the reductions in the policy and other short-term rates, the weighted lending rate for business loans decreased by 30 basis points to 6.6% during the period (from 6.9% in 2007:Q4). The rate for personal loans also fell by 30 basis points to 9%. Average deposit rates (3-12 months) decreased from 3.5% to 1.6% during the quarter, further widening the already big spread between deposit and lending rates.

4. Domestic Prices

According to available Consumer Price Index (CPI) data, domestic prices rose by 0.5% during 2008:Q1, when compared to the index level at the end-2007:Q4. On an annual basis, inflation is running at 4.9%. It should however be noted that the CPI numbers are based on a new basket of commodities (2006 base year). Hence, the new inflation numbers are not directly comparable to inflation numbers from previous years, given the change in the underlying basket of commodities.

5. Domestic Public Debt

During 2008:Q1, Bahrain's domestic public debt increased to BD634.6 million, up from BD616.6 million in 2007:Q4 (3% increase) (Table 7). This represented a significant slowdown when compared to the 18.5% growth recorded during the previous quarter.

Table 7: Domestic Public Debt Outstanding (BD millions)

	2007:Q1	2007:Q2	2007:Q3	2007:Q4	2008:Q1
Total Outstanding	565.1	545.0	520.0	616.6	634.6
--% of GDP*	9.6	9.3	8.7	10.4	10.7
Development bonds	0.0	0.0	0.0	0.0	0.0
Treasury bills	90.0	85.0	90.0	90.0	108.0
Islamic leasing securities	457.0	442.0	412.0	508.6	508.6
Al Salam Islamic securities	18.1	18.0	18.0	18.0	18.0

*Provisional 2006 GDP

Source: Central Bank of Bahrain

This change is mainly due to an expansion in the stock of Treasury bills outstanding from BD90 million to BD108 million (20% increase). The levels of both Islamic leasing securities and Al Salam Islamic securities remained unchanged during the quarter.

6. Exchange Rates and Official Reserves

Reflecting the recent gains made by the US dollar against the Pound Sterling, the Bahraini dinar appreciated slightly against the Pound Sterling during 2008:Q1 (from 0.751 to 0.749) (Table 8). However, the dinar depreciated against the Euro, Japanese Yen and Swiss Franc.

Table 8: BD Exchange Rates Against Selected Currencies*

	2007:Q1	2007:Q2	2007:Q3	2007:Q4	2008:Q1
US Dollar	0.376	0.376	0.376	0.376	0.376
Pound Sterling	0.739	0.752	0.758	0.751	0.749
Euro	0.501	0.506	0.532	0.554	0.594
Japanese Yen**	3.200	3.050	3.270	3.360	3.770
Swiss Franc	0.309	0.306	0.322	0.335	0.377

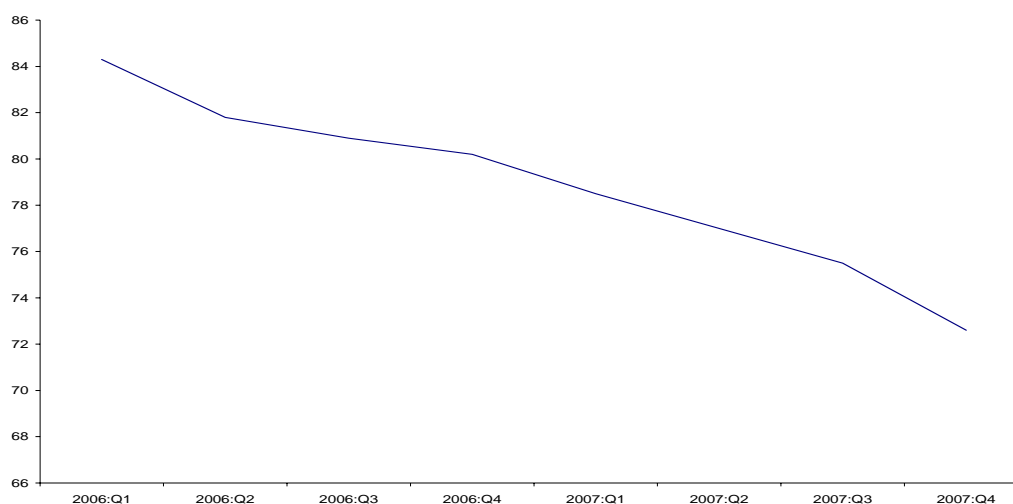
*Last working day of each period

** Per 1000 units

Source: Central Bank of Bahrain

Available data for end-2007:Q4 shows that Bahrain's Real Effective Exchange Rate (REER) is still trending downwards, suggesting continued improvements in the overall external competitive position (Chart 1).

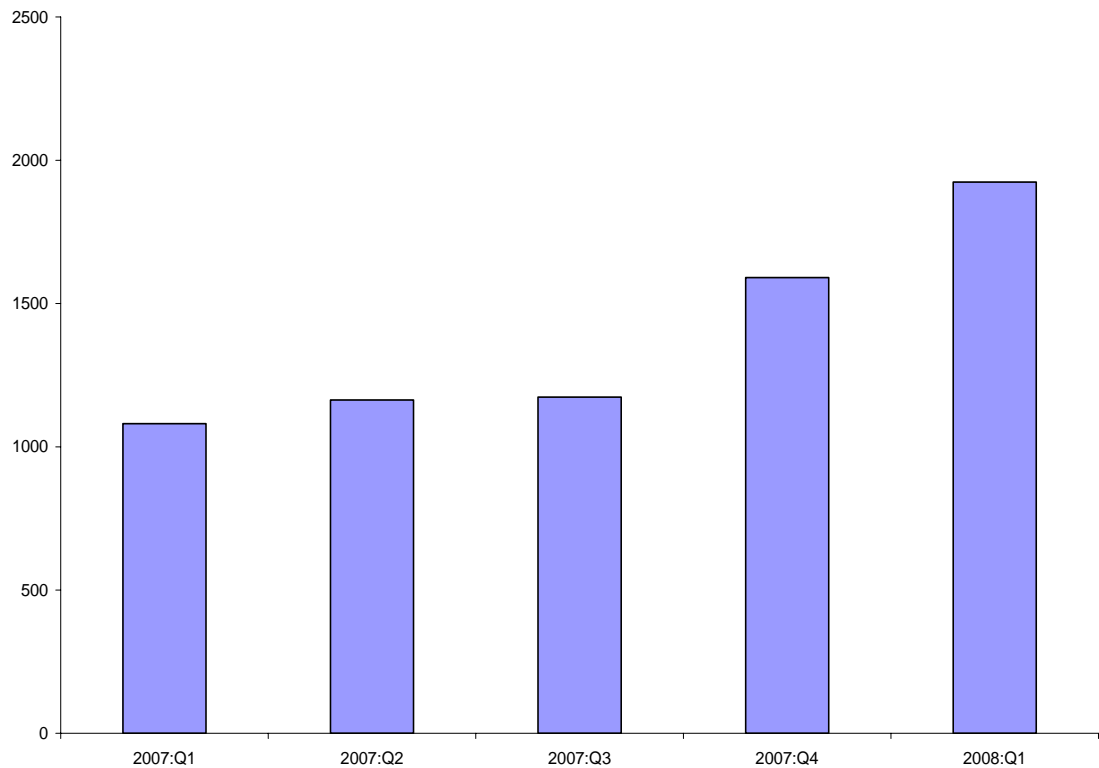
**Chart 1: Trends in Real Effective Exchange Rates
(2000=100; period averages)**



Source: IMF, International Financial Statistics, April 2008

The level of official reserves rose further during 2008:Q1, with the total level of reserves (gold, foreign exchange, SDR and IMF reserve position) standing at BD1924 million, 21% higher than the BD1590.6 million attained at the end of the previous quarter (Chart 2). *Year-on-year*, the level of reserves was 78% higher than its level for 2007:Q1.

Chart 2: Trends in Official Reserves—2007:Q1-2008:Q1 (BD millions)*



**Includes holdings of gold, foreign currencies, SDR and reserve position at the IMF*
 Source: Central Bank of Bahrain

7. The Stock Market

Total market capitalization of the Bahrain Stock Exchange (BSE) rose to BD10.9 billion by the end of 2008:Q1, compared to BD10.2 billion in the previous quarter (Table 9). Year-on-year, market capitalization was 41.5% higher than for the similar period of 2007. Growth in market size during 2008:Q1 was due principally to the 22% expansion in the market capitalization of the “commercial banks” segment.

Table 9: Market Capitalization on the Bahrain Stock Exchange (BD Million)*

	2007:Q1	2007:Q2	2007:Q3	2007:Q4	2008:Q1	2008:Q1 Growth (%)
Commercial banks	2546.8	3006.6	3122.6	3313.6	4043.3	22%
Investment	3621.1	3874.6	4178.3	4983.5	4861.8	-2.4%
Insurance	172.2	183.4	200.2	205.2	209.0	1.9%
Services	1227.1	1384.7	1519.7	1542.0	1629.3	5.7%
Industrial	16.0	16.2	16.7	16.6	15.4	-7.2%
Hotel and Tourism	113.4	117.9	119.5	124.0	131.3	5.9%
TOTAL	7696.8	8583.6	9157.0	10185.1	10890.3	6.9%

*end of quarter numbers

Source: Bahrain Stock Exchange

The BSE All-Share Index rose to 2789.89 points at the end of March 2008, compared to the 2755.27 points recorded for the fourth quarter of 2007 (Table 10). Measured year-on-year, the Index level during 2008:Q1 was 29.1% higher than the corresponding figure for the previous year.

Table 10: Sectoral Indices of Bahrain All-Share Index*

	2007:Q1	2007:Q2	2007:Q3	2007:Q4	2008:Q1
Commercial banks	2876.03	3395.28	3526.30	3479.10	3646.83
Investment	1862.58	1993.65	2134.92	2546.61	2482.86
Insurance	1937.80	2065.76	2257.89	2315.99	2359.36
Services	1717.99	1938.63	2036.19	2031.39	2154.33
Industrial	1384.42	1411.59	1450.16	1438.47	1338.20
Hotel and Tourism	2117.57	2201.22	2231.37	2315.15	2452.20
OVERALL INDEX	2159.78	2409.27	2543.92	2755.27	2789.89

*end of quarter numbers

Source: Bahrain Stock Exchange

Liquidity on the BSE improved during 2008:Q1, with the turnover ratio (value of trading as a share of market capitalization) rising to 2.8%, versus 1.7% during the previous quarter (Table 11). Trading during the quarter was dominated by the “commercial banks” sector which accounted for 68% of total trading (by value), displacing the “investment” segment into second place with 20.7% of total trading.

Table 11: Liquidity on the BSE

	2007:Q1	2007:Q2	2007:Q3	2007:Q4	2008:Q1
A. Overall Market Liquidity					
Value of Shares Traded (BD millions)	41.0	92.0	94.8	175.2	311.3
Market capitalization (BD millions)	7696.8	8583.6	9157.0	10185.1	10890.3
Turnover ratio*	0.5%	1.0%	1.0%	1.7%	2.8%
B. Value of Shares Traded by Sector (% shares)					
Commercial banks	36.7	34.5	39.1	31.5	67.6
Investment	48	44.2	45.8	57.4	20.7
Insurance	1.3	3.6	2.7	1.4	0.7
Services	7.9	11.2	11.1	9.0	10.2
Industrial	0.1	0.2	0.02	0.03	0.1
Hotel and Tourism	0.6	2.7	0.55	0.40	0.22

*Turnover ratio is calculated as value of shares traded as a percentage of total market capitalization

**Figures may not add to a hundred due to rounding

Source: Bahrain Stock Exchange

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