



مصرف البحرين المركزي

Central Bank of Bahrain

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Financial Stability Directorate

# Monetary and Financial Trends

First Quarter 2007

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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 2007 and highlights developments in the following monetary and financial indicators: i) monetary aggregates; ii) domestic credit; iii) interest rates; iv) domestic public debt; v) official reserves; vi) exchange rates; and vii) the stock market.

## Highlights

### Monetary Aggregates

- Narrow money (M1) and broad money (M2) expanded by 15.2% and 6.6% respectively during 2007:Q1.
- The fastest growing component of the money stock was demand deposits (18% growth), while currency in circulation and quasi-money (savings and time deposits) rose by more modest amounts (2.2% and 2.6% respectively)
- The growth in money supply reflects the increase in net foreign assets (NFA) which rose by 23.6%
- The increase in NFA was offset to some extent by a decline of 12.8% in net domestic assets (NDA).

### Credit Developments

- Total domestic credit grew by 6.1% to reach BD3219.8 million, driven by a 6.8% increase in private sector credit. Lending to government declined by 6% during the period under review.
- Focusing on private sector credit components, personal loans grew by 8.5% during the quarter, while business loans rose by 5.5%.
- Loans “with salary assignment” constituted the bulk of personal loans while business loans were dominated by loans to the “trade” segment.
- *Year-on-year*, the growth of private sector credit (20.5%) exceeded the growth of nominal GDP (17%), suggesting the existence of a lending boom to the private sector. Most of the year-on-year expansion in private sector lending was due to a rapid growth in business loans.

### Interest Rates

- Most short-term interest rates declined or remained the same during the quarter, but the weighted average of commercial bank deposit rates saw a slight increase from 4.4% to 5.2%.
- Both the commercial bank personal lending rate and the return on long-term Islamic leasing securities edged up during the quarter.
- The CBB raised its key policy interest rate (i.e. the rate on the 1-week deposit facility) by 50 basis points to 5.00% in the course of 2007:Q1.

### Domestic Public Debt

- The stock of domestic public debt decreased by 16.8% to stand at BD679.1 million.
- This shrinkage reflected reductions in outstanding debt across all categories.

### Official Reserves

- Official reserves reached BD1080.4 million, 35.5% higher than the level attained during the same period last year.
- However, the import coverage declined to 3.4 months of imports (compared to 3.7 months of imports in 2006:Q1)

### Exchange Rates

- The Bahraini dinar has lost some value against major trading currencies as its anchor currency (the dollar) weakened over the past year and a half.
- The largest gainer was the Pound Sterling, which gained 12.8% in value against the dinar between 2006:Q1 and 2007:Q1.
- The Real Effective Exchange Rate (REER) has been on a downward path, indicating improvements in Bahrain's international competitive position.

## **Stock Market**

- The BSE All-Share Index fell to 2159.78 points during 2007:Q1, compared to 2217.58 in 2006:Q4.
- Total market capitalization is slightly lower than the level attained at the end of 2006:Q4, but higher than the level at the same period last year.

## 1. Monetary Aggregates<sup>1</sup>

Broad money, as measured by M2, grew by 6.6% in the first quarter of 2007, slightly faster than both the 5.2% growth recorded in the previous quarter and the 4.8% growth recorded over the same period of 2006 (Table 1). *Year-on-year*, the level of M2 was 17% higher than its level at the end of March 2006, comparable to the 17% growth in nominal GDP in 2006<sup>2</sup>.

The expansion in narrow money, M1, was even quicker, increasing by 15.2% during 2007:Q1. This represented a substantial acceleration when compared to the 5.9% expansion of the previous quarter and the 8.5% growth recorded during 2006:Q1. *Year-on-year*, the level of M1 was 28.4% higher than its level at the end of March 2006.

The rapid expansion in M1 in particular is a reflection of the ongoing economic boom since this monetary aggregate is typically used for transactions purposes and is roughly indicative of domestic demand trends.

**Table 1: Developments in Monetary Aggregates**

	2006:Q1	2006:Q2	2006:Q3	2006:Q4	2007:Q1
M2 (BD millions)	3679.7	3936.8	3837.0	4035.9	4302.6
<i>M2 Growth (%)</i>	<i>4.8%</i>	<i>7.0%</i>	<i>-2.5%</i>	<i>5.2%</i>	<i>6.6%</i>
M1 (BD millions)	1153	1242.9	1214.5	1285.8	1481
<i>M1 Growth (%)</i>	<i>8.5%</i>	<i>7.8%</i>	<i>-2.3%</i>	<i>5.9%</i>	<i>15.2%</i>

Source: Central Bank of Bahrain

The trends in M1 and M2 largely reflect the fast growth in demand deposits, which expanded by 18% during 2007:Q1 to reach BD1248.3

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

<sup>2</sup> Preliminary estimates put 2006 nominal GDP at BD5883.3 million compared to BD5031.2 million in 2005.

million (Table 2). Currency expanded at a relatively low pace from BD227.7 million in 2006:Q4 to BD232.7 million as at end 2007:Q1 (2.2% growth). Savings and time deposits (quasi-money) also recorded a relatively slow growth of 2.6% over the period (from BD2749.4 million to BD2821.6 million).

*Year-on-year*, demand deposits were 31% higher than the level attained at the end of 2006:Q1. Currency and quasi-money were higher by 17% and 11% respectively.

**Table 2: Developments in Components of Money Supply**

	2006:Q1	2006:Q2	2006:Q3	2006:Q4	2007:Q1
Currency outside banks (BD millions)	198.9	211.0	206.7	227.7	232.7
<i>Growth Rate</i>	<i>4.2</i>	<i>6.1</i>	<i>-2.0</i>	<i>10.2</i>	<i>2.2</i>
Demand deposits (BD millions)	954.1	1031.9	1007.8	1058.1	1248.3
<i>Growth Rate</i>	<i>9.5</i>	<i>8.2</i>	<i>-2.3</i>	<i>5.0</i>	<i>18.0</i>
Savings and Time Deposits (BD millions)	2,536.7	2,693.9	2,622.5	2,749.4	2,821.6
<i>Growth rate</i>	<i>3.5</i>	<i>6.2</i>	<i>-2.6</i>	<i>4.8</i>	<i>2.6</i>

\* Central government and the Social Insurance system

Source: Central Bank of Bahrain

In terms of *sources of monetary expansion*, the growth in money supply during 2007:Q1 is explained by the increase in net foreign assets (NFA), which grew by 23.6% to reach BD2769.5 million (Tables 3 and 4). For comparison, NFA grew by 12.6% over a similar period in 2006. The growth in NFA was primarily driven by the growth in the NFA of retail banks, which expanded by 41.4% during 2007:Q1 to reach BD1730.9 million. This increase manifests Bahrain's increasing current account surpluses and the corresponding net outflows on the capital and financial account. Bahraini banks are holders of significant amounts of foreign equities, bonds and notes.

On the other hand, net domestic assets (NDA) decreased by 12.8% to BD2311.4 million from BD2652.4 million in 2006:Q4. This is in contrast to the 7.7% growth registered during the corresponding period last year. Liabilities exceed assets on the "other assets" category, with the deficit



widening by 43% during the quarter, while claims on government fell by 19.1%, much more than the 7.4% decline of 2006:Q4 and the 2.5% decline experienced in 2006: Q1. Claims on the private sector grew by 6.7%, reflecting faster growth in credit to the private sector.

**Table 3: Monetary Survey (BD millions)**

	2006:Q1	2006:Q2	2006:Q3	2006:Q4	2007:Q1
<b>Net Foreign Assets (NFA)</b>	1,578.6	1,601.4	1,798.6	2,240.2	2,769.5
<i>Central Bank of Bahrain</i>	755	785.2	825.3	1015.7	1038.6
<i>Retail banks</i>	823.6	816.2	973.3	1224.5	1730.9
<b>Net Domestic Assets (NDA)</b>	2981.3	2968.5	2717.4	2652.4	2311.4
<i>Claims on government</i>	658.6	655.9	614.1	568.6	459.8
<i>Claims on private sector</i>	2764.5	2882	2935.5	3122.5	3332.4
<i>Other assets (net)</i>	-441.8	-569.4	-832.2	-1038.7	-1480.8

Source: Central Bank of Bahrain

**Table 4: Contributions to Monetary Growth (% changes)**

	2006:Q1	2006:Q2	2006:Q3	2006:Q4	2007:Q1
<b>Growth in M2</b>	4.8	7.0	-2.5	5.2	6.6
<b>Net Foreign Assets (NFA)</b>	12.6	1.4	12.3	24.5	23.6
<i>Central Bank of Bahrain</i>	6.7	4.0	5.1	23.1	2.3
<i>Retail banks</i>	18.7	-0.9	19.2	25.8	41.4
<b>Net Domestic Assets (NDA)</b>	7.7	-0.4	-8.4	-2.4	-12.8
<i>Claims on government</i>	-2.5	-0.4	-6.4	-7.4	-19.1
<i>Claims on private sector</i>	5.4	4.3	1.9	6.4	6.7
<i>Other assets (net)</i>	-16.8	28.9	46.2	24.8	42.6

Source: Central Bank of Bahrain

## 2. Credit Developments

In the quarter under review, total domestic credit grew by 6.1% to BD3219.8 million, compared to the 4.7% growth of the previous quarter and the 4.4% growth recorded during a similar period of 2006 (Table 5). The growth in domestic credit was primarily due to the 6.8% increase in private sector credit, despite recent increases in personal and business loan rates. Notably, lending to government actually declined by 6%

during 2007:Q1, continuing a trend that was established over the previous four quarters.

*Year-on-year*, domestic credit expanded by 17.5%, slightly higher than the 17% growth rate of nominal GDP in 2006. The year-on-year growth of private sector credit was however faster at 20.5%, indicating an ongoing boom in lending to the private sector. Lending to business accounts for the bulk of the year-on-year expansion, growing by 31% compared to the 10% growth in personal loans (see Table 6).

**Table 5: Trends in Domestic Credit (BD millions)**

	2006:Q1	2006:Q2	2006:Q3	2006:Q4	2007:Q1
<b>Total Domestic Credit</b>	<b>2738.4</b>	<b>2856.0</b>	<b>2896.2</b>	<b>3033.4</b>	<b>3219.8</b>
<i>Growth (%)</i>	<i>4.4%</i>	<i>4.3%</i>	<i>1.4%</i>	<i>4.7%</i>	<i>6.1%</i>
Credit to General Government	194.2	188.0	191.5	161.5	152.1
<i>Growth (%)</i>	<i>-3.8%</i>	<i>-3.1%</i>	<i>1.4%</i>	<i>-15.9%</i>	<i>-5.9%</i>
Credit to Private Sector	2544.2	2668.0	2704.7	2871.9	3067.7
<i>Growth (%)</i>	<i>5.1%</i>	<i>4.9%</i>	<i>1.4%</i>	<i>6.2%</i>	<i>6.8%</i>
<b>Memo Items</b>					
Share of Private Sector Credit	92.9%	93.4%	93.4%	94.7%	95.3%
Share of Public Sector Credit	7.1%	6.6%	6.6%	5.3%	4.7%

*Source: Central Bank of Bahrain*

By end 2007:Q1, private sector credit accounted for 52.1% of GDP, up from 50.5% in 2006:Q1. Total domestic credit accounted for 54.7% of GDP, up from the 54.4% reached during 2006:Q1.

In terms of composition, the bulk of private sector credit has consistently gone to the private sector, which accounted for 95.3% of total domestic credit at the end of 2007:Q1. In general, the share of domestic credit going to the government has been declining slowly. The expanded private sector lending (and the declining lending to the public sector) mirrors the continued growth of the non-oil sector in Bahrain and the increasing importance of the private sector in economic activity.

**Table 6: Trends in Retail Private Domestic Credit (BD millions)**

	2006:Q1	2006:Q2	2006:Q3	2006:Q4	2007:Q1	<b>2007:Q1 GROWTH (%)</b>
<b>BUSINESS</b>	<b>1307.8</b>	<b>1402.6</b>	<b>1516.4</b>	<b>1619.0</b>	<b>1708.1</b>	<b>5.5%</b>
--Manufacturing	306.8	313.1	313.2	312.3	296.4	-5.1%
--Mining and Quarrying	3.3	2.0	4.1	1.8	3.2	77.8%
--Agriculture, fishing and dairy	7.9	4.1	42.1	6.5	6.5	0.0%
--Construction and real estate	328.5	361.1	388.8	484.2	508.8	5.1%
--Trade	447.8	496.8	544.1	551.5	597.2	8.3%
--Non-bank financial	72.8	77.2	67.8	75.1	97.9	30.4%
--Transport and communication	48.9	62.0	46.6	49	46.5	-5.1%
--Hotels and restaurants	25.6	23.4	20.7	22.0	24.1	9.5%
--Other sectors	66.2	62.9	89.0	116.6	127.5	9.3%
<b>PERSONAL</b>	<b>1236.4</b>	<b>1265.4</b>	<b>1188.3</b>	<b>1252.9</b>	<b>1359.6</b>	<b>8.5%</b>
--Secured by Property Mortgage	168.8	188.7	195.1	232.0	262.6	13.2%
--Secured by Vehicle Title	75.6	76.0	79.4	98.0	93.1	-5.0%
--Secured by deposits	20.0	24.9	28.8	15.5	28.2	81.9%
--With salary assignment	674.1	691.5	715.2	729.7	762.4	4.5%
--Credit card receivables	76.0	66.7	68.9	69.6	69.5	-0.1%
Other	221.9	217.6	100.9	108.1	143.8	33.0%
<b>TOTAL</b>	<b>2544.2</b>	<b>2668.0</b>	<b>2704.7</b>	<b>2871.9</b>	<b>3067.7</b>	<b>6.8%</b>

Source: Central Bank of Bahrain

Table 6 above presents a breakdown of lending to the private sector by activity. Personal loans stood at BD1359.6 million in 2007:Q1, representing 44.3% of outstanding private sector credit. This level of personal loans was up by 8.5% over 2006:Q4 and year-on-year comparisons show that personal loans were 10% higher than for 2006:Q1. Personal loans “with salary assignment” represented the largest proportion of the total (56%), followed by loans secured by property mortgage (19.3%). Most of the

growth in personal loans during 2007:Q1 occurred in the “secured by deposits” category, which increased by 81.9%.

Business loans stood at BD1708.1 million in 2007:Q1, representing 55.7% of outstanding private sector credit. This level of business loans was up by 5.5% over 2006:Q4 and year-on-year comparisons show that business loans were over 30% higher than for 2006:Q1. Loans to the “trade” segment accounted for the lion’s share (35%), followed by loans to “construction and real estate” (29.7%). Most of the growth in business loans during 2007:Q1 occurred in the “mining and quarrying” segment, which increased by 77.8%.

### 3. Interest Rates

Compared to 2006:Q4, *short-term interest rates* declined in 2007:Q1, an indication that ample liquidity is available at the short end of the market and also reflecting falling US rates (Table 7). The average 3-month inter-bank rate (BHIBOR) declined from 5.2% in 2006:Q4 to 5.1% and the 6-month inter-bank rate also fell from 5.2% to 5.1%. Similarly, yields on the 3-month Treasury bill fell from 4.9% to 4.7% and rates on the 6-month Treasury bill fell from 5.2% to 5%. The CBB increased its key policy rate (the 1-week deposit rate) on two occasions from 4.5% at the beginning of 2007:Q1 to 5% at the end of the quarter.

**Table 7: Structure of Interest Rates (%)**

	2006:Q1	2006:Q2	2006:Q3	2006:Q4	2007:Q1
3 month money market/inter-bank rate (BHIBOR)*	n.a	n.a	n.a	5.2	5.1
6 month money market/inter-bank rate (BHIBOR)*	n.a	n.a	n.a	5.2	5.1
CBB Key policy rate (end-of-quarter)	4.6	5.0	4.4	4.5	5.0
3 month treasury bill yield	4.8	5.4	5.0	4.9	4.7
6 month treasury bill yield	n.a	5.5	0.0	5.2	5.0
Commercial bank lending rate – personal**	9.0	8.6	9.2	8.9	9.1
Commercial bank lending rate – business**	7.3	7.8	7.8	7.6	7.6
Commercial bank deposit rate (3-12 mths)**	4.2	4.5	4.4	4.4	5.2

\*BHIBOR was introduced in December 2006

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

Source: Central Bank of Bahrain

Weighted lending rates for business loans remained unchanged at 7.6% during the quarter but similar rates for personal loans increased slightly by 20 basis points to 9.1%. Average deposit rates increased from 4.4% to 5.2% quarter-to-quarter.

## 4. Domestic Public Debt

Bahrain's domestic public debt decreased from BD679.1 million at the end of December 2006 to BD565.1 million at the end of March 2007 (a fall of 16.8%)( Table 8). This change is attributable to reductions in the size of all categories of debt with Treasury bills outstanding falling by BD72 million (44% reduction), Islamic leasing securities by BD15 million (3% reduction) and Al Salam securities by BD 27 million (60% fall).

Reflecting the reduction in the size of domestic public debt, the debt-GDP ratio fell to 9.6% by end-March 2007, compared to 11.4% as at end-March 2006.

**Table 8: Domestic Public Debt Outstanding (BD millions)**

	2006:Q1	2006:Q2	2006:Q3	2006:Q4	2007:Q1
<b>Total Outstanding</b>	<b>672.1</b>	<b>697.1</b>	<b>697.1</b>	<b>679.1</b>	<b>565.1</b>
--% of GDP*	11.4	11.8	11.8	11.5	9.6
Development bonds	0.0	0.0	0.0	0.0	0.0
Treasury bills	175.0	180.0	180.0	162.0	90.0
Islamic leasing securities	452.0	472.0	472.0	472.0	457.0
Al Salam Islamic securities	45.1	45.1	45.1	45.1	18.1

\*Provisional GDP

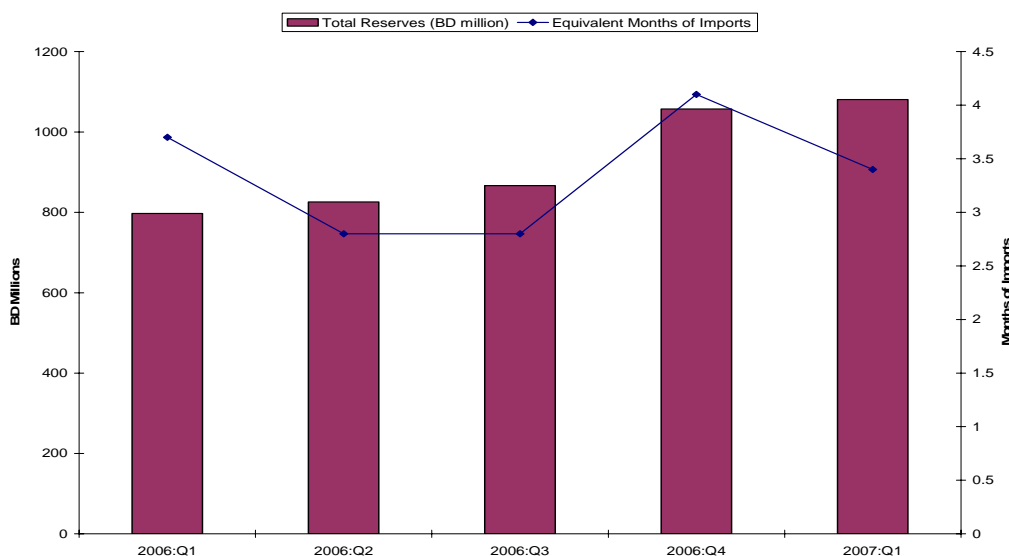
Source: Central Bank of Bahrain

## 5. Official Reserves

Bahrain's official reserves have been accumulating at a rapid pace, reaching BD1080.4 million (roughly \$2.8 billion) by the end of 2007:Q1 (Chart 1). This was 35.5% higher than the level attained during the same period last year. The reserves position was sufficient to finance 3.4 months

of imports, slightly down from the 3.7 months import coverage attained in 2006:Q1.

**Chart 1: Trends in Official Reserves\* – 2006:Q1-2007:Q1**



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

## 6. Exchange Rates

The Bahraini dinar has been officially pegged to the US dollar since 2001 at a rate of BD 0.376 to the dollar. Therefore, as the dollar has fallen against other major currencies over the past year, the BD has also weakened against these currencies. Between 2006:Q1 and 2007:Q1, the BD lost 12.8% of its value against the pound sterling, 10.3% against the Euro, 0.3% against the Yen and 7.3% against the Swiss franc (Table 9).

**Table 9: BD Exchange Rates Against Selected Currencies\***

	2006:Q1	2006:Q2	2006:Q3	2006:Q4	2007:Q1
US Dollar	0.376	0.376	0.376	0.376	0.376
Pound Sterling	0.655	0.683	0.710	0.736	0.739
Euro	0.454	0.472	0.479	0.493	0.501
Japanese Yen**	3.190	3.220	3.190	3.160	3.200
Swiss Franc	0.288	0.302	0.303	0.307	0.309

Source: Central Bank of Bahrain

\*Last working day of each period

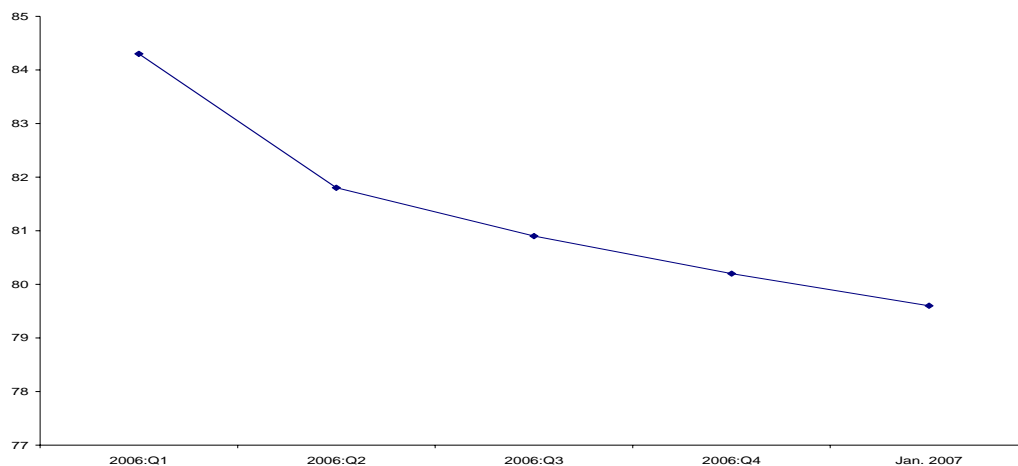
\*\* Per 1000 units

There are concerns that the declining value of the dinar against other major currencies may be contributing to domestic inflation, given the impact on import prices. However, this will depend to a large extent on the extent of exchange rate “pass-through”, i.e. the degree to which higher import prices are reflected in higher domestic prices.

In order to understand Bahrain’s external competitiveness in terms of its exchange rates, we take a look at trends in the Real Effective Exchange Rate (REER) (Chart 2). International competitiveness is determined by three main factors: i) the exchange rate; ii) domestic price movements; and iii) foreign price movements. The REER takes account of all these factors and is calculated as the ratio of an index of the dinar’s average exchange rate over a period to a weighted geometric average of exchange rates for the currencies of selected countries and the euro area, with adjustments for relative movements in national price or cost indicators of Bahrain, the selected countries and the euro area<sup>3</sup>.

As Chart 2 indicates, Bahrain’s REER has been on a downward trend, declining by around 5.6% between 2006:Q1 and January 2007. This indicates that Bahrain’s international competitive position has been improving.

**Chart 2: Trends in Real Effective Exchange Rates  
(2000=100; period averages)**



Source: IMF, *International Financial Statistics*, May 2007

<sup>3</sup> See IMF, “Introduction”, *International Financial Statistics*, May 2007.

## 7. The Stock Market

During 2007:Q1, total market capitalization of the Bahrain Stock Exchange (BSE) rose to BD7.7 billion, compared to BD6.4 billion a year ago (Table 10). First quarter capitalization is however lower than capitalization as at end 2006:Q4.

**Table 10: Market Capitalization on the Bahrain Stock Exchange (BD Million)**

	2006:Q1	2006:Q2	2006:Q3	2006:Q4	2007:Q1
Commercial banks	2052.7	2313.2	2539.1	2591.8	2546.8
Investment	2607.8	2640.6	3670.5	3680.4	3621.1
Insurance	192.3	179.7	177.3	167.5	172.2
Services	1390.8	1269.1	1485.2	1398.4	1227.1
Industrial	17.3	16.5	17.4	16.8	16.0
Hotel and Tourism	114.9	107.9	113.1	108.1	113.4
<b>TOTAL</b>	<b>6375.8</b>	<b>6527.1</b>	<b>8002.6</b>	<b>7963.1</b>	<b>7696.8</b>

Source: Bahrain Stock Exchange

Year-on-year, the growth in market size was driven by the “Commercial banks” and “investments” segments, which saw increases of 24% and 39% respectively. All the other segments recorded declines in market capitalization (year-on-year).

The BSE All-Share Index fell to 2159.78 points in the first quarter of 2007 (compared to 2217.58 in 2006:Q4), reflecting the negative impact of the 2006 market correction on investor confidence (Table 11). However, measured year-on-year, the Index level during 2007:Q1 was slightly higher than the corresponding figure for 2006:Q1.

**Table 11: Sectoral Indices of Bahrain All-Share Index**

	2006:Q1	2006:Q2	2006:Q3	2006:Q4	2007:Q1
Commercial banks	2469.56	2595.52	2869.54	2925.77	2876.03
Investment	1922.80	1756.23	1847.89	1848.22	1862.58
Insurance	2168.39	2023.50	1995.53	1883.96	1937.80
Services	1953.04	1782.09	2079.22	1957.76	1717.99
Industrial	1493.06	1422.67	1507.52	1456.41	1384.42
Hotel and Tourism	2143.32	2013.72	2109.85	2017.75	2117.57
<b>OVERALL INDEX</b>	<b>2137.89</b>	<b>2046.17</b>	<b>2234.42</b>	<b>2217.58</b>	<b>2159.78</b>

Source: Bahrain Stock Exchange



Low liquidity continues to be a feature of the market, with the turnover ratio (value of trading as a share of market capitalization) falling to 0.5% during 2007:Q1, compared to the 1.1% registered a year earlier (Table 12). As in previous periods, trading was dominated by the “investment” and “commercial banks” segments (in order of magnitude).

**Table 12: Liquidity on the BSE**

	2006:Q1	2006:Q2	2006:Q3	2006:Q4	2007:Q1
<b>A. Overall Market Liquidity</b>					
Value of Shares Traded (BD millions)	73.7	142.3	218.3	88.5	41.0
Market capitalization (BD millions)	6375.8	6527.1	8002.6	7963.1	7696.8
Turnover ratio*	1.1	2.2	2.7	1.1	0.5
<b>B. Value of Shares Traded by Sector (% shares)**</b>					
Commercial banks	32.4	75	19.9	46.3	36.7
Investment	46.7	20.3	76.5	48.6	48
Insurance	3.5	0.15	0.24	0.24	1.3
Services	15.1	4.0	2.8	4.7	7.9
Industrial	0.01	0.01	0.01	0.01	0.1
Hotel and Tourism	0.38	0.47	0.23	0.16	0.6

\*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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