



مَصْرِفُ الْبَحْرَيْنِ الْمُرَكَّبِي

Central Bank of Bahrain

Financial Stability Directorate

Monetary and Financial Trends

Second 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 Second 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) exchange rates; vi) official reserves; and vii) the stock market.

Highlights

Monetary Aggregates

- Narrow money (M1) and broad money (M2) expanded by 13.5% and 11% respectively during 2007:Q2.
- The fastest growing component of the money stock was demand deposits (15.3% growth), while currency in circulation rose modestly by 3.8%.
- Quasi-money (savings and time deposits) also grew briskly during the period, increasing by 9.7%, compared to the 2.6% growth recorded during 2007:Q1.
- The growth in money supply reflects the increase in net foreign assets (NFA) which rose by 27.6% during the second quarter.
- The increase in NFA was offset to some extent by a decline of 11.6% in net domestic assets (NDA).

Credit Developments

- Total domestic credit grew by 7.3% to reach BD3453.6 million, on the back of a 40% increase in lending to the government and a much smaller 5.6% increase in private sector credit.
- An examination of the components of private sector credit shows that personal loans grew by 6.1% during the quarter, while business loans rose by 5.3%.
- Loans “with salary assignment” constituted the bulk of personal loans (54% of the total) while business loans were dominated by loans to the “construction and real estate” segment (33.2% of the total).
- *Year-on-year*, the growth of private sector credit (21.4%) exceeded the growth of nominal GDP (17%), reflecting the ongoing boom in lending to the private sector.

Interest Rates

- Most short-term interest rates edged upwards during 2007:Q2, except for the commercial banks' personal lending rate which declined from 9.1% to 9% and the commercial bank deposit rate which fell from 5.2% to 5.1%.
- The CBB key policy interest rate (i.e. the rate on the 1-week deposit facility) remained unchanged at 5% during the quarter.

Domestic Public Debt

- In continuation of the downward trend of the previous quarters, the stock of domestic public debt (securities only) decreased slightly from BD565.1 million to BD545 million.
- The decline during 2007:Q2 reflected reductions in outstanding debt across all categories of securities.

Exchange Rates and Official Reserves

- During the second quarter of 2007, the Bahraini dinar depreciated against the Pound Sterling and the Euro, reflecting the ongoing weakness of its anchor currency (the dollar).
- The Real Effective Exchange Rate (REER) continues on its downward path, suggesting improvements in Bahrain's international competitive position.
- Official reserves reached BD1163.5 million during 2007:Q2, 41% higher than the level attained during the same period last year.

Stock Market

- In a sign of returning investor confidence, the BSE All-Share Index rose to 2409.27 points during 2007:Q2, compared to 2159.78 in the first quarter.
- Total market capitalization increased to BD8.5 billion, compared to the BD7.7 billion attained during the first quarter. Year-on-year, market capitalization is 32% higher than the level at the same period of 2006.

1. Monetary Aggregates¹

Broad money (M2) grew by 11% during the second quarter of 2007, faster than the 6.6% expansion in the first quarter and the 7% growth recorded over the same period of 2006 (Table 1). *Year-on-year*, the level of M2 was 21.3% higher than its level for 2006:Q2.

As in 2007:Q1, narrow money (M1) increased at a faster pace than M2 in the second quarter, expanding by 13.5%. This however represented a slight slowdown when compared to the 15.2% expansion recorded in 2007:Q1 (but much higher than the 7.8% growth recorded during the corresponding period of last year). *Year-on-year*, the level of M1 was 35.3% higher than its level at the end of 2006:Q2.

Table 1: Developments in Monetary Aggregates

	2006:Q2	2006:Q3	2006:Q4	2007:Q1	2007:Q2
M2 (BD millions)	3936.8	3837.0	4035.9	4302.6	4777.7
<i>M2 Growth (%)</i>	<i>7.0%</i>	<i>-2.5%</i>	<i>5.2%</i>	<i>6.6%</i>	<i>11.0%</i>
M1 (BD millions)	1242.9	1214.5	1285.8	1481	1681.4
<i>M1 Growth (%)</i>	<i>7.8%</i>	<i>-2.3%</i>	<i>5.9%</i>	<i>15.2%</i>	<i>13.5%</i>

Source: Central Bank of Bahrain

A look at the components of the money supply indicates that demand deposits grew briskly, expanding by 15.3% during 2007:Q2 to reach BD1439.9 million (Table 2). Savings and time deposits (quasi-money) also recorded fairly rapid growth during the quarter, increasing by 9.7%, compared to the 2.6% growth recorded during the first quarter. By comparison, currency expanded at a much slower pace, rising from BD232.7 million in 2007:Q1 to BD241.5 million as at end 2007:Q2 (3.8% growth).

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

Year-on-year, demand deposits were 39.5% higher than the level attained at the end of 2006:Q2. Currency and quasi-money were higher by 14.5% and 15% respectively.

Table 2: Developments in Components of Money Supply

	2006:Q2	2006:Q3	2006:Q4	2007:Q1	2007:Q2
Currency outside banks (BD millions)	211.0	206.7	227.7	232.7	241.5
<i>Growth Rate</i>	<i>6.1</i>	<i>-2.0</i>	<i>10.2</i>	<i>2.2</i>	<i>3.8</i>
Demand deposits (BD millions)	1031.9	1007.8	1058.1	1248.3	1439.9
<i>Growth Rate</i>	<i>8.2</i>	<i>-2.3</i>	<i>5.0</i>	<i>18.0</i>	<i>15.3</i>
Savings and Time Deposits (BD millions)	2,693.9	2,622.5	2,749.4	2,821.6	3096.3
<i>Growth rate</i>	<i>6.2</i>	<i>-2.6</i>	<i>4.8</i>	<i>2.6</i>	<i>9.7</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:Q2 is explained by the increase in net foreign assets (NFA), which grew by 27.6% to reach BD3535.8 million (Tables 3 and 4). The growth in NFA was primarily driven by the growth in the NFA of retail banks, which expanded by 39.8% during 2007:Q2 to reach BD2420.1million. This reflects the acquisition of foreign equities, bonds and notes by Bahraini retail banks.

In contrast, net domestic assets (NDA) decreased by 11.6% to BD2042.8 million from the BD2311.4 million attained in 2007:Q1. During the corresponding period of last year, NDA declined by -0.4%. Liabilities continue to exceed assets on the "other assets" category, with the deficit widening by 40% (compared to the 29% widening of a year earlier). Claims on government increased by 21.8%, in sharp contrast to the 19.1% fall recorded in 2007:Q1. This is due to an increase in the pace of lending to the government (see Section 2 below). Claims on the private sector grew at a much slower rate of 6.7%.

Table 3: Monetary Survey (BD millions)

	2006:Q2	2006:Q3	2006:Q4	2007:Q1	2007:Q2
Net Foreign Assets (NFA)	1,601.4	1,798.6	2,240.2	2,769.5	3535.8
<i>Central Bank of Bahrain</i>	785.2	825.3	1015.7	1038.6	1115.7
<i>Retail banks</i>	816.2	973.3	1224.5	1730.9	2420.1
Net Domestic Assets (NDA)	2968.5	2717.4	2652.4	2311.4	2042.8
<i>Claims on government</i>	655.9	614.1	568.6	459.8	560.0
<i>Claims on private sector</i>	2882	2935.5	3122.5	3332.4	3556.3
<i>Other assets (net)</i>	-569.4	-832.2	-1038.7	-1480.8	-2073.5

Source: Central Bank of Bahrain

Table 4: Contributions to Monetary Growth (% changes)

	2006:Q2	2006:Q3	2006:Q4	2007:Q1	2007:Q2
Growth in M2	7.0	-2.5	5.2	6.6	11.0
Net Foreign Assets (NFA)	1.4	12.3	24.5	23.6	27.6
<i>Central Bank of Bahrain</i>	4.0	5.1	23.1	2.3	7.4
<i>Retail banks</i>	-0.9	19.2	25.8	41.4	39.8
Net Domestic Assets (NDA)	-0.4	-8.4	-2.4	-12.8	-11.6
<i>Claims on government</i>	-0.4	-6.4	-7.4	-19.1	21.8
<i>Claims on private sector</i>	4.3	1.9	6.4	6.7	6.7
<i>Other assets (net)</i>	-28.9	-46.2	-24.8	-42.6	-40.0

Source: Central Bank of Bahrain

2. Credit Developments

During the second quarter of 2007, total domestic credit grew by 7.3% to BD3453.6 million, compared to the 6.1% growth of the previous quarter and the 4.3% growth recorded during a similar period of 2006 (Table 5). The growth in domestic credit was driven primarily by a remarkable 40% expansion in credit to general government, a sharp reversal from the 6% decline registered during the first quarter. Lending to the private sector increased by 5.6%, a slight slowdown when compared to the 6.8% growth of the previous quarter.

Year-on-year, total domestic credit expanded by 21%, exceeding the 17% growth rate of nominal GDP in 2006. The year-on-year growth of private sector credit was slightly faster at 21.4%, reflecting the ongoing boom in

lending to the private sector. A breakdown of private sector credit reveals that lending to business was the primary driver of the year-on-year expansion, growing by 28.2% compared to the 14% growth in personal loans (see Table 6).

Table 5: Trends in Domestic Credit (BD millions)

	2006:Q2	2006:Q3	2006:Q4	2007:Q1	2007:Q2
Total Domestic Credit	2856.0	2896.2	3033.4	3219.8	3453.6
<i>Growth (%)</i>	<i>4.3%</i>	<i>1.4%</i>	<i>4.7%</i>	<i>6.1%</i>	<i>7.3%</i>
Credit to General Government	188.0	191.5	161.5	152.1	213.0
<i>Growth (%)</i>	<i>-3.1%</i>	<i>1.4%</i>	<i>-15.9%</i>	<i>-5.9%</i>	<i>40.0%</i>
Credit to Private Sector	2668.0	2704.7	2871.9	3067.7	3240.6
<i>Growth (%)</i>	<i>4.9%</i>	<i>1.4%</i>	<i>6.2%</i>	<i>6.8%</i>	<i>5.6%</i>
Memo Items					
Share of Private Sector Credit	93.4%	93.4%	94.7%	95.3%	93.8%
Share of Public Sector Credit	6.6%	6.6%	5.3%	4.7%	6.2%

Source: Central Bank of Bahrain

In terms of composition, the private sector continues to receive the bulk of domestic credit, accounting for 93.8% during 2007:Q2, slightly down from the 95.3% recorded at the end of 2007:Q1. This reduction was due to the increase in lending to the government during the second quarter of 2007.

Table 6 below presents a breakdown of lending to the private sector by activity. Personal loans stood at BD1442.3 million at the end of 2007:Q2, accounting for 44.5% of outstanding private sector credit. Personal loans grew by 6.1% during the quarter, indicating a slowdown when compared to the 8.5% growth seen in 2007:Q1. Personal loans “with salary assignment” represented the largest proportion of the total (54%), followed by loans secured by property mortgage (19%).

Most of the growth in personal loans during 2007:Q2 occurred in the “other” category, which increased by 36.4%. Notably, loans “secured by deposits” declined by 5.7% during the quarter, a sharp contrast to the 81.9% increase witnessed during the previous quarter.

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

	2006:Q2	2006:Q3	2006:Q4	2007:Q1	2007:Q2	2007:Q2 GROWTH (%)
BUSINESS	1402.6	1516.4	1619.0	1708.1	1798.3	5.3%
--Manufacturing	313.1	313.2	312.3	296.4	290.6	-2.0%
--Mining and Quarrying	2.0	4.1	1.8	3.2	3.0	-6.3%
--Agriculture, fishing and dairy	4.1	42.1	6.5	6.5	6.0	-7.7%
--Construction and real estate	361.1	388.8	484.2	508.8	598.0	17.5%
--Trade	496.8	544.1	551.5	597.2	540.9	-9.4%
--Non-bank financial	77.2	67.8	75.1	97.9	102.0	4.2%
--Transport and communication	62.0	46.6	49	46.5	60.2	29.5%
--Hotels and restaurants	23.4	20.7	22.0	24.1	35.7	48.1%
--Other sectors	62.9	89.0	116.6	127.5	161.9	27.0%
PERSONAL	1265.4	1188.3	1252.9	1359.6	1442.3	6.1%
--Secured by Property Mortgage	188.7	195.1	232.0	262.6	272.9	3.9%
--Secured by Vehicle Title	76.0	79.4	98.0	93.1	99.7	7.1%
--Secured by deposits	24.9	28.8	15.5	28.2	26.6	-5.7%
--With salary assignment	691.5	715.2	729.7	762.4	777.9	2.0%
--Credit card receivables	66.7	68.9	69.6	69.5	69.1	-0.6%
Other	217.6	100.9	108.1	143.8	196.1	36.4%
TOTAL	2668.0	2704.7	2871.9	3067.7	3240.6	5.6%

Source: Central Bank of Bahrain

Business loans stood at BD1798.3 million in 2007:Q2, accounting for 55.5% of outstanding private sector credit. This level of business loans was up by 5.3% over 2007:Q1 and year-on-year comparisons show that business loans were over 28% higher than the level for 2006:Q2. Loans to the “construction and real estate” segment accounted for the lion’s share (33.2%), displacing the “trade” segment into second place at 30%. Most of

the growth in business loans during 2007:Q2 occurred in the “hotels and restaurants” segment, which increased by 48.1%.

3. Interest Rates

Short-term interest rates edged upwards during 2007:Q2 (Table 7). The average 3-month and 6-month inter-bank rates (BHIBOR) rose from 5.1% in the first quarter to 5.2% by the end of the second quarter, while the 3-month Treasury bill yield also increased from 4.7% to 5%. The CBB key policy rate remained unchanged at 5% during the quarter.

Table 7: Structure of Interest Rates (%)

	2006:Q2	2006:Q3	2006:Q4	2007:Q1	2007:Q2
3 month money market/inter-bank rate (BHIBOR)*	n.a	n.a	5.2	5.1	5.2
6 month money market/inter-bank rate (BHIBOR)*	n.a	n.a	5.2	5.1	5.2
CBB Key policy rate (end-of-quarter)	5.0	4.4	4.5	5.0	5.0
3 month treasury bill yield	5.4	5.0	4.9	4.7	5.0
6 month treasury bill yield	5.5	0.0	5.2	5.0	5.0
Commercial bank lending rate – personal**	8.6	9.2	8.9	9.1	9.0
Commercial bank lending rate – business**	7.8	7.8	7.6	7.6	8.0
Commercial bank deposit rate (3-12 mths)**	4.5	4.4	4.4	5.2	5.1

*BHIBOR was introduced in December 2006

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

Source: Central Bank of Bahrain

The weighted lending rate for business loans increased to 8% during the period (from 7.6% in 2007:Q1) although a similar rate for personal loans continue its downward path, decreasing slightly by 10 basis points to 9.0%. This is on the back of the 20 basis points decline witnessed during the first quarter. Average deposit rates (3-12 months) decreased from 5.2% to 5.1%, in contrast to the increase registered during 2007:Q1.

4. Domestic Public Debt

The second quarter of 2007 witnessed a further reduction in the size of Bahrain's domestic public debt (securities only) by 3.5%, from BD565.1 million at the end of March 2007 to BD545.0 million by the end of June 2007 (Table 8). This change is attributable to reductions in the size of all categories of debt with Treasury bills outstanding falling by BD5 million (5.5% reduction) and Islamic leasing securities by BD15 million (3.3% reduction). Al Salam securities saw a much smaller decrease from BD18.1 million to BD18.0 million.

Reflecting the downward trend in the size of domestic public debt, the debt-GDP ratio fell to 9.3% by end-June 2007, compared to 11.8% as at end-June 2006.

Table 8: Domestic Public Debt Outstanding (BD millions)

	2006:Q2	2006:Q3	2006:Q4	2007:Q1	2007:Q2
Total Outstanding	697.1	697.1	679.1	565.1	545.0
--% of GDP*	11.8	11.8	11.5	9.6	9.3
Development bonds	0.0	0.0	0.0	0.0	0.0
Treasury bills	180.0	180.0	162.0	90.0	85.0
Islamic leasing securities	472.0	472.0	472.0	457.0	442.0
Al Salam Islamic securities	45.1	45.1	45.1	18.1	18.0

*Provisional 2006 GDP

Source: Central Bank of Bahrain

5. Exchange Rates and Official Reserves

During 2007:Q2, the Bahraini dinar depreciated against the Pound Sterling and the Euro, but gained in value against the Japanese Yen and the Swiss Franc (Table 9). Given the dinar's pegged relation to the dollar, the loss of value against the Sterling and the Euro reflects the slide of the dollar against these currencies.

Table 9: BD Exchange Rates Against Selected Currencies*

	2006:Q2	2006:Q3	2006:Q4	2007:Q1	2007:Q2
US Dollar	0.376	0.376	0.376	0.376	0.376
Pound Sterling	0.683	0.710	0.736	0.739	0.752
Euro	0.472	0.479	0.493	0.501	0.506
Japanese Yen**	3.220	3.190	3.160	3.200	3.050
Swiss Franc	0.302	0.303	0.307	0.309	0.306

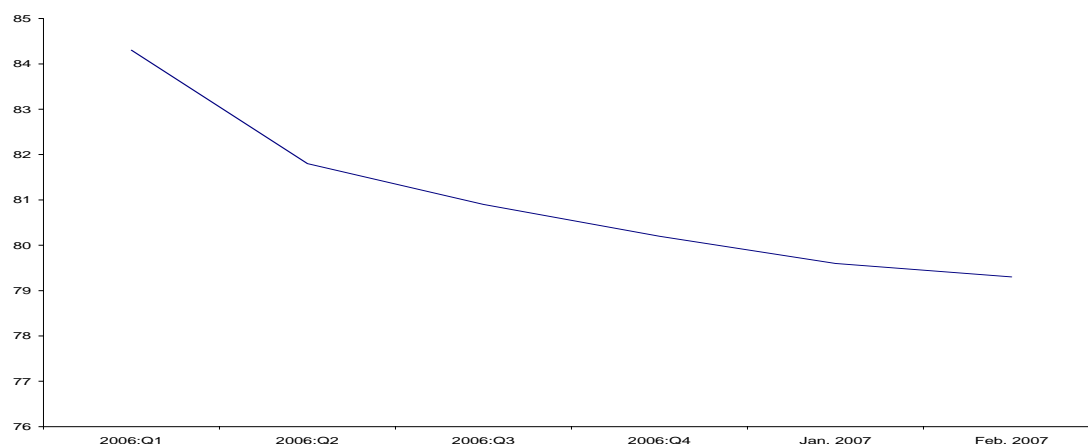
Source: Central Bank of Bahrain

*Last working day of each period

** Per 1000 units

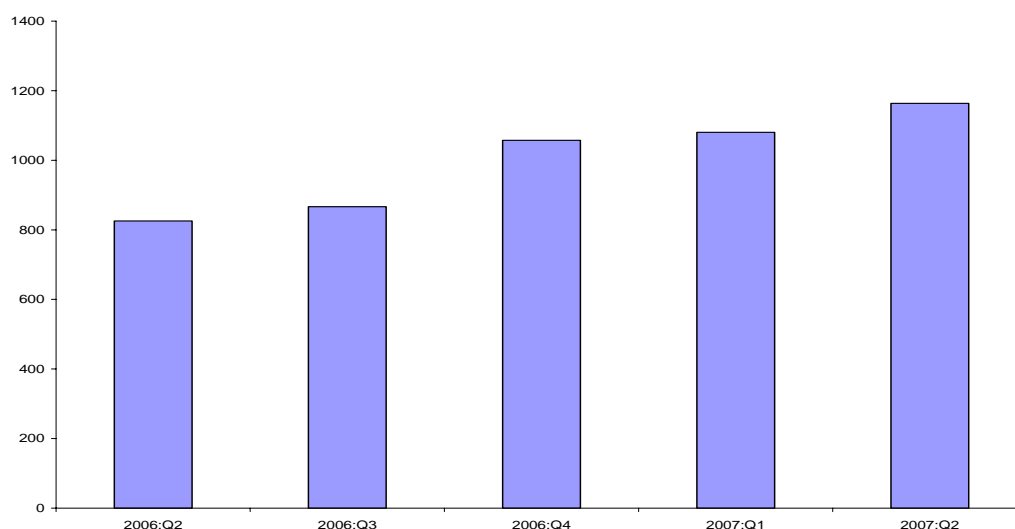
The most recent available data for February 2007 reveals that Bahrain's Real Effective Exchange Rate (REER) continues on its downward path, suggesting improvements in the overall external competitive position (Chart 1).

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



Source: IMF, International Financial Statistics, May 2007

Bahrain continues to accumulate official reserves which reached BD1163.5 million (roughly \$3.1 billion) by the end of 2007:Q2 (Chart 2). This was 35.5% higher than the level attained during the same period last year.

Chart 2: Trends in Official Reserves* – 2006:Q2-2007:Q2

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

6. The Stock Market

During 2007:Q2, total market capitalization of the Bahrain Stock Exchange (BSE) rose to BD8.5 billion, compared to BD7.7 billion at the end of the first quarter. Year-on-year, market capitalization was 31.5% higher than for the similar period of 2006 (Table 10).

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

	2006:Q2	2006:Q3	2006:Q4	2007:Q1	2007:Q2
Commercial banks	2313.2	2539.1	2591.8	2546.8	3006.6
Investment	2640.6	3670.5	3680.4	3621.1	3874.6
Insurance	179.7	177.3	167.5	172.2	183.4
Services	1269.1	1485.2	1398.4	1227.1	1384.7
Industrial	16.5	17.4	16.8	16.0	16.2
Hotel and Tourism	107.9	113.1	108.1	113.4	117.9
TOTAL	6527.1	8002.6	7963.1	7696.8	8583.6

Source: Bahrain Stock Exchange

Growth in market size during 2007:Q2 was driven by the “commercial banks” and “services” segments, which saw increases of 18% and 12.8% respectively in capitalization. Year-on-year, the growth in market size was driven by the “commercial banks” and “investments” segments, which saw increases of 30% and 46.7% respectively.

The BSE All-Share Index rose to 2409.27 points in the second quarter of 2007 (compared to 2159.78 in 2007:Q1), reflecting the return of investor confidence in the market and indicating that the market may finally be recovering from the after-effects of the Gulf-wide correction in stock markets during 2006 (Table 11). Measured year-on-year, the Index level during 2007:Q2 was 17.7% higher than the corresponding figure for 2006:Q2.

Table 11: Sectoral Indices of Bahrain All-Share Index

	2006:Q2	2006:Q3	2006:Q4	2007:Q1	2007:Q2
Commercial banks	2595.52	2869.54	2925.77	2876.03	3395.28
Investment	1756.23	1847.89	1848.22	1862.58	1993.65
Insurance	2023.50	1995.53	1883.96	1937.80	2065.76
Services	1782.09	2079.22	1957.76	1717.99	1938.63
Industrial	1422.67	1507.52	1456.41	1384.42	1411.59
Hotel and Tourism	2013.72	2109.85	2017.75	2117.57	2201.22
OVERALL INDEX	2046.17	2234.42	2217.58	2159.78	2409.27

Source: Bahrain Stock Exchange

Table 12: Liquidity on the BSE

	2006:Q2	2006:Q3	2006:Q4	2007:Q1	2007:Q2
A. Overall Market Liquidity					
Value of Shares Traded (BD millions)	142.3	218.3	88.5	41.0	92.0
Market capitalization (BD millions)	6527.1	8002.6	7963.1	7696.8	8583.6
Turnover ratio*	2.2	2.7	1.1	0.5	1.0
B. Value of Shares Traded by Sector (% shares)**					
Commercial banks	75	19.9	46.3	36.7	34.5
Investment	20.3	76.5	48.6	48	44.2
Insurance	0.15	0.24	0.24	1.3	3.6
Services	4.0	2.8	4.7	7.9	11.2
Industrial	0.01	0.01	0.01	0.1	0.2
Hotel and Tourism	0.47	0.23	0.16	0.6	2.7

*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

Although relatively low liquidity persists on the market, 2007:Q2 saw a slight increase in the turnover ratio (value of trading as a share of market capitalization), which stood at 1.0% compared to 0.5% during the previous quarter (Table 12).

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