



مصرف البحرين المركزي
Central Bank of Bahrain

Financial Stability Directorate

Monetary and Financial Trends

Third 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 Third 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:Q3, *narrow money* (M1) fell by 4.7% while *broad money* (M2) increased by 1.2%.
- *Currency in circulation* was the fastest growing component of the money stock during the quarter, increasing by 11.5%. *Quasi-money* (savings and time deposits) grew by 4.2% while *demand deposits* declined by 7.0%.
- The overall growth in money supply was mainly due to a 14.8% expansion in *Net Foreign Assets* (NFA).
- Conversely, *Net Domestic Assets* (NDA) decreased by 4.1% during the quarter.

Credit Developments

- Total domestic credit grew by 8.6% to reach BD 5,513.5 million, representing a slowdown in domestic credit growth when compared to the 9.8% growth recorded last quarter.
- Private sector credit *increased* by 7.5% (vs. 9.8% in Q2) alongside a 31.3% *expansion* in lending to general government (vs. the 9.7% *increase* in Q2).
- An analysis of private sector credit components shows that *business loans* increased significantly by 21.8%, much *faster* than the 3.5% growth in the second quarter.
- *Personal loans* declined by 14.0% during the quarter, compared to the 20.9% growth in the previous quarter.
- Loans “With Salary Assignment” constituted the bulk of personal loans (45.9% of the total), slightly higher from the 44.9% share recorded in the previous quarter. This is followed by loans “Secured by Property Mortgage” which made up 26.7% of total personal loans.
- *Business loans* went primarily to the “construction and real estate” segment, which accounted for 25.9% of the total.
- The *year-on-year* growth of private sector credit (34.3%) was higher than the growth in 2007 nominal GDP (16.4%), indicating that the

boom in private sector lending is persisting; although the ongoing global financial turmoil appears to be having a dampening effect.

Interest Rates

- Short-term interest rates increased during the third quarter; the 3-month and 6-month inter-bank rates rose to 3.6% and 3.7% respectively by the end of the quarter. The 3-month Treasury bill yield increased to 2.3%.
- The CBB key policy rate remained unchanged at 2.0% at the end of the quarter.

Domestic Prices

- Inflation numbers released by the CIO, based on a revised basket of commodities (2006 base year) show that the *consumer price index* increased by 1.2% for 2008:Q3.
- During 2008:Q3 prices for “housing, water, electricity & fuels” grew the fastest, growing by 2.6%; *year-on-year* prices for “food beverages and tobacco” grew the most, increasing by 5.5%.
- *Year-on-year* inflation was 2.2%.

Domestic Public Debt

- The stock of domestic public debt (securities only) remained unchanged during the quarter at BD 705.0 million.
- Domestic public debt remained unchanged due to the issue of BD 15.0 million in Islamic leasing securities, which offset matured Islamic leasing securities during the last quarter.
- Outstanding Treasury bills similarly remained unchanged at BD 180.0 million as well as Al Salam Islamic Securities at BD 18.0 million.

Exchange Rates and Official Reserves

- The Bahraini dinar appreciated against key currencies (Euro, Yen, Pound Sterling and Swiss Franc) during the third quarter. The dinar appreciated the most against the Pound Sterling increasing by 8.5%.

- The accumulation of official reserves declined during 2008:Q3, with reserves reaching BD 1,412.2 million, 15.7% lower than the previous quarter. On a yearly basis, reserves were 20.2% higher than the level attained during the same period of 2007.

Stock Market

- Total market capitalisation decreased to BD 10.3 billion, compared to the BD 11.5 billion attained during the second quarter. Year-on-year, market capitalisation was 12.2% lower than the level at the same period of 2007.
- The fall in market capitalisation was attributable to the reduction in market capitalisation of the “Commercial banks”, “Services” and “Investment” segments by 13.6%, 14.6% and 7.9% respectively.
- The BSE All-Share Index declined to 2,462.72 points during 2008:Q3, compared to 2,859.03 in the second quarter.
- Liquidity declined during the quarter, with the turnover ratio standing at 0.8%, compared to 1.8% recorded at the end of the second quarter.

1. Monetary Aggregates¹

In the third quarter of 2008, *narrow money* (M1) decreased by 4.7%, compared with an increase of 18.5% witnessed during the second quarter (Table 1). *Year-on-year*, the level of M1 was 37.8% higher than its level for 2007:Q3. In contrast to the fall in M1, *broad money* (M2) increased slightly by 1.2% during 2008:Q3, compared to the 8.8% expansion in the second quarter. *Year-on-year*, the level of M2 was 30.8% higher than its level for 2007:Q3.

Table 1: Developments in Monetary Aggregates

(BD Million)

	2007:Q3	2007:Q4	2008:Q1	2008:Q2	2008:Q3
M1	1,525.5	1,572.6	1,860.8	2,204.7	2,101.9
<i>M1 Growth (%)</i>	<i>-9.3</i>	<i>3.1</i>	<i>18.3</i>	<i>18.5</i>	<i>-4.7</i>
M2	5,099.4	5,682.6	6,056.9	6,588.0	6,668.8
<i>M2 Growth (%)</i>	<i>6.7</i>	<i>11.4</i>	<i>6.5</i>	<i>8.8</i>	<i>1.2</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 fall of M1 was largely influenced by a 7.0% decrease in demand deposits during 2008:Q3. In contrast, there was an increase of 11.5% in the level of currency outside banks from BD 275.5 million in the second quarter to BD 307.2 million by the end of the third quarter. However, there was a 4.2% increase in savings and time deposits from BD 4,383.3 million in the second quarter to BD 4,566.9 million in 2008:Q3, which led to the slight growth in M2.

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

Table 2: Developments in Components of Money Supply

(BD Million)

	2007:Q3	2007:Q4	2008:Q1	2008:Q2	2008:Q3
Currency Outside Banks	233.0	256.2	265.3	275.5	307.2
<i>Growth Rate (%)</i>	<i>-3.5</i>	<i>10.0</i>	<i>3.6</i>	<i>3.8</i>	<i>11.5</i>
Demand Deposits	1,292.5	1,316.4	1,595.5	1,929.2	1,794.7
<i>Growth Rate (%)</i>	<i>-10.2</i>	<i>1.8</i>	<i>21.2</i>	<i>20.9</i>	<i>-7.0</i>
Savings and Time Deposits	3,573.9	4,110.0	4,196.1	4,383.3	4,566.9
<i>Growth Rate (%)</i>	<i>15.4</i>	<i>15.0</i>	<i>2.1</i>	<i>4.5</i>	<i>4.2</i>

* Central government and the Social Insurance system

Source: Central Bank of Bahrain

Table 3: Contributions to Monetary Growth

(% Change)

	2007:Q3	2007:Q4	2008:Q1	2008:Q2	2008:Q3
Net Foreign Assets (NFA)	6.6	-1.8	0.9	-8.0	14.8
<i>Central Bank of Bahrain</i>	<i>1.2</i>	<i>36.9</i>	<i>21.5</i>	<i>-13.4</i>	<i>-16.0</i>
<i>Retail Banks</i>	<i>9.1</i>	<i>-18.4</i>	<i>-13.9</i>	<i>-2.5</i>	<i>42.6</i>
Net Domestic Assets (NDA)	7.7	34.3	12.4	26.0	-4.1
<i>Claims on Government</i>	<i>-0.04</i>	<i>9.5</i>	<i>-0.4</i>	<i>10.9</i>	<i>6.8</i>
<i>Claims on Private Sector</i>	<i>12.8</i>	<i>7.8</i>	<i>11.6</i>	<i>10.9</i>	<i>8.2</i>
<i>Other Assets (net)</i>	<i>-14.3</i>	<i>-16.4</i>	<i>-6.6</i>	<i>12.9</i>	<i>-35.8</i>

Source: Central Bank of Bahrain

An examination of the *sources of monetary expansion* reveals that a 14.8% increase in net foreign assets (NFA) was the key driver of the expansion in money supply during the third quarter (Table 3). Growth in NFA was primarily driven by claims on retail banks, which grew by 42.6% (vs. a decrease of 2.5% in 2008:Q2).

On the other hand, net domestic assets (NDA) declined by 4.1% during the quarter. This was mainly due to a 35.8% decline in the “other assets (net)” category. There was also an 8.2% expansion in claims on the private sector and claims on government also increased by 6.8%.

Liabilities continue to exceed assets on the “other assets (net)” category, with the net deficit widening by 35.8% during the quarter.

2. Credit Developments

During 2008:Q3, total domestic credit increased by 8.6% to BD 5,513.5 million, a slightly slower growth rate when compared to the 9.8% growth of the previous quarter (Table 4). The major factor behind this trend was the slowdown in growth of credit to the private sector from 9.8% in the second quarter to 7.5% in the third quarter. However, lending to general government rose dramatically by 31.3%, compared to the 9.7% increase during 2008:Q2.

Table 4: Trends in Domestic Credit

(BD Million)

	2007:Q3	2007:Q4	2008:Q1	2008:Q2	2008:Q3
Total Domestic Credit	3,877.4	4,183.9	4,623.1	5,077.3	5,513.5
<i>Growth (%)</i>	12.3	7.9	10.5	9.8	8.6
Credit to General Government	197.0	262.3	212.1	232.6	305.3
<i>Growth (%)</i>	-7.5	33.1	-19.1	9.7	31.3
Credit to Private Sector	3,680.4	3,921.6	4,411.0	4,844.7	5,208.2
<i>Growth (%)</i>	13.6	6.6	12.5	9.8	7.5
Memo Items					
Share of Private Sector Credit	94.9	93.7	95.4	95.4	94.5
Share of Public Sector Credit	5.1	6.3	4.6	4.6	5.5

Source: Central Bank of Bahrain

Year-on-year, total domestic credit expanded by 42.2%. Private sector credit shows a similar pattern, with year-on-year growth of 41.5%, indicating that the lending boom to households and business enterprises is persisting. However, it seems that the ongoing global financial turbulence is beginning to have a dampening effect, especially on personal loans.

In terms of composition, the private sector continues to receive the bulk of domestic credit, accounting for 94.5% during the third quarter.

A breakdown of private sector credit indicates that lending to business grew significantly during the third quarter, increasing by 21.9% compared to the 3.6% recorded during 2008:Q2 (see Table 5, next page). In contrast, personal loans decreased by 14.0% during the same quarter, compared to 20.7% growth experienced during the second quarter. *Year-on-year*,

personal loans rose by 18.1%. Year-on-year lending to business expanded by 56.0%.

Table 5 also presents a breakdown of lending to the private sector by activity. Personal loans stood at BD 1,667.9 million at the end of 2008:Q3, accounting for 32.0% of total outstanding private sector credit. Personal loans “with salary assignment” represented the largest proportion of personal loans (45.9%), slightly higher than the 44.9% share attained in the second quarter. Personal loans “Secured by Property Mortgage” were the next largest component of total personal loans, accounting for 26.7%.

The decrease in personal loans in 2008:Q3 was broad based. The segment with the highest decrease was loans “Secured by deposits” which fell by 49.5%. Next came loans “Secured by Property Mortgage” (-31.1%), then loans “with salary assignment” (-12.1%), and finally loans “secured by vehicle title” (-7.1%). Conversely, credit card receivables and “other” personal loans grew by 4.0% and 47.5% respectively.

Business loans stood at BD 3,540.3 million in 2008:Q3, representing 68.0% of outstanding private sector credit. Loans to the “construction and real estate” segment accounted for the largest share of business loans (40.3%), with the “trade” segment in second place at 29.2%. Most of the growth in business loans during 2008:Q3 occurred in the “transport and communication” segment, which increased by 47.1% during the quarter, followed by “Mining and Quarrying” which increased by 38.1%. Notably, there were negative growth rates in loans to “Manufacturing” (-2.6%) and “Non-bank financial” (-3.8%).

Table 5: Trends in Retail Private Domestic Credit

(BD Millions)

	2007:Q3	2007:Q4	2008:Q1	2008:Q2	2008:Q3	2008:Q3 GROWTH (%)
BUSINESS	2,268.6	2,432.0	2,804.5	2,904.8	3,540.3	21.9
--Manufacturing	369.0	425.4	435.6	416.2	405.5	-2.6
--Mining and Quarrying	16.7	8.0	3.6	4.2	5.8	38.1
--Agriculture, Fishing and Dairy	5.7	6.4	6.5	6.4	7.5	17.2
--Construction and Real Estate	711.7	776.6	943.5	1,027.6	1,425.8	38.8
--Trade	650.4	735.3	782.0	854.0	1,033.1	21.0
--Non-bank Financial	144.8	171.0	209.3	259.7	249.8	-3.8
--Transport and Communication	111.8	95.5	114.1	77.3	113.7	47.1
--Hotels and Restaurants	54.4	44.3	53.1	55.9	71.3	27.5
--Other Sectors	204.1	169.5	256.8	203.5	227.8	11.9
PERSONAL	1,411.8	1,489.6	1,606.5	1,939.9	1,667.9	-14.0
--Secured by Property Mortgage	273.4	376.0	451.8	646.2	445.3	-31.1
--Secured by Vehicle Title	97.8	113.2	122.1	114.5	106.4	-7.1
--Secured by Deposits	28.7	25.6	28.9	72.9	36.8	-49.5
--With Salary Assignment	721.5	675.7	753.7	871.7	765.8	-12.1
--Credit Card Receivables	74.6	75.4	71.5	74.8	77.8	4.0
Other	215.8	223.7	178.5	159.8	235.8	47.6
TOTAL	3,680.4	3,921.6	4,411.0	4,844.7	5,208.2	7.5

Source: Central Bank of Bahrain

3. Interest Rates

Short-term interest rates increased during 2008:Q3, due to liquidity pressures created by the global financial crisis (Table 6).

The 3-month and 6-month inter-bank rates increased to 3.6% and 3.7% respectively by the end of the quarter as did the 3-month Treasury bill yield, reaching 2.3%. The CBB key policy rate remained unchanged at 2.0% by the end of the quarter. Given the Bahraini dinar's peg to the US dollar, interest rates in Bahrain are required to track rates in the US.

Table 6: Structure of Interest Rates

(%)

	2007:Q3	2007:Q4	2008:Q1	2008:Q2	2008:Q3
3 Month Inter-bank Rate (BHIBOR)*	5.4	4.9	3.3	2.8	3.6
6 Month Inter-bank Rate (BHIBOR)*	5.4	5.0	3.4	3.3	3.7
CBB Key Policy Rate (end-of-quarter)	5.0	4.0	2.25	2.0	2.0
3 Month Treasury Bill Yield	5.0	4.0	2.8	2.1	2.3
6 Month Treasury Bill Yield	5.0	4.2	2.9	2.2	2.4
Commercial Bank Lending Rate—Personal**	9.3	9.3	9.0	7.8	8.2
Commercial Bank Lending Rate—Business**	8.1	6.9	6.6	6.9	6.8
Commercial Bank Deposit Rate (3-12 mths)**	4.2	3.5	1.6	1.8	1.9

*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 decreased slightly to 6.8% during the period (from 6.9% in 2008:Q2). On the other hand, the rate for personal loans increased to 8.2% from 7.8% in the previous quarter. However, average deposit rates (3-12 months) increased from 1.8% to 1.9% during the quarter, resulting in a wider spread between personal lending and deposit rates but a narrower spread vis-à-vis business lending rates.

As a result, Bahraini individual account holder are paying increased rates on their loan facilities and receiving lower interest payments on their deposits. Businesses should from the slightly lower rates on their loans.

4. Domestic Prices

Inflation numbers for 2008:Q3 show that the consumer price index increased by 1.2%, compared to 1.1% increase in the second quarter. *Year-on-year*, inflation increased by 2.2% (Table 7).

Table 7: Consumer Price Index

(2006=100)

Major Group of Commodities	2007:Q3*	2007:Q4**	2008:Q1**	2008:Q2**	2008:Q3**
Food, Beverages & Tobacco	110.6	107.8	112.0	115.5	116.7
Clothing & Footwear	110.6	101.9	103.8	103.9	103.9
Housing, Water, Electricity & Fuels	105.3	104.3	104.8	105.7	108.4
Household Goods & Services	101.7	104.3	105.2	105.4	107.0
Healthcare Services	101.9	99.9	101.0	101.4	102.4
Transport	101.2	100.3	100.8	101.2	101.6
Communication	100.0	100.0	100.0	100.0	100.0
Recreation & Culture	101.0	100.2	100.2	100.2	100.2
Education	101.5	101.6	101.5	101.9	102.7
Miscellaneous	105.0	102.7	104.5	106.0	108.6
General Index	105.1	104.4	104.9	106.1	107.4

* Reflects end of September data

**Quarterly averages

Source: Central Informatics Organisation

On a year-on-year basis², prices for “food beverages and tobacco” increased by 5.5% to reach 116.7 index points. Next were household goods and services which increased by 5.2% to reach an average of 107.0 index points. For the same period, there was a substantial decrease in prices of clothing and footwear, which decreased by 6.1% and a slight decrease in prices for communication services, which decreased by 0.8%.

For the latest quarter, the highest price rise was in the “housing, water, electricity and fuels” sub segment, which grew on average by 2.6%, this is followed by miscellaneous goods, which experienced a price increase of 2.5%.

² Year-on-year comparisons for the CPI use average quarterly data.

5. Domestic Public Debt

The size of Bahrain's domestic public debt (securities only) remained unchanged at BD 705.0 million during the third quarter (Table 8).

Table 8: Domestic Public Debt Outstanding

(BD Millions)

	2007:Q3	2007:Q4	2008:Q1	2008:Q2	2008:Q3
Total Outstanding	520.0	616.6	764.6	705.0	705.0
--% of GDP	7.5	8.9	11.0	10.2	10.2
Development Bonds	0.0	0.0	0.0	0.0	0.0
Treasury Bills	90.0	90.0	108.0	180.0	180.0
Islamic Leasing Securities	412.0	508.6	638.6	507.0	507.0
Al Salam Islamic Securities	18.0	18.0	18.0	18.0	18.0

Source: Central Bank of Bahrain

The outstanding balance of Treasury bills remained unchanged at BD 180.0 million, as new issuance of T-bills at BD 165.0 million offset the matured T-bills of the same value in the last quarter. Similarly, the new issues of the Islamic leasing securities at BD 15.0 million offset the matured Islamic leasing securities last quarter, to reach a balance of BD 507.0 million. Al Salam Islamic securities outstanding remained unchanged at BD 18.0 million.

Domestic public debt as a percentage of 2007 nominal GDP stood at 10.2% at the end of 2008:Q3.

6. Exchange Rates and Official Reserves

During 2008:Q3, the Bahraini dinar appreciated strongest against the Pound Sterling (8.5%) and against other key currencies (Table 9).

Table 9: BD Exchange Rates Against Selected Currencies*

	2007:Q3	2007:Q4	2008:Q1	2008:Q2	2008:Q3
US Dollar	0.376	0.376	0.376	0.376	0.376
Pound Sterling	0.758	0.751	0.749	0.750	0.686
Euro	0.532	0.554	0.594	0.593	0.543
Japanese Yen**	3.270	3.360	3.770	3.550	3.530
Swiss Franc	0.322	0.335	0.377	0.369	0.342

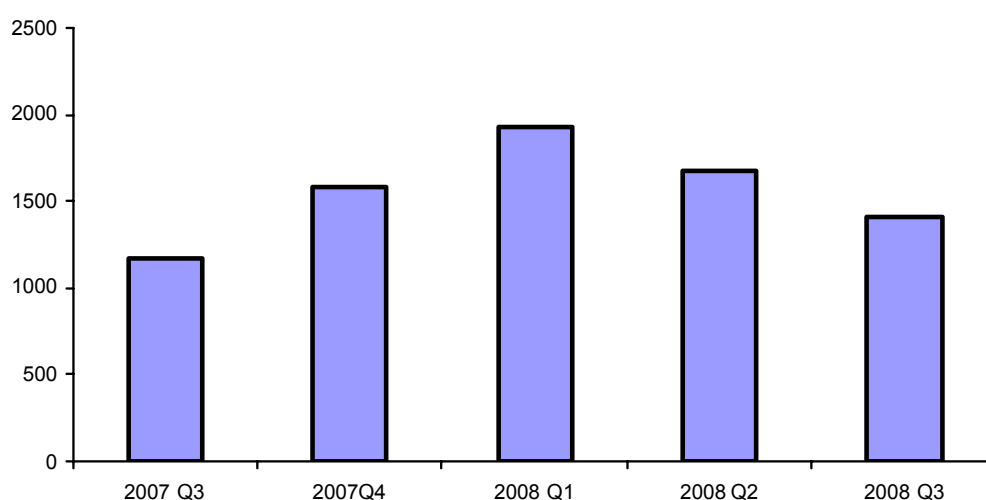
*Last working day of each period

** Per 1000 units

Source: Central Bank of Bahrain

The accumulation of official reserves slowed during the quarter, with total reserves (gold, foreign exchange, SDR and IMF reserve position) standing at BD 1,412.2 million at the end of the quarter (Chart 3). This was 15.7% lower than the level at the end of the second quarter but 20.2% above the level attained during the same period of 2007.

Chart 1: Trends in Official Reserves—2007:Q3-2008:Q3 (BD Million)*



*Includes holdings of gold, foreign currencies, SDR and reserve position at the IMF

Source: Central Bank of Bahrain

7. The Stock Market

During 2008:Q3, total market capitalisation of the Bahrain Stock Exchange (BSE) fell to BD 10.2 billion, compared to BD 11.5 billion at the end of the second quarter (Table 10). Year-on-year, market capitalisation was 12.2% lower than for the similar period of 2007. The decrease in market size during 2008:Q3 was driven by the reduction in the market capitalisation of the “Commercial banks”, “Services” and “Investment” segments by 13.6%, 14.6% and 7.9% respectively.

Table 10: Market Capitalisation on the Bahrain Stock Exchange*

(BD Million)

	2007:Q3	2007:Q4	2008:Q1	2008:Q2	2008:Q3	2008:Q3 Growth (%)
Commercial Banks	3,122.6	3,313.6	4,043.3	4,092.1	3,535.2	-13.6
Investment	4,178.3	4,983.5	4,861.8	5,399.4	4,971.7	-7.9
Insurance	200.2	205.2	209.0	205.1	209.0	1.9
Services	1,519.7	1,542.0	1,629.3	1,627.8	1,390.3	-14.6
Industrial	16.7	16.6	15.5	15.9	15.9	0.0
Hotel and Tourism	119.5	124.0	131.4	147.1	154.0	4.6
TOTAL	9,157.1	10,185.2	10,890.4	11,487.5	10,276.2	-10.5

*end of quarter numbers

Source: Bahrain Stock Exchange

The BSE All-Share Index fell to 2,462.72 points in the third quarter of 2008 (compared to 2,859.03 in 2008:Q2) (Table 11). Measured year-on-year, the index level during 2008:Q3 was 3.1% lower than the corresponding figure for 2007:Q2.

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

	2007:Q3	2007:Q4	2008:Q1	2008:Q2	2008:Q3
Commercial banks	3,526.30	3,479.10	3,646.83	3,690.81	3,188.52
Investment	2,134.92	2,546.61	2,482.86	2,593.06	2,207.05
Insurance	2,257.89	2,315.99	2,359.36	2,313.98	2,358.51
Services	2,036.19	2,031.39	2,154.33	2,145.66	1,832.63
Industrial	1,450.16	1,438.47	1,338.20	1,374.20	1,376.77
Hotel and Tourism	2,231.37	2,315.15	2,452.20	2,745.52	2,875.28
OVERALL INDEX	2,543.92	2,755.27	2,789.89	2,859.03	2,462.72

*end of quarter numbers

Source: Bahrain Stock Exchange

Liquidity on the BSE declined during 2008:Q3, with the turnover ratio (value of trading as a share of market capitalisation) falling to 0.8%, versus 1.8% during the previous quarter (Table 12). As in previous periods, the “commercial banks” and “investment” segments dominated trading during the period, accounting for 46.2% and 41.7% of the value of shares traded respectively.

Table 12: Liquidity on the BSE

	2007:Q3	2007:Q4	2008:Q1	2008:Q2	2008:Q3
A. Overall Market Liquidity (BD Million)					
Value of Shares Traded	94.8	175.2	311.3	203.6	79.0
Market Capitalisation	9,157.0	10,185.1	10,890.4	11,487.5	10,276.2
Turnover Ratio*	1.0	1.7	2.9	1.8	0.8
B. Value of Shares Traded by Sector (% Shares)					
Commercial Banks	39.1	31.5	67.7	45.8	46.2
Investment	45.8	57.4	20.7	43.7	41.7
Insurance	2.7	1.4	0.7	1.0	0.7
Services	11.1	9.0	10.2	8.5	10.2
Industrial	0.0	0.0	0.1	0.0	0.0
Hotel and Tourism	0.6	0.4	0.2	0.8	0.9

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

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

Source: Bahrain Stock Exchange

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