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Central Bank of Bahrain

Financial Stability Directorate

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Fourth 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 Fourth 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:Q4, *narrow money* (M1) fell by 9.7% while *broad money* (M2) increased by 0.9%.
- *Quasi-money* (savings and time deposits) was the fastest growing component of the money stock during the quarter, increasing by 5.8%. *Currency in circulation* and *Demand deposits* declined by 1.0% and 11.2% respectively.
- The overall reduction in money supply was mainly due to a 31.8% fall in *Net Foreign Assets* (NFA).
- On the other hand, *Net Domestic Assets* (NDA) increased by 33.3% during the quarter.

Credit Developments

- Total domestic credit grew by 6.8% to reach BD 5,887.6 million, representing a slowdown in domestic credit growth when compared to the 8.6% growth recorded last quarter.
- Private sector credit *increased* by 7.6% (vs. 7.5% in Q3) in contrast to a 7.2% *decline* in lending to general government (vs. the 31.2% *increase* in Q3).
- An analysis of private sector credit components shows that growth in *business loans* slowed to increase by 9.3%, compared to a faster 21.8% growth in the third quarter.
- *Personal loans* increased by 4.0% during the quarter, compared to a 14.0% reduction in the previous quarter.
- Loans “With Salary Assignment” constituted the bulk of personal loans (46.3% of the total), slightly higher than the 45.9% share recorded in the previous quarter. This is followed by loans “Secured by Property Mortgage” which made up 21.6% of total personal loans.
- *Business loans* went primarily to the “construction and real estate” segment, which accounted for 39.8% of the total.

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- The *year-on-year* growth of private sector credit (42.9%) was higher than the growth in 2008 nominal GDP (18.7%).

Interest Rates

- Short-term interest rates witnessed a mixed trend during the fourth quarter.
- The 3-month and 6-month T-bill increased to reach 2.8% and 3.0% respectively.
- The 3-month and 6-month inter-bank rates dropped to 2.8% and 2.9% respectively by the end of the quarter.
- The CBB key policy rate decreased to 0.75% at the end of the quarter.

Domestic Prices

- Inflation numbers show that the reported *consumer price index* increased by 1.7% during 2008:Q4.
- *Year-on-year* inflation was 4.6%.

Domestic Public Debt

- The stock of domestic public debt (securities only) remained unchanged during the fourth quarter at BD 705.0 million.
- Treasury bills remained unchanged at BD 180.0 million as the new issue of T-bills offset maturing bills.
- Islamic leasing securities (Ijara) as well as Al Salam Islamic securities remained unchanged at BD 507.0 million and BD 18.0 million respectively.

Exchange Rates and Official Reserves

- During the fourth quarter, the Bahraini dinar appreciated against the Euro and Pound Sterling, while depreciating against the Japanese Yen and the Swiss Franc.
- Bahrain's *Real Effective Exchange Rate* (REER) (2000=100) increased by 89.1 points for the quarter compared to 82.4 points for the previous quarter.
- During 2008:Q4, official reserves reached BD 1,480.4 million, 7.0% lower than the level attained during the same period of 2007.

Stock Market

- Total market capitalisation decreased to BD 7.5 billion, compared to the BD 10.3 billion attained during the third quarter. Year-on-year, market capitalisation was 26.2% lower.
- The fall in market capitalisation was attributable to the reduction in market capitalisation of all segments due to the global financial crisis.
- The BSE All-Share Index declined to 1,804.07 points during 2008:Q4, compared to 2,462.72 in the previous quarter.
- Liquidity increased during the quarter, with the turnover ratio standing at 2.6%, compared to 0.8% recorded at the end of the third quarter.

1. Monetary Aggregates¹

In the fourth quarter of 2008, *narrow money* (M1) decreased by 9.7%, compared with a decrease of 4.6% witnessed during the third quarter (Table 1). *Year-on-year*, the level of M1 was 20.7% higher than its level for 2007:Q4. In contrast to the fall in M1, *broad money* (M2) experienced a growth rate of 0.9% during 2008:Q4, compared to the 1.2% growth in the third quarter. *Year-on-year*, the level of M2 was 18.4% higher than its level for 2007:Q4.

Table 1: Developments in Monetary Aggregates

(BD Million)

	2007:Q4	2008:Q1	2008:Q2	2008:Q3	2008:Q4
M1	1,572.6	1,860.8	2,204.7	2,101.9	1,898.7
<i>M1 Growth (%)</i>	<i>3.1</i>	<i>18.3</i>	<i>18.4</i>	<i>-4.6</i>	<i>-9.7</i>
M2	5,682.6	6,056.9	6,588.0	6,668.8	6,728.4
<i>M2 Growth (%)</i>	<i>11.4</i>	<i>6.5</i>	<i>8.7</i>	<i>1.2</i>	<i>0.9</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 an 11.2% decrease in demand deposits during 2008:Q4. There was also a decrease of 1.0% in the level of currency outside banks from BD 307.2 million in the third quarter to BD 304.2 million by the end of the fourth quarter. However, there was a 5.8% increase in savings and time deposits from BD 4,566.9 million in the third quarter to BD 4,829.7 million in 2008:Q4, 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:Q4	2008:Q1	2008:Q2	2008:Q3	2008:Q4
Currency Outside Banks	256.2	265.3	275.5	307.2	304.2
<i>Growth Rate (%)</i>	<i>10.0</i>	<i>3.6</i>	<i>3.8</i>	<i>11.5</i>	<i>-1.0</i>
Demand Deposits	1,316.4	1,595.5	1,929.2	1,794.7	1,594.5
<i>Growth Rate (%)</i>	<i>1.8</i>	<i>21.2</i>	<i>20.9</i>	<i>-7.0</i>	<i>-11.2</i>
Savings and Time Deposits	4,110.0	4,196.1	4,383.3	4,566.9	4,829.7
<i>Growth Rate (%)</i>	<i>15</i>	<i>2.1</i>	<i>4.5</i>	<i>4.2</i>	<i>5.8</i>

* Central government and the Social Insurance system

Source: Central Bank of Bahrain

Further examination reveals a 31.8% decrease in net foreign assets (NFA) during the fourth quarter (Table 3). The decrease in NFA was due to a decline in claims on retail banks, which dropped by 51.3% (vs. an increase of 42.6% in 2008:Q3).

On the other hand, net domestic assets (NDA) increased by 33.3% during the quarter. This was mainly due to a 7.2% growth in claims on the private sector.

Liabilities continue to exceed assets on the "other assets (net)" category, with the net deficit widening by 38.1% during the quarter.

Table 3: Contributions to Monetary Growth

(% Change)

	2007:Q4	2008:Q1	2008:Q2	2008:Q3	2008:Q4
Net Foreign Assets (NFA)	-1.8	0.89	-8.0	14.8	-31.8
<i>Central Bank of Bahrain</i>	36.8	21.5	-13.4	-16.0	5.0
<i>Retail Banks</i>	-18.3	-13.9	-2.5	42.6	-51.3
Net Domestic Assets (NDA)	34.3	12.4	26.0	-4.1	33.3
<i>Claims on Government</i>	9.4	-0.44	10.9	6.8	-4.4
<i>Claims on Private Sector</i>	7.8	11.5	10.8	8.2	7.2
<i>Other Assets (net)</i>	-16.4	6.5	-12.9	-35.8	-38.1

Source: Central Bank of Bahrain

2. Credit Developments

During 2008:Q4, total domestic credit increased by 6.8% to reach BD 5,887.6 million, a slightly slower growth rate when compared to the 8.6% growth of the previous quarter (Table 4). A major contributor to the slower credit growth was the 7.2% decrease in credit extended to general government, a reversal of the large 31.2% increase in the third quarter. However, credit to the private sector increased by 7.6%, compared to the 7.5% increase during 2008:Q3.

Table 4: Trends in Domestic Credit

(BD Million)

	2007:Q4	2008:Q1	2008:Q2	2008:Q3	2008:Q4
Total Domestic Credit	4,183.9	4,623.1	5,077.3	5,513.5	5,887.6
<i>Growth (%)</i>	8.0	10.5	9.8	8.6	6.8
Credit to General Government	262.3	212.1	232.6	305.3	283.2
<i>Growth (%)</i>	33.1	-19.1	9.7	31.2	-7.2
Credit to Private Sector	3,921.6	4,411.0	4,844.7	5,208.2	5,604.4
<i>Growth (%)</i>	6.6	12.5	9.8	7.5	7.6
Memo Items					
Share of Private Sector Credit	93.7	95.4	95.4	94.5	95.2
Share of Public Sector Credit	6.3	4.6	4.6	5.5	4.8

Source: Central Bank of Bahrain

Year-on-year, total domestic credit expanded by 40.7%, exceeding the 38.0% year-on-year growth rate recorded at the end of 2007. Private sector credit shows a similar pattern, with year-on-year growth of 42.9%.

In terms of composition, the private sector continues to receive the bulk of domestic credit, accounting for 95.2% of the total during the fourth quarter.

A breakdown of private sector credit indicates that business lending grew by 9.3% during the fourth quarter, a slower growth rate compared to the 21.8% increase recorded during 2008:Q3 (see Table 5, next page). Personal loans increased by 4.0% during the same quarter, compared to the 14.0% reduction experienced during the third quarter. Year-on-year, personal and business loans rose by 16.4% and 59.1% respectively.

Table 5: Trends in Retail Private Domestic Credit

(BD Millions)

	2007:Q4	2008:Q1	2008:Q2	2008:Q3	2008:Q4	2008:Q4 GROWTH (%)
BUSINESS	2,432.0	2,804.5	2,904.8	3,540.3	3,870.5	9.3
--Manufacturing	425.4	435.6	416.2	414.7	464.3	12.0
--Mining and Quarrying	8.0	3.6	4.2	5.8	8.1	39.7
--Agriculture, Fishing and Dairy	6.4	6.5	6.4	7.5	8.7	16.0
--Construction and Real Estate	776.6	943.5	1,027.6	1,425.8	1,539.7	8.0
--Trade	735.3	782.0	854.0	1,023.9	1,065.4	4.1
--Non-bank Financial	171.0	209.3	259.7	249.8	226.5	-9.3
--Transport and Communication	95.5	114.1	77.3	113.7	84.8	-25.4
--Hotels and Restaurants	44.3	53.1	55.9	71.3	84.9	19.1
--Other Sectors	169.5	256.8	203.5	227.8	388.1	70.4
PERSONAL	1,489.6	1,606.5	1,939.9	1,667.9	1,733.9	4.0
--Secured by Property Mortgage	376.0	451.8	646.2	445.3	374.5	-15.9
--Secured by Vehicle Title	113.3	122.1	114.5	106.4	128.7	21.0
--Secured by Deposits	25.7	28.9	72.9	36.8	32.9	-10.6
--With Salary Assignment	675.7	753.7	871.7	765.8	803.5	4.9
--Credit Card Receivables	75.4	71.5	74.8	77.8	79.5	2.2
Other	223.7	178.5	159.8	235.8	314.8	33.5
TOTAL	4,183.9	4,623.1	5,077.3	5,513.5	5,887.6	6.8

Source: Central Bank of Bahrain

Table 5 also presents a breakdown of lending to the private sector by activity. Personal loans stood at BD 1,733.9 million at the end of 2008:Q4, accounting for 29.5% of total outstanding private sector credit. Personal loans “with salary assignment” represented the largest proportion of personal loans (46.3%), slightly higher than the 45.9% share attained in the third quarter. Personal loans “Secured by Property Mortgage” were the next largest component of total personal loans, accounting for 21.6%.

Personal loans increased by 4.0% in 2008:Q4. The largest contributors to that increase were loans to “others” and “secured by vehicle title” which increased by 33.5% and 21.0% respectively.

Business loans stood at BD 3,870.5 million in 2008:Q4, representing 65.7% of outstanding private sector credit. Loans to the “construction and real estate” segment accounted for the largest share of business loans (39.8%), with the “trade” segment in second place at 27.5%. Most of the growth in business loans during 2008:Q4 occurred in the “other sectors” segment, which increased by 70.4% during the quarter, followed by “mining and quarrying” which rose by 39.7%. Notably, there were negative growth rates in loans to the “transport and communication” (-25.4%) and “non-bank financial” (-9.3%) sectors.

3. Interest Rates

Short-term interest rates showed a mixed trend during the fourth quarter of the year. Treasury bill yield (3-month and 6-month) increased to reach 2.8% and 3.0% respectively. In contrast, the 3-month and 6-month inter-bank rates decreased to 2.8% and 2.9% respectively by the end of the quarter. The CBB key policy rate also decreased to 0.75 compared to 2.0% at end of the previous quarter.

Table 6: Structure of Interest Rates

	2007:Q4	2008:Q1	2008:Q2	2008:Q3	2008:Q4
3 Month Inter-bank Rate (BHIBOR)*	4.9	3.3	2.8	3.6	2.8
6 Month Inter-bank Rate (BHIBOR)*	5.0	3.4	3.3	3.7	2.9
CBB Key Policy Rate (end-of-quarter)	4.0	2.25	2.0	2.0	0.75
3 Month Treasury Bill Yield	4.0	2.8	2.1	2.3	2.8
6 Month Treasury Bill Yield	4.2	2.9	2.2	2.4	3.0
Commercial Bank Lending Rate—Personal**	9.3	9.0	7.8	8.2	8.1
Commercial Bank Lending Rate—Business**	6.9	6.6	6.9	6.8	7.4
Commercial Bank Deposit Rate (3-12 mths)**	3.5	1.6	1.8	1.9	1.3

*BHIBOR was introduced in December 2006

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

Source: Central Bank of Bahrain

The weighted average lending rate for business loans increased to 7.4% during the period (from 6.8% in 2008:Q3). On the other hand, the rate for personal loans decreased slightly to 8.1%, from 8.2% in Q3:2008. In addition, average deposit rates (3-12 months) decreased from 1.9% to 1.3% over the same period, resulting in a wider spread between *both* personal and business loan rates against deposit rates. This trend shows that deposit rates have been more responsive to the recent cuts in the CBB policy rate.

4. Domestic Prices

Inflation numbers for 2008:Q4 show that the consumer price index increased by 1.7%, compared to 1.2% increase in the third quarter. *Year-on-year*, inflation increased by 4.6% (Table 7).

Table 7: Consumer Price Index

(2006=100)

Major Group of Commodities	2007:Q4*	2008:Q1*	2008:Q2*	2008:Q3*	2008:Q4*
Food, Beverages & Tobacco	107.8	112.0	115.5	116.7	119.5
Clothing & Footwear	101.9	103.8	103.9	103.9	104.6
Housing, Water, Electricity & Fuels	104.3	104.8	105.7	108.4	109.5
Household Goods & Services	104.3	105.2	105.4	107.0	109.4
Healthcare Services	99.9	101.0	101.4	102.4	101.7
Transport	100.3	100.8	101.2	101.6	102.6
Communication	100.0	100.0	100.0	100.0	100.0
Recreation & Culture	100.2	100.2	100.2	100.2	103.5
Education	101.6	101.5	101.9	102.7	103.6
Miscellaneous	102.7	104.5	106.0	108.6	111.7
General Index	104.4	104.9	106.1	107.4	109.2

*Quarterly averages

Source: Central Informatics Organisation

On a year-on-year basis², prices for “food beverages and tobacco” increased by 10.9% to reach 119.5 index points. Next were “miscellaneous” commodities, which increased by 8.8% to reach an

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

average of 111.7 index points. For the same period, “communication” remained unchanged at 100.0 index points.

For the latest quarter, the highest price rise was in the “recreation & culture” sub-segment, which grew on average by 3.2%; “miscellaneous” goods come next, which experienced a price increase of 2.8%.

5. Domestic Public Debt

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

Table 8: Domestic Public Debt Outstanding

(BD Millions)

	2007:Q4	2008:Q1	2008:Q2	2008:Q3	2008:Q4
Total Outstanding	616.6	764.6	705.0	705.0	705.0
--% of GDP	8.9	9.3	8.6	8.6	8.6
Development Bonds	0.0	0.0	0.0	0.0	0.0
Treasury Bills	90.0	108.0	180.0	180.0	180.0
Islamic Leasing Securities (Ijara)	508.6	638.6	507.0	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 maturing bills. Similarly, the new issues of the Islamic leasing securities (Ijara) at BD 15.0 million offset the maturing Islamic leasing securities, 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 2008 nominal GDP stood at 8.6% at the end of 2008:Q4.

6. Exchange Rates and Official Reserves

During 2008:Q4, the Bahraini dinar appreciated against the pound sterling and the euro, while it depreciated against the Japanese yen and the Swiss franc during the same period (Table 9). The dinar appreciated the most against the pound sterling, ending at BD 0.543 at the end of the quarter.

Table 9: BD Exchange Rates Against Selected Currencies*

	2007:Q4	2008:Q1	2008:Q2	2008:Q3	2008:Q4
US Dollar	0.376	0.376	0.376	0.376	0.376
Pound Sterling	0.751	0.749	0.750	0.686	0.543
Euro	0.554	0.594	0.593	0.543	0.530
Japanese Yen**	3.360	3.770	3.550	3.530	4.160
Swiss Franc	0.335	0.377	0.369	0.342	0.355

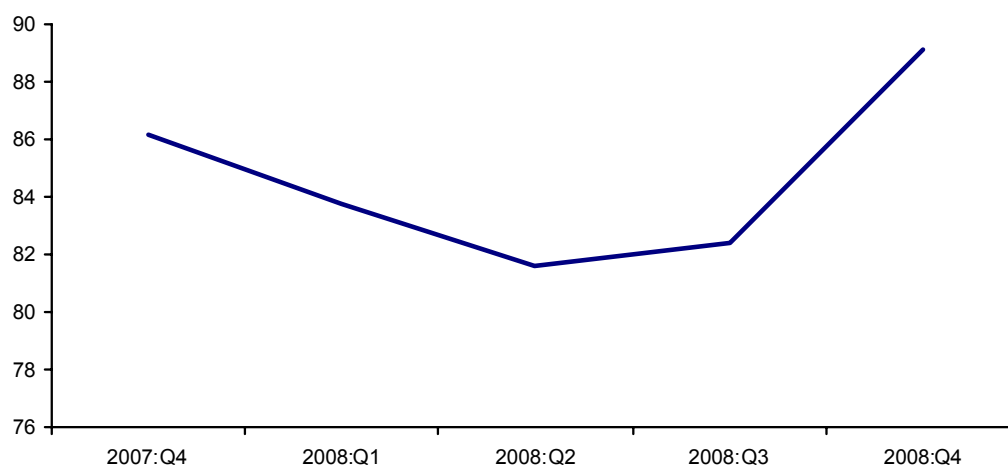
*Last working day of each period

** Per 1000 units

Source: Central Bank of Bahrain

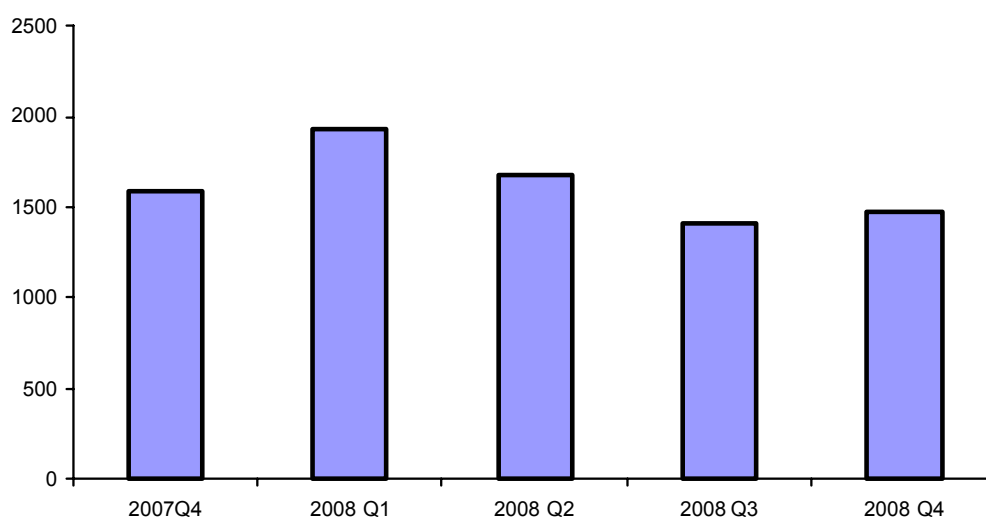
Bahrain's Real Effective Exchange Rate (REER) (2000=100) increased and recorded an index value of 89.1 for the fourth quarter compared to 82.4 for the previous quarter (Chart 2).

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



Source: IMF, International Financial Statistics

During the fourth quarter, official reserves increased with the total level of reserves (gold, foreign exchange, SDR and IMF reserve position) standing at BD 1,480.4 million at the end of the quarter (Chart 3). This was 4.8% higher than the level at the end of the third quarter but 7.0% lower than the level attained during the same period of 2007.

Chart 3: Trends in Official Reserves—2007:Q4-2008:Q4 (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:Q4, total market capitalisation of the Bahrain Stock Exchange (BSE) fell significantly to BD 7.5 billion, compared to a BD 10.2 billion fall at the end of the third quarter (Table 10). Year-on-year, market capitalisation was 26.1% lower. The decrease in market size during 2008:Q4 was mainly due to the global financial crisis.

Table 10: Market Capitalisation on the Bahrain Stock Exchange*

(BD Million)

	2007:Q4	2008:Q1	2008:Q2	2008:Q3	2008:Q4	2008:Q4 Growth (%)
Commercial Banks	3,313.6	4,043.3	4,092.1	3,535.2	2,531.3	-28.4
Investment	4,983.5	4,861.8	5,399.4	4,971.6	3,376.7	-32.1
Insurance	205.2	209.0	205.1	208.9	201.7	-3.4
Services	1,542.0	1,629.3	1,627.8	1,390.3	1,242.9	-10.6
Industrial	16.6	15.5	15.9	15.9	14.7	-7.5
Hotel and Tourism	124.0	131.4	147.1	154.0	152.6	-0.9
TOTAL	10,185.2	10,890.4	11,487.5	10,276.2	7,520.1	-26.8

*end of quarter numbers

Source: Bahrain Stock Exchange

The BSE All-Share Index fell to 1,804.07 points in the fourth quarter of 2008 (compared to 2,462.72 in 2008:Q3) (Table 11). Measured year-on-year, the index level during 2008:Q4 was 34.5% lower than the corresponding figure for 2007:Q4.

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

	2007:Q4	2008:Q1	2008:Q2	2008:Q3	2008:Q4
Commercial banks	3,479.10	3,646.83	3,690.81	3,188.52	2,117.04
Investment	2,546.61	2,482.86	2,593.06	2,207.05	1,582.53
Insurance	2,315.99	2,359.36	2,313.98	2,358.51	2,275.97
Services	2,031.39	2,154.33	2,145.66	1,832.63	1,638.30
Industrial	1,438.47	1,338.20	1,374.20	1,376.77	1,273.93
Hotel and Tourism	2,315.15	2,452.20	2,745.52	2,875.28	2,848.57
OVERALL INDEX	2,755.27	2,789.89	2,859.03	2,462.72	1,804.07

*end of quarter numbers

Source: Bahrain Stock Exchange

Liquidity on the BSE grew during 2008:Q4, with the turnover ratio (value of trading as a share of market capitalisation) at 2.6%, versus 0.8% during the previous quarter (Table 12). For the same period, the “commercial banks” and “services” segments represented 38.27% and 24.51% of value of shares traded respectively.

Table 12: Liquidity on the BSE

	2007:Q4	2008:Q1	2008:Q2	2008:Q3	2008:Q4
A. Overall Market Liquidity (BD Million)					
Value of Shares Traded	175.2	311.3	203.6	79.0	193.3
Market Capitalisation	10,185.1	10,890.4	11,487.5	10,276.2	7,520.15
Turnover Ratio*	1.7	2.9	1.8	0.8	2.6
B. Value of Shares Traded by Sector (% Shares)					
Commercial Banks	31.5	67.7	45.8	46.2	38.3
Investment	57.4	20.7	43.7	41.7	23.6
Insurance	1.4	0.7	1.0	0.7	0.2
Services	9.0	10.2	8.5	10.2	24.5
Industrial	0.0	0.1	0.0	0.0	0.0
Hotel and Tourism	0.4	0.2	0.8	0.9	0.2

*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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