His Highness
Shaikh Khalifa Bin Salman Al Khalifa

The Prime Minister

His Majesty
King Hamad Bin Isa Al Khalifa

King of Bahrain

His Highness
Shaikh Salman Bin Hamad Al Khalifa

The Crown Prince
Commander-In-Chief
of the Bahrain Defence Force

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CHAPTER IV : THE BANKING SECTOR

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Governor's Foreword

I am honoured to present this Annual Report for 2006, the first such report for the Central Bank of Bahrain ('CBB').

As was the case with the Annual Reports of the CBB's predecessor organisation, the Bahrain Monetary Agency, this Annual Report presents a summary of international and domestic economic developments, including the performance of Bahrain's financial sector. It also describes the activities of the CBB and presents its audited financial accounts for 2006.

The key development for this institution in 2006, of course, was the promulgation of the Central Bank of Bahrain and Financial Institutions Law on 6 September 2006, which terminated the Bahrain Monetary Agency ('BMA') and replaced it with the CBB. This important event marked the culmination of reforms initiated in 2002, aimed at creating a single, integrated regulator for the financial services sector in the Kingdom of Bahrain.

The new law was also important in a number of other respects: it marks a significant modernisation and simplification of the legal landscape, with respect to the financial sector, and creates new statutory offences of market abuse and insider dealing. Furthermore, it introduces new provisions, for the first time in Bahrain law, relating to close-out netting. In short, the new law provides the CBB and the financial sector in Bahrain a solid basis on which to continue progressing and contributing to the development of the national economy.

Meanwhile, the international economy continued to show remarkable resilience, with world output increasing by just over 5% in 2006. Bahrain's economy also grew strongly, recording another year with real growth above 7%, whilst inflationary pressures remained relatively subdued.

The financial sector performed extremely well too. Total banking sector assets rose by a third to reach USD 187 billion, whilst financial sector licensees reached 376 by the end of 2006, a net increase on end-2005's total of 365. Financial sector employment remained buoyant.

The CBB, and its predecessor the BMA, continued to develop the regulatory framework and their supervisory efforts in 2006, in order to secure financial stability. In addition to transition related work, achievements last year included a major change to the licensing framework for financial institutions, which modernised and simplified regulations in this area. A new rulebook was introduced for investment firms, and work continued with implementing Basel II for banks and the new rulebook for insurers, introduced in 2005. Finally, new requirements for collective investment

2006

schemes were issued for consultation in December 2006, with the objective of upgrading existing requirements dating back to the 1990s, and further consolidating Bahrain's status as a regional centre for funds activity.

These regulatory initiatives contributed to maintaining Bahrain's credibility and reputation as a well-regulated financial centre, and in attracting a number of high profile international firms to open offices in Bahrain.

In closing, I would like to express my thanks to the staff of the CBB for their efforts, as well as to the support of the financial sector itself, government ministries and other bodies.

I would particularly like to express my sincere thanks to His Majesty, King Hamad Bin Isa Al Khalifa; His Highness the Prime Minister, Shaikh Khalifa Bin Salman Al Khalifa; and His Highness the Crown Prince and Commander-in-Chief of the Bahrain Defence Force, Shaikh Salman Bin Hamad Al Khalifa, for their continued guidance and support of the Central Bank of Bahrain.

Rasheed M. Al-Maraj
Governor

Our Vision:

To strengthen the position of Bahrain as a major international financial centre through the application of sound monetary and financial policies consistent with international best practices.

Our Mission:

- To ensure monetary and financial stability in the Kingdom of Bahrain.
- To regulate, develop and maintain confidence in the financial sector.

The CBB will carry out its mission through:

- Providing central banking services to the government and the financial sector that are cost effective, reliable and that support national objectives and Bahrain's position as a leading financial centre,
- Ensuring that the regulation and supervision of the financial sector meets the highest international standards, while maintaining Bahrain's reputation for market friendly regulation and encouraging ongoing investment by leading global firms in the Bahrain financial sector,
- Ensuring the consistent application of regulatory standards in banking, insurance and capital markets as well as encouraging an open and cooperative approach in dealing with financial institutions,
- Working with international organisations such as the International Monetary Fund (IMF), the Bank for International Settlements (BIS), the International Organisations of Securities Commissions (IOSCO), the International Association of Insurance Supervisors (IAIS) and the Financial Action Task Force (FATF), in order to foster the stability of the global financial system,
- Facilitating market innovation, including the development of Islamic banking and finance and encouraging the use of training and technology to ensure Bahrain's financial sector is globally competitive,
- Promoting a culture of excellence within the CBB work environment that emphasises the highest standards of professionalism, integrity, prudence, teamwork and innovation.

1 International Economic Context

1.1 World output

In 2006, the global economy continued along the path of solid growth, with world output increasing by 5.1%. This growth was remarkable, given the increases in oil prices since 2005 and higher interest rates in major countries. There were concerns about economic trends in the United States as the housing market and the automobile industry weakened during 2006. However, growth in other major countries compensated for the weaknesses in the US economy. The Euro area in particular saw a pickup in growth rates as exports from both Germany and France expanded. Although Japan experienced a slowdown in growth in the second quarter of 2006, its newly-found growth momentum continued to be aided by increasing domestic consumption and investment. China also continued to maintain its growth rates at record levels (over 10% per annum).

Table 1-1: Summary of World Output, 2003-2006

	2003	2004	2005	2006
World	4.1	5.3	4.9	5.1
United States	2.5	3.9	3.2	3.4
Euro area	0.8	2.1	1.3	2.4
Japan	1.8	2.3	2.6	2.7
China	10.0	10.1	10.2	10.0
Other Asia	8.4	8.8	9.0	8.7
Middle East	6.4	5.5	5.7	5.8

Source: IMF, World Economic Outlook Database

1.2 Inflation

Inflationary pressures emerged in several countries as the brisk growth in world output put strain on productive capacity and oil prices rose to record levels. Consumer prices in the advanced economies rose from 2.3% in 2005 to 2.6% in 2006. Inflation in emerging markets fell slightly from 5.3% to 5.2% over the same period.

1.3 Unemployment

Unemployment rates in the United States declined from 5.1% in 2005 to 4.2% by end-2006. This was achieved against a backdrop of softening trends in different sectors of the economy. Relative to the United States, unemployment rates in the Euro area remained high, standing at around 8% by end-2006, slightly down from the 9% recorded a year earlier. Unemployment in Japan remained low at 4.1% as the economy begins to emerge out of the prolonged period of deflation.

1.4 Interest rates

Monetary tightening in the US resulted in higher money market rates relative to 2005 and the Euro area also experienced higher rates. In Japan, we saw the end of the zero interest rates that have prevailed for a few years. However, interest rates are still low by historical standards as financial markets enjoyed ample amounts of liquidity and higher investor appetite for risk.

Table 1-2: Money Market Rates, 2005-2006

(Period averages; percent per annum)

	2005	2006			
		Q1	Q2	Q3	Q4
United States	3.21	4.46	4.90	5.25	5.25
Euro area	2.19	2.61	2.89	3.22	3.59
Japan	-	-	0.02	0.22	0.26

Source: IMF, International Financial Statistics, February 2007

1.5 Exchange rates

Over the course of 2006, the values of major currencies against the SDR revealed contrasting trends. While the US dollar and the Japanese Yen fell against the SDR (by 5.2% and 6.1% respectively), both the Euro and the Pound Sterling appreciated by 5.7% and 7.6% respectively. Virtually zero interest rates in Japan explained the weakness of the Yen but the decline of the USD was principally due to lingering concerns about the health of the US economy.

Table 1-3: Exchange Rates of Major Currencies, 2005-2006

(Units per SDR; end of period)

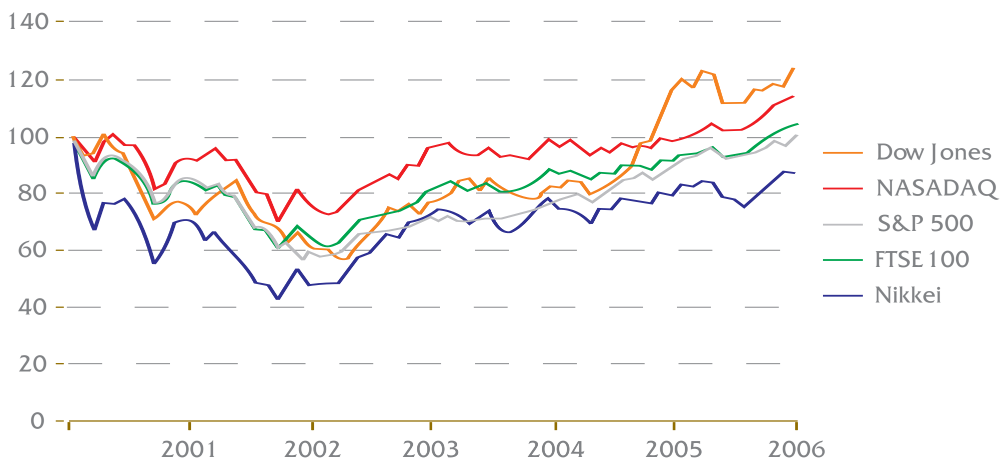
	2005	2006			
		Q1	Q2	Q3	Q4
US Dollar	1.4293	1.4409	1.4794	1.4764	1.5044
Euro	1.21155	1.19039	1.16367	1.16617	1.14229
Japanese Yen	168.61	169.16	170.05	173.92	178.95
Pound Sterling	0.83005	0.83051	0.80646	0.78942	0.76638

Source: IMF, International Financial Statistics, February 2007

1.6 Equity markets

Overall, global equity markets recorded impressive performances in 2006. By the end of November, the S&P 500 and both the Dow Jones Index and the technology-sensitive NASDAQ index all recorded gains. The Japanese Nikkei index also climbed during the year, reflecting the resumption of growth in Japan after years of deflation. It is notable that equity markets not only succeeded in reversing the losses suffered in May and June, but were subsequently resilient in the face of adverse news and events, including a large loss by a hedge fund and political instability in several emerging markets.

Chart 1-1: Major World Stock Market Indices, 2001-2006



1.7 Commodity prices

From a high of USD 70/barrel in the second quarter of 2006, oil prices subsequently softened, falling to USD 59.72/barrel in the fourth quarter. This trend was attributable to weakened demand for oil as concerns about supply shortages eased. Prices of selected metals rose, with gold prices increasing from an average of USD 553.98/troy ounce in the first quarter of 2006 to USD 614.47/troy ounce by the fourth quarter. Over the same period, aluminium prices similarly rose from USD 2,423/metric tonne to USD 2,727.63. Copper prices also exhibited similar upward trends until the final quarter of 2006 when copper prices dropped due to profit-taking by investors.

Table 1-4: Trends in Commodity Prices, 2005-2006

Commodity	2005	2006			
		Q1	Q2	Q3	Q4
Oil (UK Brent; USD/barrel)	54.44	61.91	69.83	70.09	59.72
Gold (USD/troy ounce)	444.84	553.98	627.4	621.5	614.47
Aluminium (USD/metric tonne)	1900.52	2423.07	2655.67	2485.93	2727.63
Copper (USD/metric tonne)	3676.5	4947.5	7228.8	7679.88	7069.23

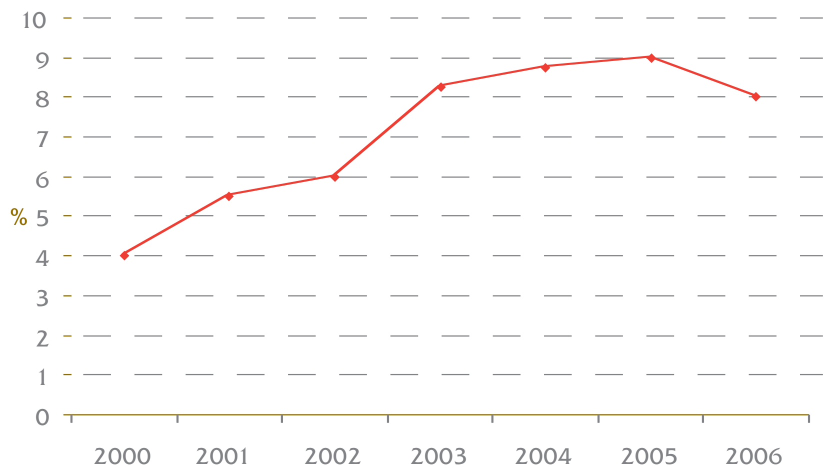
Source: IMF, International Financial Statistics, February 2007

Bahrain Economic Developments

2.1 Economic Performance

Bahrain enjoyed robust economic performance in 2006. Gross Domestic Product (GDP) grew by 19.7% at current prices and 7.8% at constant prices in 2005; and it is estimated that this strong rate of growth continued into 2006, with the economy growing by 13.1% in nominal terms and 7.1% in real terms during 2006. Although Bahrain's growth rates have historically tended to follow international oil prices, the non-oil sector, which is estimated to have had a real growth of 8.0% in 2006, has been a significant component of the overall growth in the Bahrain economy.

Chart 2-1: Real Non-Oil GDP Growth, 2000-2006



* Estimate
Source: IMF Article IV Staff Report, January 2006.

Bahrain's fiscal position improved significantly in 2005, rising from a net surplus of BD 60.0 million or 1.4% of GDP in 2004, to BD 257.3 million or 5.1% of GDP for the year 2005. Preliminary estimates for the year 2006 show a government surplus of approximately 1%.

In 2006, despite the impact of an expansion in domestic demand, Bahrain achieved strong economic growth in a relatively low inflation environment. The reported consumer price index (CPI, 1994-1995=100) increased from 107.1 in 2005 to 109.3 in 2006, a rise of 2.1%. The prices of personal services, house-related expenses and medical care increased by 8.9%, 3.7%, and 3.3% respectively. Conversely prices of recreational activities, clothing and goods for home services fell by 1.2%, 0.7% and 0.6% respectively. The inflationary pressures experienced by Bahrain are relatively low by world standards, reflecting the success of the government's policy in maintaining subsidies for energy, housing and food, which totalled BD 500 million in 2006.

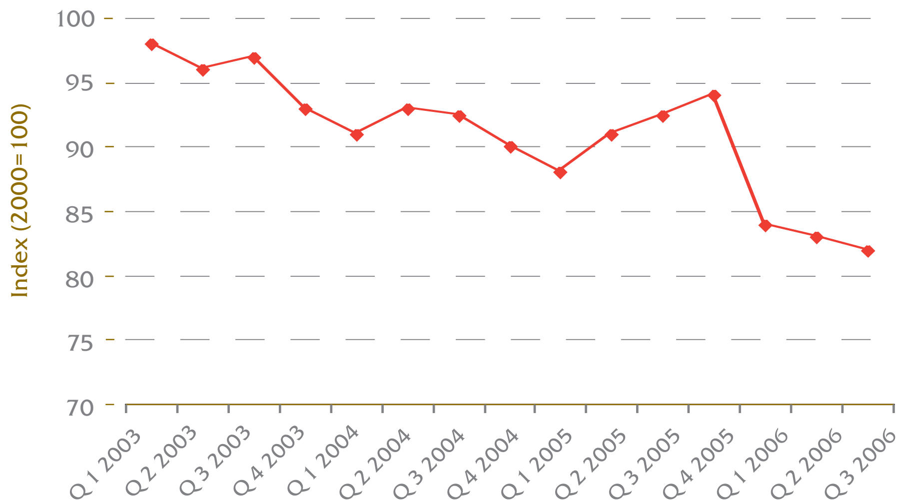
Table 2-1: Consumer Price Index (CPI), 2005-2006

Groups	End-2005	End-2006	Annual Change %
Food, Beverages and Tobacco	103.1	105.2	2.0
Ready-Made Clothes, Textiles and Footwear	103.5	102.8	-0.7
House-Related Expenses, Fuel, Lighting & Water	117.4	121.8	3.7
Goods for Home Services	88.9	88.4	-0.6
Transportation Services	101.4	102.6	1.2
Education	135.1	136.7	1.2
Medical Care & Health Services	107.0	110.5	3.3
Service Requirements of Personal Care	95.9	104.4	8.9
Culture, Entertainment and Recreation	104.1	102.9	-1.2
General C.P.I.	**107.1**	**109.3**	**2.1**

Source: Central Informatics Organisation.

Bahrain maintains a fixed exchange rate policy to the United States dollar. The nominal exchange rate remained unchanged during the course of 2006. The US dollar weakened during the course of 2006; as such, the dinar weakened against most other world currencies, as measured by the Real Effective Exchange Rate. The effective depreciation of the dinar is in contrast to the appreciation which occurred during 2005, and reflects the competitiveness and increase of Bahrain's trade in exports.

Chart 2-2: Real Effective Exchange Rate (BD against basket of World Currencies), 2003-2006



Source: IMF International Financial Statistics, February 2007.

2.2 Foreign Trade and Balance of Payments

In combination with the effect of high oil prices on export revenues, Bahrain had large foreign currency receipts resultant from a net increase in exports during 2006. Bahrain had a trade balance surplus that increased from BD 781.4 million in 2005 to BD 984.8 million in 2006.

The value of total exports increased from BD 3,769.2 million in 2005 to BD 4,347.6 million in 2006, or by 15.3%. This increase was primarily due to a rise in the value of oil exports by 18.4% from BD 2,926.6 million in 2005 to BD 3,465.8 million in 2006. Although oil exports constituted the highest share of total exports (accounting for 77.7%), growth in the value of non-oil exports was much more substantial, growing by 4.7% in 2006 compared to 13.9% for 2005.

The value of total imports increased from BD 2,987.8 million in 2005 to BD 3,362.8 million in 2006, or by 12.6%. Oil imports increased from BD 1,567.8 million in 2005 to BD 1,843.0 million in 2006, or by 17.6%. This was mirrored in the growth of the value of non-oil imports, which increased by 7.0% in 2006, showing an increase of demand resulting from escalating levels of private consumption and investment.

Table 2-2: Foreign Trade, 2005-2006

	BD Millions		Change	Relative
	2005*	2006*	(%)	Share(%)
Total Exports	**3769.2**	**4347.6**	**15.3**	**100.0**
Oil Exports	2926.8	3465.8	18.4	77.7
Non-Oil Exports	842.6	881.8	4.7	22.3
Total Imports	**2987.8**	**3362.8**	**12.6**	**100.0**
Oil Imports	1567.8	1843.0	17.6	52.5
Non-Oil Imports	1420.0	1519.8	7.0	47.5
Trade Balance	**781.4**	**984.8**	**26.0**	

*Provisional Data
Sources: National Oil and Gas Authority and Central Informatics Organisation.

Provisional balance of payments data for Bahrain shows a current account surplus of BD 721.3 million for the year 2006. The surplus was the result of an increase in the goods surplus which was recorded at BD 1,179.7 million in 2006 compared with BD 949.4 million in 2005. The surplus has shown the benign benefits received by the Bahrain economy from the surge in oil prices and exports in the economy. The current account surplus for 2006 is the highest surplus in the history of the Bahrain economy.

The capital and financial account registered a net outflow of BD 724.3 million at the end of 2006. Whilst there was a large outflow in portfolio investments abroad, recorded at BD 3,855.9 million, direct investment inflow to Bahrain was exceptionally high, registering at BD 1,096.0 million. This reflects Bahrain's open economy and positive attitude towards FDI, and this has been reflected in particular in the financial sector with foreign flows of capital. Consequently, Bahrain recorded an overall balance position of BD 309.1 million, also an historical record.

Table 2-3: Balance of Payments, 2004-2006

(BD Millions)

Items	2004	2005*	2006*
1. Current Account (a+b+c+d)	**156.2**	**592.2**	**721.3**
a. Goods	558.5	949.4	1,179.7
General Merchandise	520.1	909.3	1,127.1
Exports (fob)	2,827.0	3,769.2	4,347.6
- Oil	2,087.3	2,926.6	3,465.8
- Non-Oil	739.7	842.6	881.8
Imports (fob)	-2,306.9	-2,859.9	-3,220.5
- Oil	-1,039.7	-1,567.8	-1,843.0
- Non-Oil	-1,267.2	-1,292.1	-1,377.5
Repairs on goods	**38.4**	**40.1**	**52.6**
b. Services (net)	**234.9**	**257.8**	**262.0**
- Transportation	69.5	81.5	80.0
- Travel	179.5	190.2	222.7
- Insurance Services	-13.1	-12.8	-14.2
- Other Business Services	-1.0	-1.1	-26.6
c. Income (net)	**-216.1**	**-155.0**	**-144.7**
Investment Income	-216.1	-155.0	-144.7
- Direct Investment Income	-248.0	-258.4	-315.4
- Portfolio Income	175.3	386.4	598.1
- Other Investment Income	-143.4	-283.0	-427.4
d. Current Transfers (net)	**-421.1**	**-460.0**	**-575.6**
- Workers' Remittances	-421.1	-460.0	-575.6
2. Capital and Financial Account (net) (A+B)	**-187.5**	**-610.1**	**-724.3**
A. Capital Account (net)	**18.8**	**18.8**	**28.2**
- Capital Transfers	18.8	18.8	28.2
B. Financial Account (1+2+3+4)**	**-206.3**	**-628.9**	**-752.5**
1. Direct Investment	**-64.0**	**-28.1**	**727.5**
- Abroad	-389.4	-422.4	-368.5
- In Bahrain	325.4	394.3	1,096.0
2. Portfolio Investment (net)	**-1,317.8**	**-1,735.0**	**-3,218.2**
- Assets	-1,463.6	-2,645.6	-3,855.9
- Liabilities	145.8	910.6	637.7
3. Other Investment (net)	**1,234.9**	**1,244.8**	**2,047.2**
- Assets	-3,677.3	-4,347.5	-11,368.3
- Liabilities	4,912.2	5,592.3	13,415.5
4. Reserve Assets (net)	**-59.4**	**-110.6**	**-309.1**
3. Errors and Omissions	31.3	17.9	3.0

Source: Central Bank of Bahrain
*Provisional Data
**Financial transactions. A negative sign means net outflows/increases in external assets.

2.3 International Rankings

The international community has retained its positive assessment of Bahrain, based on the fundamentals underpinning the growth of the national economy.

The Kingdom of Bahrain has maintained a favourable sovereign credit rating. In 2006, Bahrain had its foreign currency debt rating upgraded from an A- with a positive outlook to an A (stable) by Standard & Poor's (S&P), and had an improvement from an A- (stable) to an A- (positive) by Fitch. As such, the rating upgrades reinforce the creditworthiness of the Bahrain government and subsequently had a clement effect on individual credit ratings for financial institutions that operate in Bahrain.

Table 2-4: GCC Foreign Currency Credit Ratings, 2006

Country	S&P		Fitch	
Bahrain	A	(Stable)	A-	(Positive)
Kuwait	A	(Stable)	AA-	(Stable)
Oman	BBB+	(Stable)	Not rated	
Qatar	A+	(Stable)	Not rated	
Saudi Arabia	A+	(Stable)	A+	(Stable)
United Arab Emirates	Not rated		Not rated	

Sources: S&P and Fitch Rating Agencies

Bahrain achieved a good ranking for the United Nations Development Programme Human Development Index (HDI) with a rank of 39th in the world. The HDI focuses on living standards, education and life expectancy and ranks countries relative to their international peers.

Bahrain is recognised as a "Front Runner" by the UNCTAD for its inward foreign direct investment (FDI) performance, signifying high FDI potential and performance. In the World Investment Report for 2006, Bahrain ranked 22nd in the world for its inward FDI performance. In December 2006, Bahrain was also awarded the title of "Middle East City of the Future" by the Financial Times business magazine. The two year award marks Bahrain's specialisation in FDI and strong economic performance across the board. The Kingdom also claimed two other awards for "Best Human Resources" and "Best FDI Promotion Strategy" while claiming runner up spots for four additional categories of "Best Economic Potential", "Best Quality of Life for Expatriates", "Most Secure", and "Best Telecoms and Transport".

As a benchmark for overall economic performance, Bahrain ranked 49th in the world for growth competitiveness by the World Economic Forum and also ranked 39th in the world by the Heritage Foundation/Wall Street Journal 2007 Index of Economic Freedom as the freest Arab country in the Middle East region.

Table 2-5: Summary of Bahrain Rankings and Indices, 2006

	HDI Rank	Index of Economic Freedom	FDI Performance	Growth Competitiveness
Bahrain Rank	39	39	22	49

Sources: UNDP, Heritage Foundation,UNCTAD and World Economic Forum

2.4 Economic Policy Initiatives

Bahrain has continued to implement and initiate economic policy programmes that aim to maintain the sustained growth of the Bahrain economy. The policy initiatives have primarily focused on economic diversification, labour market reform, structural reform and the promotion of private sector growth and investment. The Economic Development Board (EDB) has an ambitious target of doubling GDP per capita by the year 2015 by encouraging an attractive environment for economic activity to flourish.

a. Labour Market Initiatives

In January 2006, the National Employment Project (NEP) got underway. The NEP is a scheme for creating more job opportunities for unemployed Bahrainis, who can register through 20 centres distributed throughout the Kingdom. In mid-October 2006, there were government proposals for legislation to introduce financial support to unemployed Bahrainis and during August, a decree was issued establishing a bureau for employed Bahrainis in Qatar as well as the Bahrain Labour Fund. In July, His Majesty the King also issued a decree for the creation of the Institute of Public Administration, which aims to improve the efficiency of government staff through training programmes.

At the end of 2006, the EDB signed a Memorandum of Understanding (MoU) agreement with the Kuwait Finance and Investment Company (KFIC) to develop a higher education city in the Kingdom. The project will aim to put Bahrain on the forefront of specialist higher education and vocational training in line with highest academic qualification standards. It will also provide students with the necessary skills and training to meet the demands of the local and regional labour markets. The educational city will consist of a top U.S. university, an international research centre and a specialist academy, in addition to leisure, recreation and housing facilities.

b. Structural Reforms

As part of its structural reforms, an agreement was signed in June to build a causeway linking Bahrain and Qatar. Numerous other initiatives were also carried out during 2006.

As the Bahrain economy continues to diversify, the development of an attractive business and investment climate has been a key element to its future economic success. Bahrain has streamlined the process of registering new businesses, Introducing a flat registration fee of BD 20 for any new commercial entity wishing to set up operations, and lifting restrictions on foreign ownership. This has been reflected in the growth in total commercial licenses registered over the course of 2006 of 16.6%.

Table 2-6: Commercial License Registrations, 2005-2006

Sector	2005	2006 Q1	2006 Q2	2006 Q3	2006 Q4	2006 Total
Manufacturing	889	281	362	318	198	**1,159**
Construction	1,113	682	423	242	166	**1,494**
Trade, Motor Vehicle Repair, and Personal and Household Goods	2,526	712	752	777	724	**2,948**
Hotels and Restaurants	429	106	117	97	92	**405**
Transport, Storage and Communications	240	78	85	72	58	**293**
Financial Services	139	39	74	59	67	**238**
Real Estate, Rentals and Associated Activities	958	285	314	263	255	**1,097**
Non-Health Related Social Work	338	109	95	105	93	**399**
Others	74	24	12	13	19	**148**
Total Commercial Licenses	**6,706**	**2,316**	**2,234**	**1,946**	**1,672**	**8,181**
Total Licenses at End of Period*	**58,128**	**62,580**	**64,046**	**66,050**	**67,761**	**67,761**

*Denotes Total Stock of Licenses
Source: Ministry of Industry and Commerce

The government has made a priority of targeting 6 key sectors for investment as the main engine for Bahrain's economic growth: tourism, financial services, information technology, healthcare, education and training and downstream aluminium manufacturing. In February, the government and the Arab Fund for Economic and Social Development signed a loan agreement worth BD 17.5 million to fund the development of a 66 KV electric power transmission network. The agreement is the first phase of a total project which is expected to cost BD 65.6 million.

In addition to the numerous large scale projects already underway in the Kingdom, such as the Bahrain Financial Harbour, Amwaj Islands, Al-Areen Desert Spa and Durrat Al-Bahrain projects, Bahrain is also to embark on developing the first Science and Technology Park in the region. The park will host technology companies of all sizes and will seek to attract international companies to establish and operate. The park will contain science laboratories, educational facilities and a university. The EDB signed a MoU with Kuwait Finance House (KFH) in order to help develop this project which is estimated to cost USD 1 billion over 3 phases.

The Bahrain-USA free trade agreement was signed and ratified in both countries in 2005. In light of the free trade agreement, the Ministry of Commerce in conjunction with the EDB held a conference titled "Free Trade in the Middle East", whereby 150 U.S. companies convened with private sector participants from Bahrain to discuss strategies to obtain benefits from the agreement. It is expected that there will be wider trade exchanges with the U.S., new job opportunities for Bahrainis and increased efficiency in many aspects of the Bahrain economy in the future.

3

Monetary Policy and the CBB Regulatory Framework

The CBB is dedicated to ensuring monetary and financial stability in the Kingdom of Bahrain, and has the duties of regulating and maintaining confidence in the financial sector. The CBB is responsible for maintaining the fixed exchange rate of the Bahrain dinar to the United States dollar.

3.1 Monetary Policy Developments

In carrying out its duty of maintaining price stability, the CBB stands ready to buy and sell US dollars against Bahraini dinar at a tight spread around the official exchange rate of BD 1.000 = USD 2.6596. As buyer and seller of US dollars, the CBB maintains monetary stability through an exchange rate target, which impacts changes in money supply. As such, the CBB continually monitors changes in currency in circulation and monetary aggregates on the level of economic activity and prices.

For the year 2006, currency in circulation registered an increase of BD 36.9 million, or 19.3%, to reach BD 227.7 million, compared with BD 190.0 million at end-2005. M1 (currency in circulation plus private demand deposits) increased by 21.0% to reach BD 1,285.8 million at end-2006.

As a result of the increase in M1, broadly defined money M2 (M1 plus private sector savings and time deposits) increased by 14.9% to reach BD 4,035.9 million at end-2006. The broadest definition of money, M3 (M2 plus government deposits) rose by 17.4% to reach BD 4,893.3 at end-2006.

Table 3-1: Money Supply, 2005-2006

(BD Million)

Items	End - 2005	End- 2006	Change (End-2006 vs. End-2005)	
			Absolute	Percent (%)
Currency in Circulation*	190.8	227.7	36.9	19.3
M1	1,062.5	1,285.8	223.3	21.0
M2	3,512.8	4,035.9	523.1	14.9
M3	4,169.4	4,893.3	723.9	17.4

*Total currency outside banks.
Source: Central Bank of Bahrain.

Data indicates continued growth in domestic liquidity levels for the year 2006. Domestic liquidity, as defined by M3, registered a total increase of BD 723.9 million, or 17.4% at end-2006. This was primarily due to an increase in retail banks' net foreign and other assets, which increased by 75.2% and 95.6% respectively.

Table 3-2: Factors Affecting Domestic Liquidity, 2005-2006

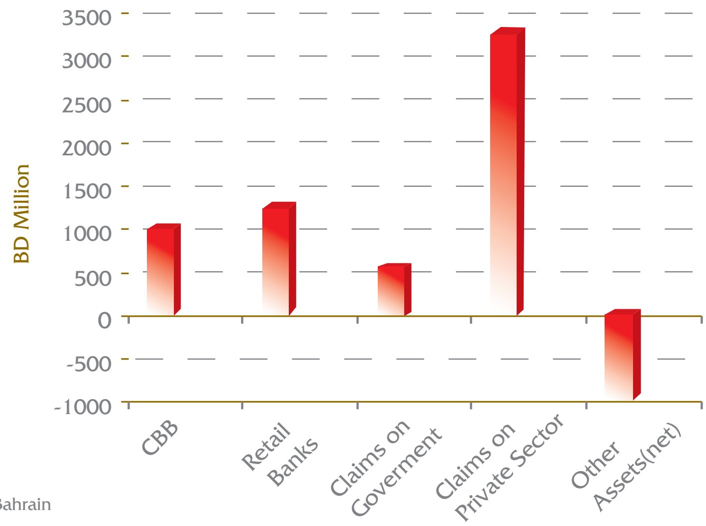
(BD Million)

Factor	End-2005	End-2006	Change (%)
A- Domestic Liquidity (M3)	**4,169.4**	**4,893.3**	**17.4**
B- Factors Affecting Liquidity			
1- Net Foreign Assets (a+b):	**1,401.5**	**2,231.3**	**59.2**
(a) CBB	707.8	1,015.7	43.5
(b) Retail Banks	693.7	1,215.6	75.2
2- Domestic Claims (a+b+c):	**2,767.9**	**2,662.0**	**-3.8**
(a) Claims on Government	675.6	577.6	-14.5
(b) Claims on Private Sector 1/	2,623.0	3,122.5	19.0
(c) Other Assets (net)	-530.7	-1,038.1	95.6

1/ Loans and holdings of securities.
Source: Central Bank of Bahrain

At the end of 2006, 63.8% of overall domestic liquidity (M3) was in the form of claims on the private sector, which also includes loans and holdings in securities. Government claims reduced by 14.5% to account for 11.8% of M3, and retail banks, the CBB and other assets account for 24.8%, 20.8% and 21.2% respectively.

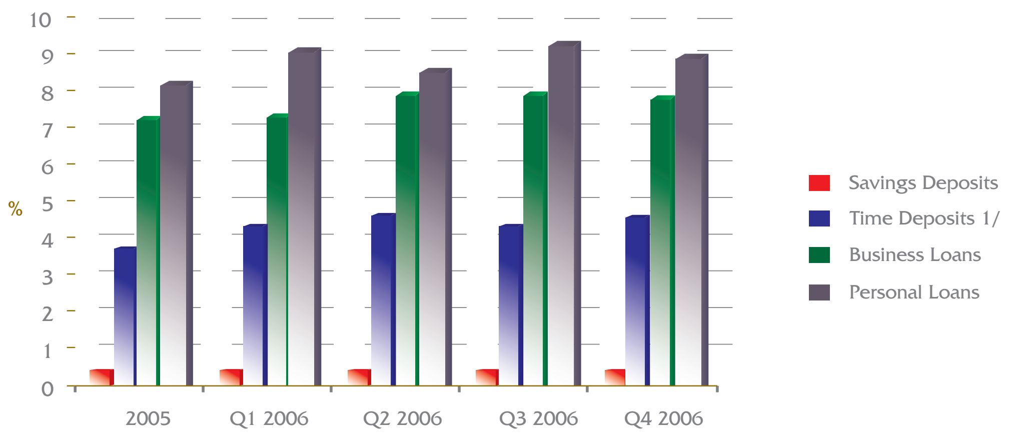
Chart 3-1: Breakdown of Factors Affecting Domestic Liquidity, 2006



Source: Central Bank of Bahrain

As Bahrain maintains a peg to the US dollar, fluctuations in interest rates in the US have influenced the movement of interest rates in Bahrain. During 2006, US monetary policy continued to tighten interest rates, causing an increase in US interest rates. Subsequently, this has affected Bahrain interest rates. The weighted average time (3-12 month) deposit rate increased from 3.70% at end-2005 to 4.40% at end-2006, while the weighted average savings rate increased from 0.32% to 0.37% for the same time period. On the lending side, business loans increased from 7.16% at end-2005 to 7.64% at end-2006, while the interest rate on personal loans rose from 8.31% to 8.89%.

Chart 3-2: Interest Rates on BD Deposits and Loans, 2005-2006



1/ Time deposits of 3-12 months.
Source: Central Bank of Bahrain

3.2 Regulatory Developments

The Central Bank of Bahrain (CBB) is the single regulator of the financial sector in the Kingdom of Bahrain. As such, its responsibilities cover the regulation of banks (retail and wholesale), Islamic financial institutions (including Islamic banks), insurance, the capital markets and other non-bank licensees.

a. New Central Bank Law

On the 7th September 2006, the CBB came into existence by virtue of the Central Bank of Bahrain & Financial Institutions Law ("CBB Law") which replaced the BMA Law of 1973. The CBB assumed all the rights and obligations of the BMA including the premises, staff, and other rule making instruments.

The CBB Law was necessitated by the expansion of the BMA's responsibilities in 2002 to include the regulation of the insurance and capital markets sectors in addition to the banking industry. The CBB Law also modernised and amalgamated the different laws which previously governed the financial services industry into a single comprehensive document.

The key enhancements of the CBB law included specific new sections giving explicit authority for the supervision of the capital markets and offering of securities, including sections concerning insider trading and market abuse; a legal framework to permit close-out netting between institutions for contracted but not yet due transactions; enhanced confidentiality sections in respect of customer information and enhanced powers for investigations and administrative proceedings by the CBB to ensure compliance with CBB regulations and directives.

As a result of the CBB Law, requirements – such as those included in the CBB Rulebook – are in the process of being updated. In the meantime, all existing rules and guidance in the Rulebooks continue to be valid.

b. Integrated Licensing Framework

In July 2006, a new integrated licensing framework formally replaced the previous licensing systems for the banking, insurance and capital markets sectors. The new framework covers the whole financial sector and consists of 5 basic license types:

1. Conventional bank licensees
2. Islamic bank licensees
3. Insurance licensees
4. Investment business licensees
5. Specialised licensees.

Unlike previous systems, each license type is defined in terms of a range of regulated activities, certain of which must be undertaken in order for a license type to be issued. Thus, a conventional bank licensee must take deposits and provide credit. The new framework is consistent with the new Central Bank Law, which requires the CBB to define regulated activities. The biggest visible change for licensees was the merging of the old offshore bank and investment bank licenses into the new "wholesale" category of bank license, which allows these banks to undertake business with Bahrain residents and in Bahrain dinar provided that individual banking transactions exceed or equal BD 7 million and investment transactions exceed USD 250,000.

c. New Trust Law

On 11th July 2006, a new law was issued to govern the activities of trustees and allow the legal recognition of trusts in the Kingdom of Bahrain. The law, issued by Royal Decree No. (23) of 2006, aims to create a strong legal basis for financial trust activities, which demonstrate great potential in the Middle East. Bahrain was one of the first countries to implement such legislation in the Middle East.

The Law provides a firm foundation for trust business, and allows the creation of more innovative structures and products, both Islamic and conventional, especially for wealth managers and residents in Bahrain and foreign countries. Trusts must be registered with the Central Bank in order to gain legal recognition. Trusts may cover all forms of property, whether tangible or intangible. The Trust Law also provides for high levels of confidentiality for settlor, beneficiaries, trustees and by the Central Bank as Registrar of Financial Trusts.

d. Collective Investment Scheme Regulations Initiative

On 21st December 2006, the CBB circulated the first consultation paper arising from a new project aimed at consolidating and streamlining the existing requirements relating to the capital markets.

The project's objective is to build on existing requirements in order to create a new framework that fully reflects the international standards, minimises the compliance burden on existing players and is supported by effective and credible enforcement proceedings.

The consultation outlines proposed requirements relating to collective investment undertakings (CIU). It updates the various circulars and regulations that have been issued in this area since 1992. Also, it introduces the CBB's first ever rules pertaining to CIUs targeting professional investors as well as market counterparties. It also aims to take a fresh look at existing regulations and circulars, to make sure they are comprehensive and effective, whilst also avoiding excessive compliance burdens on issuers and investors, in addition to streamlining and simplifying the existing collection of individual regulations and circulars in this area, by consolidating them into a single structured document.

A second objective in developing the requirements is to broaden the range of schemes offered (as well as domiciled) in Bahrain. Existing regulations are geared around retail schemes and impose investment requirements typically applied to such schemes. The new requirements aim to allow and attract schemes targeted solely at experienced and professional investors, subject to certain safeguards (such as restrictions on the type of investor who may invest in such schemes and minimum investment sizes).

The requirements in the module distinguish between three types of schemes (retail client schemes, experienced client schemes, and professional schemes), with different requirements for each. The new regulations are scheduled to be finalised and issued in May 2007.

e. IMF FSAP Review

The International Monetary Fund (IMF) published the results of its Financial Sector Assessment Program ("FSAP") in January 2006. The FSAP assesses the stability of countries' financial systems and makes recommendations to strengthen resilience to financial shocks and to promote financial sector development. FSAP programmes are voluntary and have been undertaken in more than 80 countries since 1999, when the programme was set up. The FSAP's on-site work was performed during various visits throughout 2005 along with offsite reviews of financial data, laws and regulations.

The results of the FSAP review were positive and viewed Bahrain's prudential regulations as modern and comprehensive.

f. ATM Security Measures

In late 2005, the CBB launched an initiative with the Bankers' Society to reduce ATM related fraud after attempts by criminals in many countries to clone debit and credit cards or engage in identity theft. Retail banks were required to install fraud detection and inhibiting (FDI) devices and technology in ATMs and to increase the quality and quantity of CCTV monitoring and daily checking of ATMs by staff.

Joint meetings with the Bankers' Society, the Benefit Company and Ministry of Interior officials took place in early 2006 and banks accelerated programs to move away from magnetic strip security on debit/credit cards towards "EMV/Chip & PIN" technology to enhance customer security and reduce the opportunity for card fraud. Banks were given deadlines for the installation of FDI measures and to issue EMV compliant cards by end-September 2006 and end-December 2007 respectively. Banks successfully met the first deadline and are working on the second deadline in the interest of their customers' security. Customers should expect to receive new "Chip & PIN" cards during 2007.

3.3 Regulatory Developments by Directorate

a. Licensing & Policy Directorate

The CBB, through the Licensing and Policy Directorate, strives to create an overall regulatory structure for Bahrain that is fair, effective, transparent and consistent with international best practices. The Licensing & Policy Directorate is split into two arms. The first arm, Licensing, deals with all new licensing applications by institutions or persons intending to undertake regulated activities in the Kingdom of Bahrain. It assesses the financial strength and suitability of new applicants and their controllers with the objective of ensuring that only applicants with a sound reputation, strong financial resources, a practical bussiness modeal and value-adding services are allowed to be licensed by the Central Bank. The second, Policy, produces rules and regulations consistent with international best practice standards (such as the Basel Committee, IOSCO, IAIS, IFSB and the FATF). It also reviews existing policy, taking into account the nature and needs of the local financial market, and the CBB's objective of maintaining Bahrain's position as an international financial centre.

Under the Central Bank of Bahrain and Financial Institutions Law of 2006, the CBB has an obligation to consult whenever it issues a regulation pursuant to the Law. The CBB may also issue directives under the CBB Law, which serve to implement the CBB Law or any regulation pertaining to it or to facilitate understanding of the CBB Law and associated regulations. As a matter of general practice, the CBB consults licensees and concerned parties with respect to directives that involve the development of regulatory policy.

In developing its regulatory policy, the CBB follows a three-tier approach:

1. Industry Involvement: The CBB seeks to involve relevant licensees at the earliest stage possible and discusses the proposed policy with those parties with expertise in relation to the area under consideration.

2. Consultation: After developing a draft of the proposed policy, the CBB consults with licensees likely to be affected by the change, as well as publishing a draft of the consultation on its website. It allows sufficient time to respond and takes a "best efforts" approach towards taking the views of the licensees into account.

3. Explanation: To the greatest extent possible, the CBB shares the representations that have been received with other licensees and replies to the points raised in their representations.

b. Banking Supervision Directorates

There are four Banking Supervision Directorates. Three are responsible for the prudential offsite supervision of wholesale banks, retail banks and Finaicing companies and Islamic banks respectively, whilst the fourth performs on-site inspections of all licensees.

The major policy project relating to banks in 2006 was Basel II. Basel II is the new capital adequacy framework for internationally active banks which replaces the 1988 Basel Capital Accord, which has been followed in over 120 countries. Basel II consists of 3 Pillars:

The first Pillar is the minimum capital requirements. This consists of the definition of capital for regulatory purposes, including adjustments and deductions for investments, losses and goodwill elements. It also provides for risk-adjusted charges for credit risk and market risk and for on and off-balance sheet exposures. Also, it includes capital charges for operational risk.

The key differences between Basel I and Basel II are enhanced risk sensitivity for credit risk, new capital charges for operational risk, and explicit requirements to make capital charges for not only lending but also for risks incurred by banks through their associates, subsidiaries and unconsolidated investments. This means that there is a clear difference between "consolidation" for accounting purposes and "consolidation" for regulatory purposes both in terms of methodology and scope. The above changes mean that an extensive redesign of capital adequacy regulations and reporting forms by regulators in over 100 countries.

Although a great deal of attention has been paid to Pillar One, both Pillars Two and Three also require extensive work. Pillar Two is named the Supervisory Review Process and did not exist under the 1988 Capital Accord. Pillar Two requires banks to carry out self-assessments of their capital requirements and to have capital adequacy plans and strategies on how to meet these requirements. Supervisors must assess the risk profile of banks, taking into account all the significant risks that banks are exposed to in their activities. They must then set individual capital adequacy requirements for banks based on the banks' risk profile. These requirements may involve setting minimum capital ratios significantly above the 8% minimum required under Pillar One.

Pillar Three contains enhanced disclosure requirements to promote greater market discipline so that investors, depositors, market counterparties and other stakeholders may have a greater insight into the risk profile of banks. Both Pillar Two and Three also require significant changes to the prudential rulebooks for banks. Basel II is therefore not just a series of new risk weights and amendments to reporting forms; it is a methodology to make risk management the central focus of the way that a bank is perceived by its various stakeholders.

Basel II is to be implemented in Bahrain from first Junuary 2008 onwards. The CBB believes Basel II offers significant potential benefits in terms of aligning capital management more closely with risk and is essential given the international nature of Bahrain's banking system. This means that most international banks operating in Bahrain will in any case have to implement Basel II because of their home country requirements.

Initial work on Basel II had started in 2004 by way of a questionnaire, seeking feedback from banks on the policy alternatives available under Basel II. The CBB set up four industry working groups in 2005 to assist in policy development and provide a high-level framework upon which the detailed Rulebook requirements for Pillar One of Basel II could be built upon. The working groups concluded their work in March 2006.

Subsequently, the findings and conclusions of the working groups were discussed between the CBB and the consultants, who then commenced drafting of new Rulebook modules for Pillar One of Basel II in the summer of 2006. From August to December 2006, the Pillar One modules were internally reviewed and redrafted. The modules for Pillar 2 were drafted internally by the CBB during 2006 and will be sent out for consultation in the frist half of 2007.

Retail Banking Supervision Directorate

The Retail Banking Supervision Directorate supervises conventional retail banks (20), specialised banks (2), financing companies (2) and credit card companies (5). The Directorate was created in February 2006, following an internal restructuring which saw the Banking Supervision Directorate replaced by two separate directorates, one for retail banks (and related retail licensees), the other for wholesale banks.

As part of its supervisory responsibilities, the Directorate held prudential as well as ad-hoc meetings with all the locally incorporated conventional banks, specialised banks, financing companies, credit card companies and with more than 75% of the overseas conventional banks. The prudential meetings held during 2006 focused on their strategy and performance as well as the likely evolution of their risk profiles.

The Directorate continued to liaise with banks under its supervision to assess their readiness for the implementation of Basel II, with a view to resolving problems and challenges that may arise. With this in mind, the Directorate facilitated banks' participation in QIS 5, an initiative of the Basel Committee on Banking Supervision.

To protect the interests of consumers, the Directorate conducted a study on the impact of consumer finance regulations on retail banks as well as consumers. The study indicated that there has not been any significant impact on retail Banks profitability or operations. In addition, the study showed that the new consumer finance regulation has encouraged consumers not to borrow beyond their financial capacity, and helped the banks to improve the quality of their loans portfolio.

The Directorate represent the CBB in the GCC Banking Supervision meetings.

Wholesale Banking Supervision Directorate

The Wholesale Banking Supervision Directorate is responsible for comprehensive off-site supervision of conventional wholesale banks, a new license category introduced in July 2006, which replaced the previous categories of off-shore banking units (OBUs) and investment banks (IBLs).

During 2006, the Directorate was responsible for supervising 68 conventional wholesale banks, of which 27 were locally incorporated banks and 41 were foreign branches. In addition, the Directorate oversaw 32 representative offices. It is also wroth nothing that during 2006, 2 new banks were granted wholesale bank's licenese.

As part if the Directorate's on-going supervision, the Directorate conducted 27 prudential meetings as well as various ad-hoc meetings with locally incoproporated banks and foreign branches. Such meetings are considered as forums for communicating issuse of supervisory concerns, where the Directorate conveys the CBB's directions and future plans to the banks, and the banks in return furnish the CBB with their latest development, strategies, and plans for the coming perod.

During 2006, the Directorate represented the CBB on many occasions. In March, it conducted a presentation in a conference organised by the Bank for International Settlements (BIS) and the Central Bank of UAE in Abu Dhabi highlighting the steps taken by the CBB to implement Basel II.

In October, the Directorate attended the Off-shore Group of Banking Supervisors Conference in Merida, Mexico. During the conference, the CBB representative participated in the GCC Committee of Banking Supervisors' Meeting and discussed issues of mutual interest relating to Basel II. The meeting covered topics such as Memoranda of Understanding between GCC supervisors, as well as the introduction of specialised training for GCC supervisors with the support of the BIS.

Islamic Financial Institutions Directorate

As part of its supervision process, the Directorate held prudential meetings with all the locally incorporated Islamic Banks as well as branches located in Bahrain in addition to holding ad-hoc meetings with these institutions. The Directorate also continued to liaise with banks under its supervision for assessing their readiness for implementation of Basel II.

The IFISD during 2006, has initiated the process of depending only on the online linkage of the PIRI system for all Islamic Banks.

The Directorate participated in meetings of the GCC Committee on Banking Supervision. It also represented the CBB in various national and international forums including AAOIFI meetings, GCC meetings, and the National Committee on Corporate Governance.

c. Financial Institutions Supervision

The Financial Institutions Supervision Directorate oversees the following lines of business:

Collective Investment Schemes

The CBB has always strongly supported the mutual funds industry and regards it as a fundamental element of the financial sector.

These efforts were acknowledged in 2006, when the CBB was granted the "Award for Excellence in Supporting the Islamic Fund Industry" by Failaka International, a Kuwaiti-US firm, and a recognised leader in Islamic funds monitoring and information.

As a new CBB initiative to further develop and advance the mutual funds industry, the newly introduced licensing framework for investment business, offers licensed activities such as asset management, funds management and custodial services.

During 2006, the number of mutual funds marketed in and from Bahrain grew by 17%, and locally incorporated mutual funds grew by 13% in comparison to end-2005.

Investment Business Firms

The Directorate is also responsible for the supervision of 25 investment firms. Prudential as well as other ad-hoc meetings were held during the course of 2006.

In April 2006 and as part of the licensing framework changes, new categories of investment business firms were introduced, with the objective of creating a comprehensive suite of licenses to cater for investment business activities.

The comprehensive new regulatory framework for investment firms was implemented with the introduction of Volume 4 of the CBB Rulebook. Volume 4 of the CBB Rulebook pertains to investment business licensees, and provides comprehensive guidance to applicants wishing to undertake investment business activities. As at the end of the financial year 2006, the Investment Business Rulebook Volume 4, modules have come into effect.

Financial Trusts

The Trust Service Provider must be licensed by the CBB to exercise its functions. The Trust law details the Trustee's obligations in achieving the purpose of the trust or the interests of the beneficiaries as specified in the Trust Instrument. Trust durations are not permitted to exceed one hundred years at a maximum as required by the new regulations.

The CBB has established a register for the Financial Trusts, which shall ensure confidentiality in dealing with all information related to the Settlor, the Trustee, the Protector of the Trust - if any, and the Beneficiaries

Money Changing Business

The Financial Institutions Supervision Directorate continues to be responsible for supervising the money changing sector. As at the end of 2006, the number of money changers licensed to operate in the Kingdom had reached 18, a decrease of 1 institution.

The profitability of money changers increased by 24% from the end of 2005 (BD 3,683,668) to the end of 2006 (BD 4,607,187). Such licensees are subject to stringent security and anti-money laundering measures to ensure the safety and integrity of the financial system in Bahrain.

Currently, money changers are regulated in accordance with the regulation organising the money changing business, which was issued in 1994. However, the CBB has plans to update and incorporate this regulation in Volume 5 of its Rulebook, which will cover specialised licensees (money changers, finance companies, ancillary service providers and representative offices. This project is anticipated to commence in 2007.

d. Compliance Directorate

The Compliance Directorate ensures that the licensees implement regulations and policies related to Anti-Money Laundering and Combating the Financing of Terrorism (AML/CFT). It acts as a secretariat for the AML/CFT Policy Committee and participates in drafting related laws and regulations. The Directorate conducts on-site examination visits to a number of licensees, including non-bank financial institutions and insurance companies. The purpose of these visits is to assess their compliance with CBB's AML/CFT regulations.

In 2006, the Directorate participated in drafting Law no. (54) with respect to amending certain provisions of legislative Decree no. (4) of 2001 regarding the prohibition and combating of money laundering, which included the addition of terrorism. The Directorate also participated in the preparation of the cash courier system in coordination with the Ministry of Interior and the Ministry of Finance (General Directorate of Customs).

The Directorate participated in the Middle East and North Africa Financial Action Task Force (MENAFATF) meeting held in Al-Ain from 11-13 November 2006, which included an assessment of the AML/CFT policies and procedures implemented in the Kingdom of Bahrain. Representatives from related ministries and government bodies participated in the meeting, whereby Bahrain was commended for the AML/CFT regulatory framework and its future plans for implementing assessment recommendations.

The Directorate also coordinated with the Ministry of Industry and Commerce (MOIC) to review and issue AML/CFT guidelines for the MOIC's licensees.

e. Capital Markets Supervision Directorate

The CBB has been pursuing a programme of enhancing the regulatory and supervisory framework of the capital market and has adopted the International Organisation of Securities Commissions' (IOSCO) comprehensive framework of objectives and principles of securities market regulations, in order to create a vibrant capital market in the Kingdom of Bahrain.

The Capital Markets Supervision Directorate objectives of securities regulations are also based on the framework of IOSCO principles in promoting transparency, efficiency, fairness, modernisation of infrastructure, enhancing investor protection, promoting market education, adopting and integrating international standards and best practices into CBB regulations.

Volume 4 Rulebook of the CBB includes the regulation of brokerage firms in the capital market and sets out the rules and regulations which prescribe prudential and business conduct requirements. Brokerage firms are divided into two classes of services as principals and agents. Furthermore brokerage firms' regulated activities are also divided into three categories offering firms a wide range of security dealing alternatives including but limited to underwriting, market-making, securities price stabilisation, holding client assets, and arranging and advising on financial instruments. For brokerage firms, the rulebook encompasses all requirements for licensees in chapters pertaining to general requirements, client asset rules, financial crime, accounting standards, principles of business, investment business codes of practice, money laundering and terrorism financing.

The CBB is developing a new capital market framework that would replace the existing regime. The CBB is aiming to introduce the new framework during 2007. The transfer of new regulatory responsibilities to the CBB in August 2002, which created the Gulf region's first single financial services regulator, has allowed a comprehensive review of the existing capital market framework to be carried out by the CBB.

The existing capital market framework has served Bahrain well, encompassing the different laws and regulatory bodies that have historically regulated different parts of the capital market sector. However, it was of utmost importance to initiate a comprehensive Capital Market Rulebook that would incorporate all the regulated activities within the sector and aims to create a more coherent, integrated approach to capital market regulations. The Capital Market Rulebook will cover:

- Issuing and offering of securities and financial instruments
- Listing, trading, and ongoing obligations
- Markets and Exchanges
- Clearing houses and depositories
- Corporate governance, risk management and internal controls
- Guarantee fund and investors compensation schemes
- Market conduct (Insider dealings, market abuse, etc)
- Financial crime in the securities markets (AML & CFT)
- Mergers & acquisitions rules
- Cooperation and exchange of information
- Surveillance, investigation, and enforcement
- Complaints, disputes, and arbitration

Furthermore, the new regulatory framework will adapt IOSCO and other international standards to ensure that the financial markets in Bahrain are fair, transparent and not subject to abuse. As a CBB established practice, the relevant stakeholders will be consulted prior to finalising and issuing of these regulations.

With a view to strengthening investor confidence, the CBB established a market surveillance department in the first quarter of 2006 and strengthened its investigation activities in the capital market.

This process has been facilitated by the enactment of the Central Bank of Bahrain (CBB) Law Decree No. 64 of 2006 on 6th September 2006, which created clearer criminal offences of market abuse and insider trading.

With a view to preventing insider trading and manipulation of the market, several measures have been taken. During 2006 there were 18 suspected transactions identified, including price manipulation, market manipulation and abuse of inside information. 14 cases were forwarded to the investigation stage, including 6 cases that were forwarded to the disciplinary board at the Bahrain Stock Exchange (BSE) where action has been taken against them as follows: 3 reprimands; 2 warnings and 1 suspension of brokers.

f. Insurance Supervision Directorate

The Insurance Supervision Directorate is responsible for the supervision of 153 insurance licensees. These include 72 insurance firms of which 44 are limited to business outside Bahrain and 28 are based in Bahrain. In addition the Directorate is responsible for 43 insurance brokers, of which 33 are based in Bahrain; 9 insurance consultants, 7 of which are based in Bahrain and; 1 Bahrain based insurance manager. Also registered with the CBB are actuaries (12), loss adjusters (9), 5 insurance representative offices and 2 insurance ancillary services.

The regulatory policy objectives of the Insurance Directorate are in line with the overall objectives of the CBB in promoting stability, soundness, transparency and market discipline in the insurance system; and providing an appropriate degree of protection to insurance company policyholders.

For the 2005 reporting year, insurance companies were required to implement new accounting standards – the International Financial Reporting Standard No. 4 (IFRS 4) and International Accounting Standard 39 (IAS 39). These standards had a significant impact on the financial statements submitted by insurers during 2006. All insurance licensees in the Kingdom of Bahrain were to follow these international standards and submit audited accounts accordingly. The new standards advocate a greater degree of transparency in the operations of insurance firms, particularly with respect to the accounts for investments and insurance contracts.

The International Association of Insurance Supervisors (IAIS) has continued its ongoing work in the development of its Solvency Framework and the CBB keeps abreast of these initiatives and possible impact on its insurance licensees.

During 2006, the major insurance initiatives focused on the implementation of its Volume 3 (Insurance Rulebook), which was released in May 2005. In particular, the CBB completed its consultation with the insurance industry on its regulatory reporting forms. The reporting forms for all insurance licensees were finalised during the course of 2006 and full implementation is expected during the course of 2007.

In addition, the CBB provided quarterly updates to its Insurance Rulebook, fine-tuning its rules during the implementation phase, by providing, where needed, additional transitional rules for key requirements and interpretative guidance.

The Insurance Rulebook has also been updated to reflect the new provisions resulting from the Central Bank of Bahrain and Financial Institutions Law (CBB Law) released in September 2006. In particular, provisions related to the calculation of unearned premiums have been revamped, advocating a proportionate basis as opposed to a set percentage. Also, provisions related to enforcement measures have been strengthened to reflect new powers under the CBB Law.

The third Annual Middle East Insurance Forum, under the theme of “The Influence of Global Trends on Middle East Insurance Markets”, took place in March 2006, under the patronage of the CBB. This yearly event provides the opportunity for the insurance industry in the region to convene and keep abreast of developments in the insurance market.

The Chartered Insurance Institute (CII) Academy launched a joint venture in cooperation with the Bahrain Institute of Banking and Finance (BIBF). This new academy will provide CII courses for the Middle East, through an exclusive arrangement with the BIBF.

In March 2006, the CBB hosted the 4th Regional International Association of Insurance Supervisors (IAIS) Seminar, in cooperation with the Financial Stability Institute (FSI). The seminar focused on reporting, review and redress processes that insurance supervisors deal with, and featured both local and foreign speakers. It was attended by supervisors from 10 other jurisdictions in the Middle East and North Africa regions, as well as from Bahrain.

To support various training initiatives for insurance supervisors, the IAIS also released a comprehensive training core curriculum in 2006. The CBB welcomes this initiative and has been using this curriculum as part of its internal training effort.

A captive insurance workshop was hosted by the CBB to provide potential companies with an overview of this alternative insurance vehicle to meet their needs. It is also worth noting that the first license for a captive insurer was granted in December 2006.

3.4 CBB Operations

The Banking Services Directorate is responsible for various operational functions of the CBB. The Directorate handles the issuance, allotment, and payment transfers of all government securities issued by the Kingdom of Bahrain, which include Treasury Bills, Al Salam Sukuk, and Al Ijara Sukuk. Its other major functions are cheque clearing and interbank fund transfers.

a. Government Securities Operations

There are two forms of Treasury Bills: 3-month T-Bills, which are issued on a weekly basis, except on weeks where the Al Salam Sukuk are issued, and 6-month bills, which are issued on a monthly basis. The issue amount of the 3-month T-Bills was BD 15 million, in 2006, the total amount issued as of December 31, 2006 was BD 132 million. As for the 6-month T-Bills, the issue amount is BD 5 million and the outstanding amount as of December 31, 2006 was BD 30 million.

The Al Salam Sukuk are short term notes similar to the Treasury Bills; however, they are issued in accordance with Sharia standards and with an issue amount of USD 40 million. Issued on a monthly basis, the Al Salam Sukuk have a maturity period of 91 days and the outstanding Al Salam Sukuk as of December 31, 2006 was USD 120 million (equivalent to BD 45.1 million). The underlying commodity for these Sukuk is mainly raw aluminium.

Al Ijara Sukuk are of two types: Long term and short-term. The long-term Islamic leasing securities have maturity periods of 3, 5, and 10 years. There are currently 12 issues, each of which has a different underlying asset of various existing securitised government assets. Issues 1 – 9 and issue no.12 are in US dollars and Issues 10 & 11 are in Bahraini dinars. The return rate of these issues is either floating (over USD six month LIBOR) or fixed. The outstanding Al Ijara Sukuk as of December 31, 2006 was BD 413.9 million (USD 1.1 billion).

The Government Securities Issuance Calendar is available on the CBB Website.

b. Operations with Retail Banks

In addition to its government securities operations, the Directorate also provides various operational services to retail banks as follows: short-term deposits are facilities where banks may place interest-bearing deposits at the CBB on a short-term basis ranging from one week and one month to six months. (In 2007, fixed deposits are allowed for overnight and 1 week). During 2006, the total Short-term Deposits amounted to BD 6.7 billion. As at December, 31st 2006, the total fixed deposit outstanding was BHD 202.3million.

The directorate also has other facilities for retail banks:

REPO facilities allow commercial banks to borrow from the CBB over night, two days and/or a week against their outstanding treasury bills. During 2006, total REPO transactions reached BD 729.7 million.

BD Secured is a facility in which commercial banks can borrow from the CBB for one week against their outstanding deposit accounts. During 2006, the total BD Secured transactions reached BD 1.4 billion.

c. Cheque Clearing Facilities

The CBB administers cheque clearing, interbank transfers. In the year 2006 a total of 2.6 million cheques were processed. The total value of these cheques was BD 3.0 billion. The total number of interbank fund transfar for 2006 was 186,285 and their total amount was BD 37.3 billion.

In relation to Returned Cheques, there has been an increase in the percentage of returned cheques for the year 2006 to 2.41% of all cheques for the year. The returned cheques for 2004 and 2005 were 2.36% and 2.38% respectively.

The Cheque Clearing System is also going to undergo a change. The current cheque clearing system is a Magnetic Ink Character Recognition (MICR) based solution. The CBB is in the process of implementing an electronic-based cheque truncation system and is currently evaluating the bids recently received from major venders. This system should go live during 2008.

d. Developments in the Clearing System

In terms of Payment Systems, the CBB is in the process of implementing a state of the art RTGS system which is being developed by BCSIS (a Singaporean company which specialises in RTGS systems). BCSIS will also develop a Securities Settlement System (SSS) which will complement the RTGS System and handle government securities. This will completely change the current payment system in the sense that banks can transfer funds and view their position in real time. Both systems will go live during the first half of 2007.

In 2006, there was a review of the current interest rate structure with the International Monetary Fund (IMF) which affects the money market instruments offered to the banks. There was also a review of the Reserve Requirement and the issuance of conventional and Islamic Debt. The purpose of this was to further enhance and to have a unified policy in place regarding the related operations.

The CBB has created a Money Market Forum for the purpose of discussing monetary policy issues and further develop the money market. This forum will also work to improve transparency with regards to local currency operations. The Money Market Forum comprises experienced members from local commercial banks, foreign banks and Islamic Banks.

4

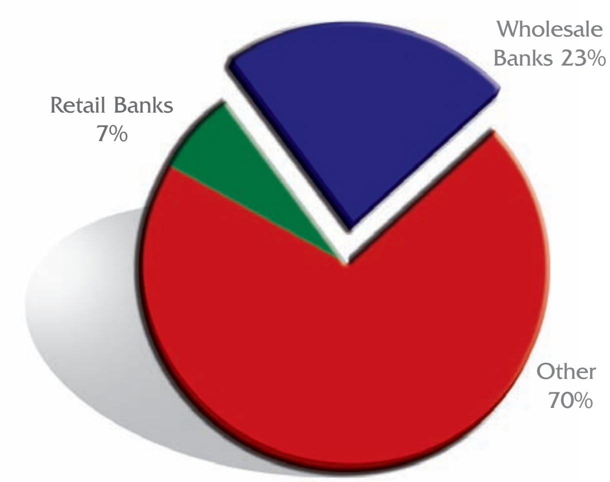
The Banking Sector

4.1 The Financial Sector

Bahrain's financial services industry continued to develop and expand during 2006, with 33 new licenses issued by the CBB and starting their business in this sector. As at end-2006, the total number of institutions licensed by the CBB stood at 376, comprising of 206 banking institutions, 156 insurance and insurance-related firms and 114 investment business and other licensees. Collectively they represent a wide range of locally incorporated, regional and international institutions, many of which serve the Middle East market as a whole.

Of the banking institutions there were 25 retail banks, 86 wholesale banks and 34 representative offices. There were also 27 investment business firms, 18 money changers and 1 broking company.

Chart 4-1: Breakdown of Financial Institutions in Bahrain, 2006



Source: Central Bank of Bahrain

a. Retail Banks

Overall, the Bahrain banking sector enjoyed a good year in 2006. Conventional retail banks in Bahrain not only increased their size but also reflected an impressive performance during the year, as a result of high oil prices and strong economic growth.

The total assets of conventional retail banks stood at BD 7.1 billion as at 31st December 2006, showing a remarkable increase of BD 1.6 billion or 28.2% over the previous year's level. This was attributed to the substantial growth in the total assets of overseas conventional retail banks, which reflected a rise of BD 825.5 million or 41.6% over the previous year to stand at BD 2.8 billion at the end of December 2006. The locally incorporated conventional retail banks also contributed to this impressive growth performance of total assets by experiencing an increase of BD 738 million or 20.8% in their asset base over the previous year, which stood at BD 4.3 billion as at the end-December 2006.

Overall net profit for the conventional retail banking sector increased by BD 35.9 million, representing a significant rise of 28.5% over the previous year to reach a level of BD 161.9 million for the year 2006. This growth was ascribed to a considerable rise of BD 24.8 million or 41.4% over 2005 in the net profits of overseas conventional retail banks to reach BD 84.7 million for the year 2006. Similarly, net profits of locally incorporated conventional retail banks showed a significant increase of BD 11.1 million, or 16.8% over the previous year, to achieve a level of BD 77.2 million.

The total equity of the conventional retail banking sector in Bahrain increased by BD 49.9 million, representing a rise of 8%, compared with the levels in 2005 and stood at BD 676 million as at December 31st 2006. Overseas conventional retail banks witnessed an increase of BD 39.9 million, representing an impressive growth of 22.9% over 2005 to stand at BD 214.4 million as at the end-December 2006, signifying greater commitment and support of the head offices to their bank branches in Bahrain. The locally incorporated conventional retail banks too showed a rise in their equity levels which stood at BD 461.6 million, reflecting an increase of 2.2% or BD 10 million over the equity levels in 2005.

The average Capital Adequacy Ratio for the locally incorporated conventional retail banks declined from 25.9% in 2005 to 21% in 2006, mainly on account of a 32% increase in the risk weighted assets of these banks, which also more than offset a 7% rise in the capital base of these banks from BD 510 million in 2005 to BD 545.5 million in 2006.

The return on equity for the retail conventional banking sector increased from 20% in 2005 to 24% in 2006, on account of a 40% rise for overseas conventional retail banks and a 16.7% rise for locally incorporated conventional retail banks.

b. Wholesale Banks

Wholesale banks had a benign year in 2006. Aggregate figures show total assets as at end-2006 increased by 32% to stand at USD 186.9 billion, compared to USD 141.5 billion as at the end of 2005. This rise was as a result of the growth in total assets of locally incorporated banks and foreign branches by 35% and 30% respectively. Total assets of locally incorporated banks stood at USD 87.2 billion in comparison to USD 64.6 billion at the end of 2005. Simultaneously, total assets of foreign branches stood at USD 99.8 billion compared to USD 76.9 billion at the end of 2005.

Total net profits of wholesale banks decreased slightly by 1% to stand at USD 1.84billion in comparison to USD 1.85 billion at the end of 2005. Total net profits of locally incorporated banks dropped by 14% to stand at USD 1.1 billion compared to USD 1.3 billion at the end of 2005. On the other hand, total net profits of foreign branches have increased by 32% to stand at USD 0.7 billion from USD 0.5 billion at the end of 2005.

With respect to the total equity of wholesale banks, excluding foreign branches as they do not maintain any capital, it increased by USD 3.1 billion or 31% to stand at USD 13.3 billion in comparison to USD 10.2 billion in 2005. Conversely, the average capital adequacy ratio of the wholesale banks has slightly declined by 1.4% to stand at 18.6% in comparison to 20% in the prior year.

c. Islamic Banks

The total assets of Islamic retail banks Increased by 65.7% to reach USD 4.3 billion at end-December 2006. Islamic wholesale banks' assets also increased assets from USD 5.1 billion in 2005 to USD 7.4 billion in 2006 an increase of 45.1%.

The overall net profit of the Islamic retail banks increased by USD 115 million representing a significant rise of 79.4% over the previous year to reach USD 260 million at 2006.

The average Capital Adequacy Ratio for the retail Islamic banks stand at 35.5%, lower than the investment banks which stood at 47.7%

d. Consolidated Banking System

The good performance of the banking sector in 2006 is reflected in the growth of the consolidated balance sheet of the banking system. The consolidated balance sheet of the banking system in Bahrain (retail banks and wholesale banks) increased from USD 140.4 billion at end-2005 to USD 187.4 billion at end-2006, an increase of USD 47.0 billion or 33.5%. Wholesale banks represented 87.7% of the consolidated balance sheet of the banking system and retail banks constituted 12.3%. Islamic banks accounted for 6.5%.

Table 4-1: Consolidated Balance Sheet of the Banking System, 2004-2006

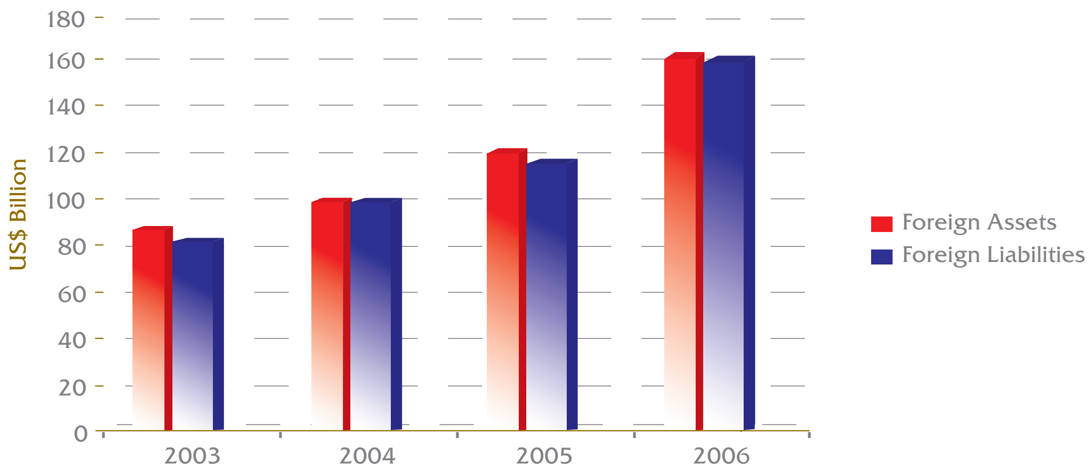
(USD Billion)

Items	Year-end			Change (%)
	2004	2005	2006	
Retail Banks *	14.6	16.5	23.1	40.0
Wholesale Banks*	104.3	123.9	164.3	32.6
Total	**118.9**	**140.4**	**187.4**	**33.5**

* Excludes assets of overseas branches and subsidiaries
Source: Central Bank of Bahrain

Total foreign assets of the banking system increased by USD 40.7 billion or 34.2%, from USD 119.0 billion at end-2005 to USD 159.7 billion at end-2006. For the same period, total foreign liabilities increased by USD 40.2 billion or 35.5% from USD 113.1 billion at end-2005 to USD 153.3 billion at end-2006. Most of the foreign assets of the banking system are concentrated in the wholesale banks, reflecting buoyant foreign investment activity. The net foreign assets of the banking system increased by USD 0.5 billion or 8.5% from USD 5.9 billion at end-2005 to USD 6.4 billion at end-2006.

Chart 4-2: Foreign Assets and Liabilities of the Banking System, 2003-2006



Source: Central Bank of Bahrain

Table 4-2: Domestic and Foreign Assets of the Banking System, 2003-2006

(USD Million)

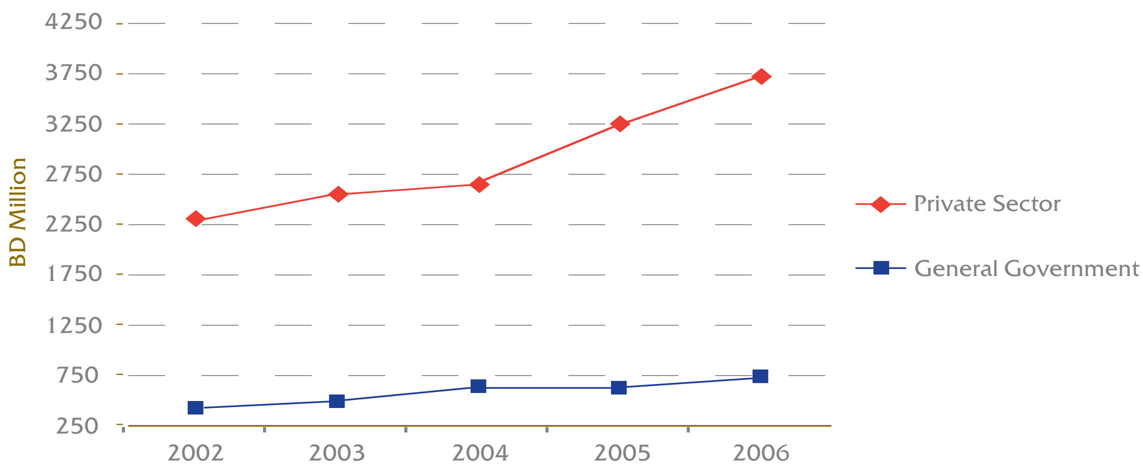
End Year	Domestic Assets					Total Foreign Assets	Total Banking System Assets
	Banks*	Private Non-Banks	General Government	Other	Total		
2003	6,965.8	5,505.5	1,382.0	693.4	14,546.7	86,388.1	100,934.8
2004	8,681.0	7,032.9	1,786.7	730.5	18,231.1	100,682.0	118,913.1
2005	10,099.8	8,403.5	1,872.1	984.1	21,359.5	119,022.2	140,381.7
2006	13,784.4	10,417.7	1,859.8	1,570.2	27,632.1	159,708.2	187,340.3

*Includes Head Offices and Affiliates
Source: Central Bank of Bahrain

e. Domestic Deposits

Deposits in Bahrain have generally been following an expansionary trend. Total private sector deposits (Bahraini dinars plus other currencies) at retail banks increased by 14.4% to reach BD 3,740.5 million at end-2006. Government deposits (Bahraini dinars plus other currencies) at retail banks amounted to BD 752.3 million at end-2006, compared with BD 649.7 million at end-2005, an increase of 15.8%.

Chart 4-3: Growth in Domestic Deposits, 2002-2006



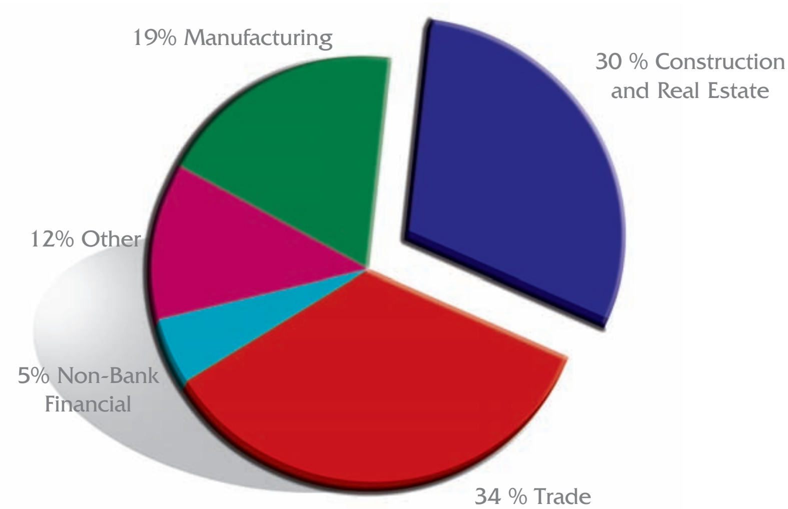
Source: Central Bank of Bahrain

f. Credit Extended

Reflecting the positive growth that Bahrain has been experiencing, credit facilities over 2006 showed an upsurge for the majority of the economic sectors operating in the Kingdom. Total outstanding credit facilities extended by retail banks to the different sectors of the domestic economy amounted to BD 3,033.4 million at end-2006, compared with BD 2,623.5 million at end-2005, an increase of 15.6%.

The business sector accounts for the majority of credit facilities extended, overtaking personal sector credit growth. This signifies the ever improving role of the banking sector in business growth. Outstanding facilities to the business sector increased by 32.0%, from BD 1,226.9 million at end-2005 to BD 1,619.0 million at end-2006. The trade sector's credit facilities increased by 26.4% and the construction and estate sector by 60.3%. The business sector's share of total outstanding credit facilities was 53.4%.

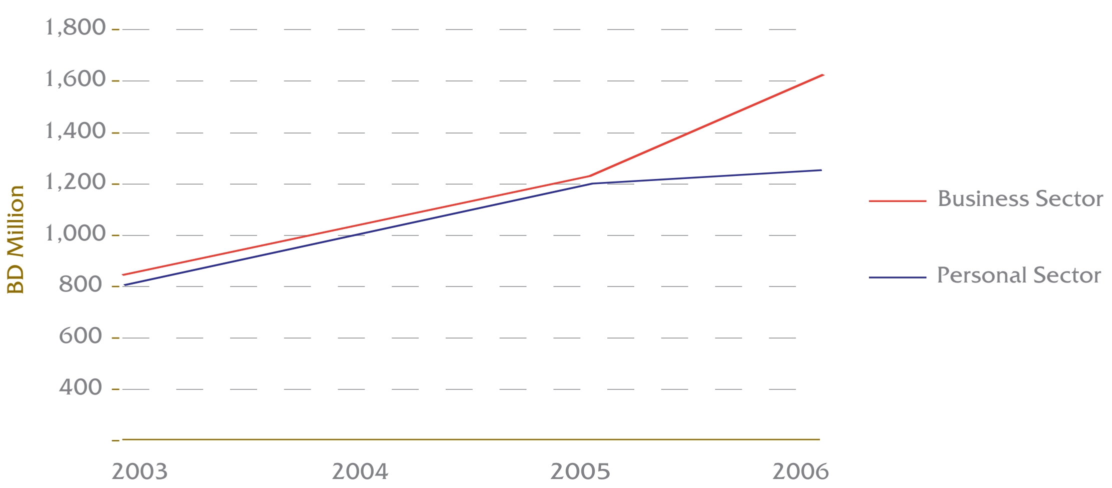
Chart 4-4: Credit Extended to Business Sectors, 2006



Source: Central Bank of Bahrain

Outstanding credit facilities to the personal sector increased by 4.9% from BD 1,194.0 million at end-2005 to BD 1,252.9 million at end-2006. The personal sector's share of total outstanding credit facilities was 41.3%.

Chart 4-5: Credit Extended to Business and Personal Sectors, 2003-2006



Source: Central Bank of Bahrain

Government credit outstanding decreased by 20.3% to BD 161.5 million at end-2006, compared with BD 202.6 million at end-2005. The substantial decrease in 2006 has meant that the Government sector's share of total outstanding credit facilities reached 5.3%.

g. Credit Card Survey

The CBB concluded its seventh annual Credit Card receivable survey for the year 2006. The survey showed an increase in the number of credit card holders and credit card accounts of 5.4% and 0.6% respectively. Bahrainis represented 72.8% of the total number of credit card holders. The total limits provided to those customers decreased by 0.6% to reach BD 184.6 million at end-2006. The amounts used by the cardholders from the limits provided reached BD 91.8 million at end-2006, an increase of around 17.8% compared with end-2005.

Table 4-3: Credit Card Data, 2005-2006

	2005	2006	Change (%)
Number of Customers	**150,335**	**158,465**	**5.4**
Bahraini	114,680	115,392	0.6
Non-Bahraini	35,655	43,073	20.8
Number of Accounts	**135,604**	**136,473**	**0.6**
Of which: Rollover Accounts (1)	92,573	108,763	17.5
Overdue Accounts (2)	19,840	26,866	35.4
Total Outstanding (BD Millions)	**77.9**	**91.8**	**17.8**
Of which: Delinquency Amounts (3)	9.6	16.4	70.8
Rollover Amounts (2)	58.3	36.6	-37.2
Interest Rates	**20.3**	**20.5**	**1.0**

(1) Accounts where minimum balance has been paid
(2) Accounts where due date has passed and minimum payment has not been made
(3) Total amount of outstanding balance not paid within 90 days
Source: Central Bank of Bahrain

h. Manpower Survey

The CBB concluded its annual manpower survey for the year end-2006. The survey showed an increase in the number of employees in the financial sector (banks and non-banks) of 18.0%. Bahrainis represented 72.0% of the total number of employees.

Total employment in the banking sector (retail banks, wholesale banks, representative offices and specialised banks) reached 7,138 at end-2006, compared with 6,172 at end-2005, an increase of 15.7%. Total employment in the non-bank financial sector reached 2,194 at end-2006, compared with 1,694 at end-2006, an increase of 29.5%. Bahrainis accounted for 60.0% of the total in the non-bank financial sector.

Table 4-4: Employment in the Financial Sector, 2005-2006

Sectors	2005			2006*		
	Bahraini	Non-Bahraini	Total	Bahraini	Non-Bahraini	Total
Banking Sector						
Retail Banks	2,429	361	2,790	3023	610	3633
Wholesale Banks	2,045	1,093	3,138	2,085	1,149	3,234
Representative Offices	24	48	72	31	45	76
Eskan Bank	109	8	117	112	14	126
Bahrain Development Bank	51	4	55	65	4	69
Total	**4,658**	**1,514**	**6,172**	**5,316**	**1,822**	**7,138**
Non-Bank Financial Sector						
Insurance Companies	650	338	988	760	369	1,129
Insurance Related Activities Companies	--	--	--	25	61	86
Money Changers	205	302	507	217	332	549
Broking Companies	26	20	46	28	19	47
Investment Advisory	62	40	102	89	60	149
Stock Brokers	35	16	51	42	13	55
Financing Companies	--	--	--	138	13	151
Investment Business Firms	--	--	--	18	10	28
Total	**978**	**716**	**1,694**	**1,317**	**877**	**2,194**
Other Institutions						
Central Bank of Bahrain	278	23	301	297	21	317
Bahrain Institute of Banking & Finance	33	13	46	40	11	51
Bahrain Stock Exchange	46	4	50	49	3	52
Total	**357**	**40**	**397**	**385**	**35**	**420**
Grand Total	**5,993**	**2,270**	**8,263**	**7,018**	**2,734**	**9,752**

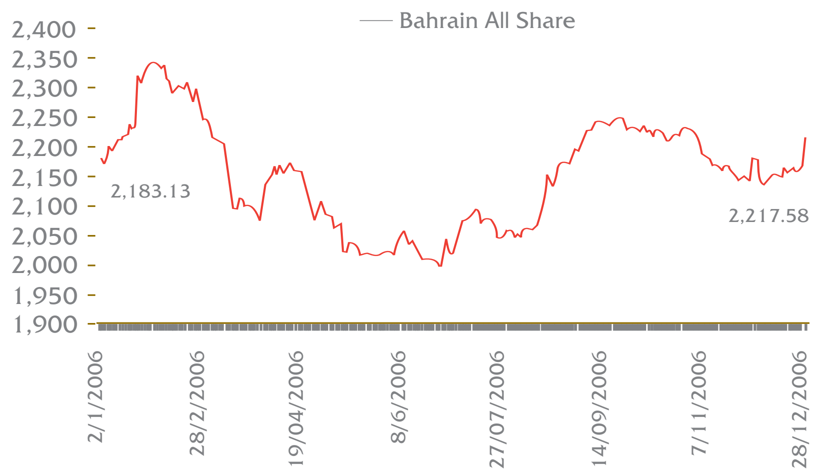
* Provisional Data
Source: Central Bank of Bahrain

5 The Capital Market

5.1 Performance of Indices

The Bahrain All Share Index closed at 2217.58 points at the end of December, marking a growth of 0.99% on its 2005 closing level.

Chart 5-1: Performance of Bahrain All Share Index, Jan. – Dec. 2006



Source: Bahrain Stock Exchange

The performance of the other indices, Esterad and Dow Jones, posted growth of 0.89% and 2.54% respectively compared to December 2005 closing.

Table 5-1: BSE Indices, 2005-2006

BSE Indices	December 2005	December 2006	Change (%)
Bahrain All Share Index	2,195.80	2,217.58	0.99
Esterad Index	2,277.06	2,297.34	0.89
Dow Jones Bahrain	183.75	188.42	2.54

Source: Bahrain Stock Exchange.

5.2 Trading Activity

The year 2006 witnessed an increase in the value of shares traded to reach BD 522.90 million compared to BD 268.08 million during the corresponding period in 2005, an increase of 95.04%. The volume of shares traded increased from 458.31 million shares to 727.63 million shares marking a 58.76% rise. The number of transactions executed was 21,699, marking a decrease of 3.40%. The daily average value of shares traded was BD 2.11 million while the daily average volume of shares was 2.94 million and the daily average number of transactions was 88.

Table 5-2: Market Activity, 2005-2006

	December 2005	December 2006	Change (%)
Value of Shares Traded (BD Million)	268.08	522.90	95.05
Volume of Shares Traded (Million)	458.31	727.63	58.76
No. of Transactions	22,463	21,699	-3.40
Daily Average Value of shares (BD Thousand)	1,077	2,117	96.63
Daily Average Volume of share (Thousand)	1,841	2,946	60.02
Average no. of Transactions	90	88	-2.22
No. of Trading Days	249	247	-0.80

Source: Bahrain Stock Exchange.

5.3 Performance of Sector Indices (Bahrain All Share Index)

The Commercial Banks Index posted a rise of 16.91% compared to last year, closing at 2,925.77 points; other sub indices decreased by different percentages.

Table 5-3: Performance of Sub-Indices, 2005-2006

Sector	2005	2006	Change (%)
Commercial	2,502.57	2,925.77	16.91
Investment	2,013.11	1,848.22	-8.19
Insurance	2,101.29	1,883.96	-10.34
Services	1,998.06	1,957.76	-2.02
Industrial	1,493.06	1,456.41	-2.45
Hotels & Tourism	2,077.55	2,017.75	-2.88

Source: Bahrain Stock Exchange.

5.4 Market Capitalisation

Market capitalisation stood at BD 7,963 million at the end of December 2006 increasing from BD 6,546 million in December 2005 achieving a growth of 21.66%.

Table 5-4: Growth of Market Capitalisation by Sector, 2005-2006

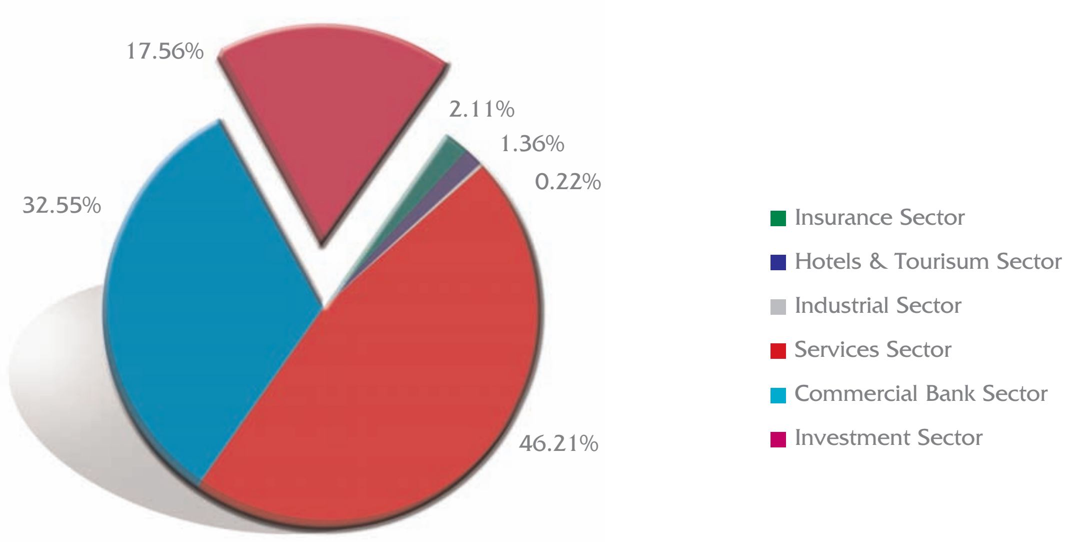
(BD Million)

Sector	2005	2006	Change (%)
Investment	2,729	3,680	34.84
Commercial Banks	2,080	2,592	24.60
Services	1,423	1,398	-1.7
Industrial	17.26	16.84	-2.6
Hotels & Tourism	111	108	-2.7
Insurance	186	168	-9.7
Total	**6,546**	**7,963**	**21.6**

Source: Bahrain Stock Exchange.

In terms of market capitalisation, the investment sector came first with 34.84% growth followed by the Commercial Banks sector with a rise of 24.60%.

Chart 5-2: Representation of Market Capitalisation Among Sectors, 2006



Source: Bahrain Stock Exchange.

On the companies front, Ahli United Bank ranked first in 2006 as its market capitalisation increased by 15.25% followed by Batelco with 13.32%.

Table 5-5: Largest Companies in Terms of Market Capitalisation, 2006

Company	Market Capitalisation (BD Million)	%
AUB	1,214	15.25
BATELCO	1,140	13.32
INVCORP	715	8.98
BARKA	710	8.92
GFH	578	7.26

Source: Bahrain Stock Exchange.

5.5 Trading of Sectors

The Investment Sector led other sectors in terms of value traded as it amounted to BD 273.3 million constituting 52.27% of the total value traded. Commercial Banks came second with BD 215.2 million representing 41.14% of the total value.

Table 5-6: Most Active sectors by Value, 2006

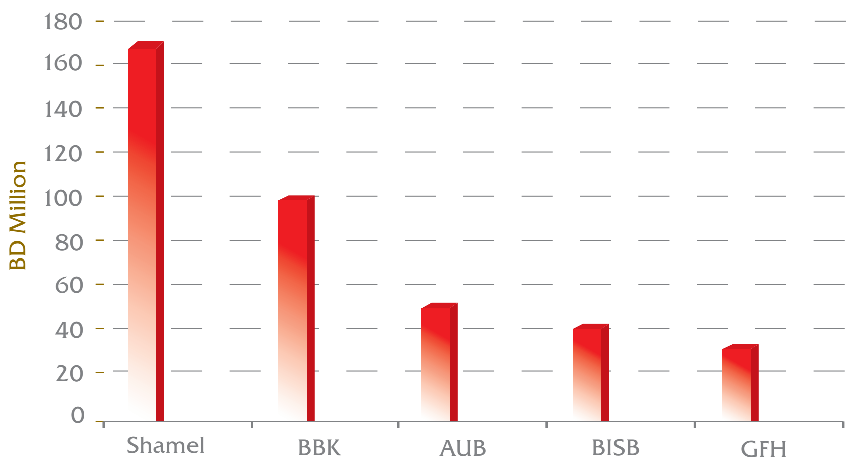
Sector	BD Million
Investment	273.3
Commercial Bank	215.2
Services	27.0
Insurance	3.5
Hotels & Tourism	1.6
Industrial	0.05
Non-Bahraini Companies	2.2
Total	522.9

Source: Bahrain Stock Exchange.

Bahrain Shamel Bank came first in terms of the value of shares traded with BD 170 million translating to 32.51% of total value of shares traded, then came Bank of Bahrain and Kuwait with BD 100 million constituting 19.12% of the total value of shares traded, then Ahli United Bank with BD 49 million and 9.37% of total value of shares traded, followed by Bahrain Islamic Bank with BD 42 million constituting 8.03% of the total value of shares traded, and finally came Gulf Finance House with BD 30.5 million constituting 5.83% of the total value of shares traded.

During 2006, the prices of 14 stocks went up, 27 went down, while the share prices of 9 companies remained unchanged.

Chart 5-3: Top Stocks by Value, 2006



Source: Bahrain Stock Exchange.

Table 5-7: Major Advancers, 2005-2006

Company	Closing 2005	Closing 2006	Change (%)
Bank Muscat	6.00	9.96	66.2
Shamel Bank	1.85	2.45	32.4
TAIB	1.26	1.60	27.0
AUB	0.94	1.18	25.5
BISB	0.55	0.615	17.8

Source: Bahrain Stock Exchange.

Table 5-8: Major Decliners, 2005-2006

Company	Closing 2005	Closing 2006	Change (%)
GLOBAL	3.40	1.320	-61.2
ESTERAD	1.730	0.865	-50.0
NASS	0.435	0.267	-38.6
BCFC	0.990	0.655	-33.8
GFH	3.80	2.38	-7.28

Source: Bahrain Stock Exchange.

5.6 Trading By Nationalities

Statistics showed that Bahraini Investors were the most active in terms of value of shares traded reaching BD 442.64 million in 2006 and capturing 42.33% of the market share. GCC Investors came second with BD 382.43 million in which they accounted 36.57% of the total value of shares traded, and finally came other non-GCC investors comprising 21.11% of the total value of shares traded with BD 220.74 million.

Table 5-9: Trading By Nationalities (Buy & Sell), 2005-2006

(BD Million)

Nationality	2005	2006
Bahraini	256.34	442.64
GCC	231.57	382.43
Other	48.25	220.74

Source: Bahrain Stock Exchange.

6.1 Economic Indicators

Table 6-1: Population, 2005-2006

	2005	2006
Total Population	**724,645**	**742,561**
Bahraini	448,491	459,012
Male	226,187	231,493
Female	222,304	227,519
Non-Bahraini	276,154	283,549
Male	190,586	195,671
Female	85,568	87,878
Total Population Growth (%)	**2.5**	**2.5**
Bahraini Population Growth (%)	**2.3**	**2.3**
Non-Bahraini Population Growth (%)	**2.7**	**2.7**

Source: Central Informatics Organisation

Table 6-2: Employment, 2005-2006

	2005	2006
Total Employment*	**336,508**	**351,862**
Growth Rate (%)	**17.9**	**4.6**
Private Sector	299,080	313,039
As a % of Total Employment	88.9	89.0
Male	268,580	283,533
Female	30,500	29,506
Bahraini**	71,900	65,614
Non-Bahraini	227,180	247,425
Civil Public Sector	37,428	38,823
As a % of Total Employment	11.1	11.0
Male	21,495	22,160
Female	15,933	16,663
Bahraini	33,691	34,771
Non-Bahraini	3,737	4,052

*Total Registered at GOSI and Civil Service Bureau.
**Number of Bahraini's employed declined in 2006 due to implementation of Law no. 40, whereby individuals with more than one job are registered singularly.
Source: General Organisation for Social Insurance and Civil Service Bureau

Table 6-3: Foreign Trade*, 2005-2006

	2005	2006
Total Exports (BD Millions)	**3,679.2**	**4,347.6**
Oil Exports	2,926.6	3,465.8
Non-Oil Exports	842.6	881.8
Total Imports (BD Millions)	**2,987.8**	**3,362.8**
Oil Imports	1,567.8	1,843.0
Non-Oil Imports	1,420.0	1,519.8
Trade Balance (BD Millions)	**781.4**	**984.8**

*Provisional Data
Source: National Oil and Gas Authority and the Central Informatics Organisation

Table 6-4: Domestic Public Debt*, 2005-2006

	2005	2006
Total Outstanding (BD Millions)	**617.1**	**679.1**
As a % of GDP (2005 GDP)	12.3	13.5
Treasury Bills	130.0	162.0
Islamic Leasing Securities	442.0	472.0
Al Salam Islamic Securities	45.1	45.1

*Provisional Data
Source: Central Bank of Bahrain

Table 6-5: BD Exchange Rates Against Major Currencies, 2005-2006

	2005	2006
US Dollar	0.376	0.376
Pound Sterling	0.648	0.736
Euro	0.446	0.493
Japanese Yen	3.180	3.160
Swiss Franc	0.286	0.307

Source: Central Bank of Bahrain

Table 6-6: Bahrain Stock Exchange, 2005-2006

	2005	2006	Change (%)
Market Capitalisation by Sector (BD Billions)			
Total Market Capitalisation	6546.34	7963.14	21.64
Investment	2729.38	3680.45	34.85
Commercial Bank	2080.13	2591.75	24.60
Services	1422.87	1398.41	-1.72
Hotel & Tourism	111.37	108.14	-2.90
Industry	17.26	16.85	-2.40
Insurance	185.52	167.54	-9.69
Trading Activities in the Market			
Bahrain All Share Index (Points)	2195.80	2217.58	0.99
Dow Jones Bahrain Index (Points)	183.75	188.42	2.54
Esterad Index (Points)	2277.06	2297.34	0.89
Value of Shares Traded (BD Millions)	268.08	522.91	95.06
Daily Average of Value of Shares Traded (BD '000)	1.08	2.13	96.82
Share Turnover (%)	4.03	6.54	62.28
Volume of Shares Traded (Millions)	458.31	727.63	57.76
Daily Average No. Of Shares Traded (Millions)	1.84	2.96	60.75
Number of Transactions	22465	21699	-3.41
Daily Average No. Of Transactions	90	88	-2.22
Number of Listed Companies*	47	50	6.38

*Includes Non-Bahraini Companies
Source: Bahrain Stock Exchange

6.2

Financial Sector Indicators

Table 6-7: Domestic Liquidity, 2004-2006

(BD Million)

Items	Year-end 2004	2005	2006	Change 2006 Absolute	%
Currency in Circulation	173.7	190.8	227.7	36.9	19.3
M1	861.1	1,062.5	1,285.8	223.3	21.0
M2	2,879.6	3,512.8	4,035.9	523.1	14.9
M3	3,545.8	4,169.4	4,893.3	723.9	17.4

Source: Central Bank of Bahrain

Table 6-8: Factors Affecting Domestic Liquidity, 2004-2006

(BD Million)

Factors	Year-end 2004	2005	2006	Changes (2005 vs. 2004)	(2006 vs. 2005)
A. Total Domestic Liquidity (M3)	**3,545.8**	**4,169.4**	**4,893.3**	**623.6**	**723.9**
B. Factors Affecting Liquidity					
1. Net Foreign Assets (a+b)	**1,117.7**	**1,401.5**	**2,231.3**	**283.8**	**829.8**
(a) CBB	598.0	707.8	1,015.7	109.8	307.9
(b) Retail Banks	519.7	693.7	1,215.6	174.0	521.9
2. Domestic Claims (a+b+c)	**2,428.1**	**2,767.9**	**2,662.0**	**339.8**	**-105.9**
(a) Claims on government	645.4	675.6	577.6	30.2	-98.0
(b) Claims on private sector 1/	2,172.8	2,623.0	3,122.5	450.2	499.5
(c) Other assets (net)	-390.1	-530.7	-1,038.1	-140.6	-507.4

1/ Loans and holdings of securities
Source: Central Bank of Bahrain

Table 6-9: Consolidated Balance Sheet of the Banking System, 2004-2006

(USD Billions)

Items	Year-end 2004	2005	2006	Change % 2006
Retail Banks	14.6	16.5	23.1	40.0
Wholesale Banks	104.3	123.9	164.3	32.6
Total	**118.9**	**140.4**	**187.4**	**33.5**

Source: Central Bank of Bahrain

Table 6-10: Geographical Classification of the Banking System's Assets/Liabilities, 2004-2006

(USD Billions)

	Year-end					
	2004		2005		2006	
Countries	Assets	Liabilities	Assets	Liabilities	Assets	Liabilities
Arab Countries	46.6	59.8	60.9	74.3	85.3	102.2
Asia	10.4	12.0	12.0	12.4	13.0	17.6
Americas	20.9	11.4	25.6	9.8	28.9	15.0
Western Europe	37.7	34.9	38.7	43.0	55.9	50.3
Others	3.3	0.8	3.2	0.9	4.3	2.3
Total	**118.9**	**118.9**	**140.4**	**140.4**	**187.4**	**187.4**

Source: Central Bank of Bahrain

Table 6-11: Currency Structure of the Banking System's Assets/Liabilities, 2004-2006

(USD Billions)

	Year-end					
	2004		2005		2006	
Currencies	Assets	Liabilities	Assets	Liabilities	Assets	Liabilities
USD	73.4	72.7	90.6	86.2	125.2	123.1
GCC Currencies	19.0	20.0	22.6	24.0	28.7	30.5
EURO	18.6	18.6	11.1	8.7	17.5	17.6
Others	7.9	7.6	16.1	21.5	16.0	16.2
Total	**118.9**	**118.9**	**140.4**	**140.4**	**187.4**	**187.4**

Source: Central Bank of Bahrain

Table 6-12: Interest Rates on BD Deposits & Loans, 2004-2006

Items	End 2004	End 2005	2006 1st Quarter	2006 2nd Quarter	2006 3rd Quarter	2006 4th Quarter
1. Deposits						
Time/1	1.96	3.70	4.17	4.51	4.40	4.40
Savings	0.35	0.32	0.32	0.35	0.38	0.37
2. Loans						
Business	5.27	7.16	7.25	7.83	7.76	7.64
Personal	7.73	8.31	8.95	8.58	9.24	8.89
3. Credit Cards	18.64	20.28	20.32	20.31	19.88	20.46

/1 Time deposits of 3-12 months.
Source: Central Bank of Bahrain

Table 6-13: Outstanding Credit to Non-Bank Residents by Economic Sector, 2004-2006

(BD Millions)

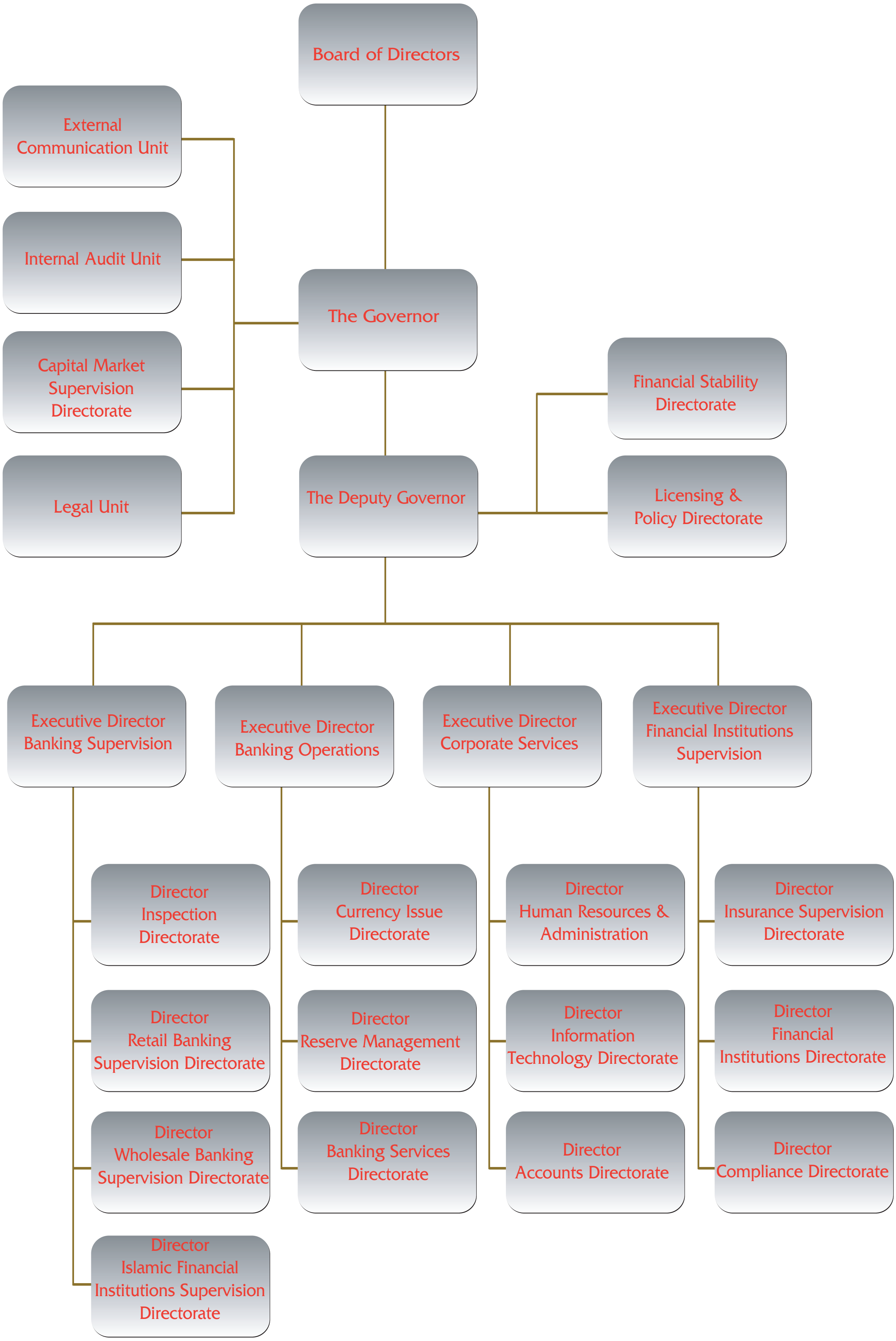
Sectors	Year - end 2004 Absolute	2004 %	2005 Absolute	2005 %	2006 Absolute	2006 %	Change 2006 Absolute	Change 2006 %
1. Business	**1,008.6**	**45.2**	**1,226.9**	**46.8**	**1,619.1**	**53.4**	**392.2**	**32.0**
Manufacturing	298.2	13.3	282.6	10.8	312.3	10.3	29.7	10.5
Mining and Quarrying	2.3	0.1	2.3	0.1	1.8	0.1	-0.5	-21.7
Agriculture, Fishing and Dairy	8.5	0.4	9.0	0.4	6.5	0.2	-2.5	-27.8
Construction and Real Estate	187.1	8.4	302.1	11.5	484.2	15.9	182.1	60.3
Trade	341.3	15.3	436.2	16.6	551.6	18.2	115.4	26.5
Non-Bank Financial	71.0	3.2	67.7	2.6	75.1	2.5	7.4	10.9
Other Business	100.2	4.5	127.0	4.8	187.6	6.2	60.6	47.7
2. General Government	**207.4**	**9.3**	**202.6**	**7.7**	**161.5**	**5.3**	**-41.1**	**-20.3**
3. Personal	**1,014.7**	**45.5**	**1,194.0**	**45.5**	**1,252.9**	**41.3**	**58.9**	**4.9**
Total	**2,230.7**	**100.0**	**2,623.5**	**100.0**	**3,033.5**	**100.0**	**410.0**	**15.6**

Source: Central Bank of Bahrain

Number of Banks & Financial Institutions End - 2006

Retail Banks	**25**
of which Islamic Banks	6
Wholesale Banks	**86**
of which Islamic Banks	18
Specialised Banks	**2**
Representative Offices	**34**
of which Islamic Representative Offices	2
Investment Business Firms	**27**
Category 1	3
of which Islamic Investment Business Firms	2
Category 2	3
of which Islamic Investment Business Firms	0
Category 3	20
of which Islamic Investment Business Firms	2
Administrators	**1**
Money Changers	**18**
Financing Companies	**4**
Provider of Ancillary Services	**9**
Broking Companies	**1**
Capital Market Brokers	**14**
Insurance Companies	**156**
Locally Incorporated Insurance and Reinsurance Companies	18
Branches Insurance Companies	9
Restricted Insurance Companies	58
Representative Offices	6
Insurance Brokers	33
Surveyors and Loss Adjusters	9
Insurance Consultants	7
Actuaries	12
Insurance Ancillary Services	2
Insurance Manager	1
Captive Insurance	1
Total	**376**

CBB ORGANISATION CHART



CBB List of Officers

H.E. Mr. Rasheed Mohammed Al-Maraj	Governor
H.E. Mr. Anwar Khalifa Al-Sadah	Deputy Governor
Mr. Khalid Hamad Abdul Rahman	Executive Director - Banking Supervision
Dr. Abdul Rahman Ali Saif	Executive Director - Banking Operations
Mr. Abdul Rahman Mohammed Al-Baker	Executive Director - Financial Institutions Supervision
Dr. Huda Hussain Al-Maskati	Executive Director - Corporate Services
Mrs. Aisha Abdulla Nuruddin	Director - Human Resources & Administration Directorate
Mr. Farid Jassim Zubari	Director - Currency Issue Directorate
Mrs. Raqia Ebrahim Bardooli	Director - Accounts Directorate
Mr. Yousif Rashid Al-Fadhel	Director - Information Technology Directorate
Mr. Ahmed Isa Al-Somaim	Director - Reserve Management Directorate
Mr. Ahmed A. Aziz Al-Bassam	Director - Licensing & Policy Directorate
Mr. Ahmed Jassim Bumtaia	Director - Compliance Directorate
Mr. Yousif Hassan Yaqoob	Director- Retail Banking Supervision Directorate
Mr. Hussain Ali Sharaf	Director- Wholesale Banking Supervision Directorate
Shaikh Salman Bin Isa Al-Khalifa	Director – Financial Stability Directorate
Mr. Tawfiq Isa Shehab	Director - Insurance Supervision Directorate
Mr. Ali Salman Thamer	Director - Capital Markets Supervision Directorate
Mr. Ahmed Mohammed Buhiji	Director - Banking Services Directorate
Mr. Abdul Rahman Abdulla Al-Sayed	Director- Islamic Financial Institutions Directorate
Mr. Khalil Jaffar Al-Hamad	Director – Inspection Directorate
Mr. Mohammed Aymen Al-Tajer	Director – Financial Institutions Directorate

Central Bank of Bahrain (Formerly Bahrain Monetary Agency)

BALANCE SHEET AND
PROFIT AND LOSS ACCOUNT AND APPROPRIATION

31 DECEMBER 2006

AUDITORS' REPORT TO H.H. THE CHAIRMAN OF THE BOARD OF DIRECTORS OF THE CENTRAL BANK OF BAHRAIN (FORMERLY BAHRAIN MONETARY AGENCY)

We have audited the accompanying balance sheet of the Central Bank of Bahrain (Formerly Bahrain Monetary Agency) ("the Central Bank") as of 31 December 2006, and the related profit and loss account and appropriation for the year then ended.

Management Responsibility for the Balance Sheet and the Related Profit and Loss Account and Appropriation.

The management is responsible for the preparation and fair presentation of the balance sheet and the related profit and loss account and appropriation in accordance with Royal Decree No. (64) for 2006. This responsibility includes: designing, implementing and maintaining internal controls relevant to the preparation and fair presentation of balance sheet, profit and loss account and appropriation that are free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

Auditors' Responsibility

Our responsibility is to express an opinion on the balance sheet and the related profit and loss account and appropriation based on our audit. We conducted our audit in accordance with International Standards on Auditing. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance whether the balance sheet and the related profit and loss account and appropriation are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the balance sheet and the related profit and loss account and appropriation. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the balance sheet and the related profit and loss account and appropriation, whether due to fraud or error. In making those risk assessments, the auditor considers internal controls relevant to the entity's preparation and fair presentation of the balance sheet and the related profit and loss account and appropriation in order to design audit procedures that are appropriate for the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by the Management, as well as evaluating the overall presentation of the balance sheet and the related profit and loss account and appropriation.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the balance sheet, related profit and loss account and appropriation present fairly, in all material respects, the financial position of the Central Bank as of 31 December 2006 and the results of its operations for the year then ended in accordance with the accounting policies set out in Note 2 and in compliance with the Royal Decree No. 64 of 2006.

12 March 2007
Manama, Kingdom of Bahrain

Central Bank of Bahrain (Formerly Bahrain Monetary Agency)
BALANCE SHEET
31 December 2006

	Notes	2006 BD '000	2005 BD '000
ASSETS			
Gold	4	**2,500**	2,500
Foreign reserves	3 & 4	**1,252,918**	1,032,297
Cash and due from Bahraini banks		**2,257**	26,873
Due from international organisations		**211**	211
Equipment		**1,037**	1,058
Other assets	5	**8,144**	9,721
		1,267,067	1,072,660
LIABILITIES AND CAPITAL FUNDS			
LIABILITIES			
Notes and coins in circulation	4	**279,722**	232,637
Bahraini Dinar deposits		**384,959**	383,308
Due to Ministry of Finance		**104,213**	-
Due to other central banks		**242**	487
Payable to Kingdom of Bahrain	7	**10,831**	-
Other deposits		**68,926**	55,315
Provision for currency withdrawn		**6,353**	6,388
Other payables		**4,243**	7,486
		859,489	685,621
CAPITAL FUNDS			
Capital	6	**200,000**	200,000
General reserve	7	**153,211**	142,380
Contingency reserve	8	**38,000**	33,000
Re-evaluation reserve	9	**16,367**	11,659
		407,578	387,039
		1,267,067	1,072,660

Chairman

Governor

The attached notes 1 to 9 form part of the balcance sheets and profit and loss account and appropriation.

Central Bank of Bahrain (Formerly Bahrain Monetary Agency)
PROFIT AND LOSS ACCOUNT AND APPROPRIATION
Year ended 31 December 2006

	Notes	2006 BD '000	2005 BD '000
INCOME			
Interest income		**74,916**	52,914
Interest expense		**36,440**	20,649
Net interest income		**38,476**	32,265
Registration and licensing fees		**4,234**	943
Net realised investment loss		**(3,465)**	(3,119)
Net realised (loss)/gain on foreign exchange		**(198)**	6,535
Other		**282**	242
		39,329	36,866
EXPENDITURE			
General and administration expenses		**10,768**	9,148
Managed funds and advisory fees		**968**	1,059
Note issue expenses		**931**	1,616
		12,667	11,823
PROFIT FOR THE YEAR		**26,662**	25,043
Transfer to contingency reserve	8	**5,000**	5,000
Transfer to general reserve	7	**10,831**	20,043
BALANCE PAYABLE TO KINGDOM OF BAHRAIN		**10,831**	-

The attached notes 1 to 9 form part of the balcance sheets and profit and loss account and appropriation.

Central Bank of Bahrain (Formerly Bahrain Monetary Agency)
NOTES TO THE BALANCE SHEET AND
PROFIT AND LOSS ACCOUNT AND APPROPRIATION
31 December 2006

1 ACTIVITIES

The Central Bank of Bahrain (formerly the Bahrain Monetary Agency) ("the Central Bank") is the Central Bank of the Kingdom of Bahrain and operates under the Royal Decree No. (64) of 2006. The Central Bank is responsible for organising the issue and circulation of the currency of the Kingdom of Bahrain as well as its foreign exchange, managing the value of the currency of Bahrain, endeavouring to ensure monetary stability, supervising and regulating the banking, insurance and capital market sectors so as to realise the objectives of the economic policy of the Kingdom of Bahrain, and participating in the creation of a developed money and financial market. The Central Bank acts as the fiscal agent on behalf of the Government of the Kingdom of Bahrain and is the supervisory authority for the financial sector in the Kingdom of Bahrain. The Central Bank has no branches or operations abroad.

The Central Bank's registered address is P O Box 27, located at the Central Bank Building, Diplomatic Area, Kingdom of Bahrain.

The balance sheet and profit and loss account and appropriation of the Central Bank for the year ended 31 December 2006 were authorised for issue in accordance with the approval of H.H. The Chairman and H.E. The Governor on 12 March 2007.

2 SIGNIFICANT ACCOUNTING POLICIES

The balance sheet and related profit and loss account and appropriation are prepared in compliance with the Royal Decree No. 64 of 2006.

Accounting convention

The balance sheet and related profit and loss account and appropriation are prepared under the historical cost convention.

Foreign reserves

Foreign reserves comprises deposits placed, net of deposits taken, and investments denominated in foreign currencies. All investments and deposits are carried at cost less provision for impairment.

For the Central Bank's internal portfolio of investments, premiums or discounts on purchase are amortised on a straight-line basis over the remaining life of the investment and included under interest income in the profit and loss account and appropriation. For investments with external fund managers, these portfolios are actively managed, accordingly there is no amortisation of premium or discounts.

Depreciation

The cost of the building and any addition thereto is expensed in the year in which the cost is incurred. The cost of other equipment is depreciated by equal annual installments over the estimated useful lives of the assets.

Foreign currencies

Foreign currency transactions are recorded at rates of exchange ruling at the date of the transactions.

Monetary assets and liabilities in foreign currencies at the balance sheet date are retranslated on the basis of the official par value of the Bahraini dinar in relation to the United States dollar and the closing market rates of exchange for the other currencies.

Forward foreign exchange contracts are stated at fair value.

In accordance with Article 22 (a) of the Royal Decree No. 64 of 2006, all profits resulting from the revaluation of the Central Bank's assets or liabilities in gold or foreign currencies as a result of any change in the parity-rate of the Bahraini Dinar or the rate of exchange of the Central Bank's assets of such currencies, are recorded in a special account to be entitled "Revaluation Reserve Account".

Gold

Gold is carried at cost.

Notes and coins in circulation

Notes and coins in circulation are stated net of the Bahraini dinar notes and coins held in banking stock.

Revenue recognition

Interest income is recognised on a time apportioned basis, taking into account the principal outstanding and the rate applicable. Registration and licensing fees are accounted for based on the calendar year to what they relate to. Investment gains are recognised when realised.

Note issue expenses

These are recognised when incurred.

3 FOREIGN RESERVES

	2006 BD '000	2005 BD '000
This comprises the following:		
Bond portfolios	**577,670**	575,511
Bank deposits and balances with portfolio managers	**675,248**	324,852
Due from Ministry of Finance	**-**	131,934
	1,252,918	1,032,297

All bonds are quoted in active markets with 96% being of investment grade BBB or higher (2005: 97%). All deposits and 92% of bonds are in US dollars (2005: 92%). For other foreign currencies, mainly Euros and Sterling, these are hedged into US dollars. The bond portfolios include BD 2,996 thousand net unrealised gains on non-US denominated bonds and related forward foreign exchange contracts used to hedge such bonds (2005: loss of BD 1,711 thousand).

The market value of the bond portfolios at 31 December 2006 was BD 575,652 thousand (2005: BD 571,570 thousand).

4 EXCESS OF AUTHORISED BACKING FOR CURRENCY IN CIRCULATION

	2006 BD '000	2005 BD '000
Authorised backing:		
Gold	**2,500**	2,500
Foreign reserves - note 3	**1,252,918**	1,032,297
	1,255,418	1,034,797
Currency in circulation:		
Notes and coins	**(279,722)**	(232,637)
Excess of authorised backing over currency in circulation	**975,696**	802,160

The fair value of gold as at 31 December 2006 was BD 36,178 thousand (2005: BD 29,298 thousand).

5 OTHER ASSETS

	2006 BD '000	2005 BD '000
Interest receivable	**3,945**	5,786
Staff loans	**2,802**	2,465
Others	**1,397**	1,470
	8,144	9,721

6 CAPITAL

	2006 BD '000	2005 BD '000
Authorised	**500,000**	400,000
Issued and fully paid up	**200,000**	200,000

In accordance with Article 11 of the Royal Decree No. 64 of 2006, the authorised capital was increased from BD 400 million to BD 500 million.

7 GENERAL RESERVE

	2006 BD '000	2005 BD '000
Balance at beginning of the year	**142,380**	122,337
Transfer from profit and loss account	**10,831**	20,043
Balance at end of the year	**153,211**	142,380

In accordance with Article 12 of the Royal Decree No. 64 of 2006, the Central Bank maintains general reserve which is credited with the following percentages of its net profits:

- 100% of the Bank's net profit until the amount of the general reserve reaches 25% of the authorized capital of the Central Bank;
- 50% of the net profit until the amount of the general reserve is equal to the authorized capital of the Central Bank;
- 25% of the net profit until the amount of the general reserve is double the amount of the authorised capital of the Central Bank.

Any net profit after such allocation is to be transferred to the Kingdom of Bahrain general account within three months of the date of the approval of the Central Bank's accounts.

Previously Article 18 of the Amiri Decree No. 23 of 1973, stated that the Central Bank was required to transfer 100% of its net profit for the year to a general reserve until it reached 50% of the authorised capital.

8 CONTINGENCY RESERVE

	2006 BD '000	2005 BD '000
Balance at beginning of the year	**33,000**	28,000
Transfer during the year	**5,000**	5,000
Balance at end of the year	**38,000**	33,000

The contingency reserve has been established to meet any future contingencies.

9 RE-EVALUATION RESERVE

	2006 BD '000	2005 BD '000
Balance at beginning of the year	**11,659**	14,587
Movement during the year	**4,708**	(2,928)
Balance at end of the year	**16,367**	11,659

The re-evaluation reserve relates to unrealised exchange gain in accordance with Article 22 (a) of the Royal Decree No. 64 of 2006.