



مَصْرِفُ الْبَحْرَيْنِ الْمَرْكَزِيّ

Central Bank of Bahrain

Financial Stability Directorate

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Preface

Financial stability can be defined as a situation where the financial system is able to function prudently, efficiently and uninterrupted, even in the face of adverse shocks.

As the single regulator for the Bahraini financial system, the Central Bank of Bahrain (CBB) attaches utmost importance to fostering the soundness and stability of the financial system. CBB recognizes that financial stability is critical to maintaining Bahrain's position as a regional financial center and ensuring that the sector continues to contribute significantly to growth, employment and development in Bahrain.

In pursuit of its objective of promoting financial stability, the CBB conducts regular financial sector surveillance, keeping a close watch on developments in individual institutions as well as in the system as a whole.

The *Financial Stability Report* (FSR) is one of the key components of CBB's financial sector surveillance framework. Produced semi-annually by the Financial Stability Directorate (FSD), its principal purpose is macro-prudential surveillance, assessing the safety and soundness of the financial system as a whole (intermediaries, markets and payments/settlement systems).

The ultimate objective of such macro-prudential analysis is to identify potential risks to financial stability and mitigate them before they crystallize into systemic financial turbulence.

This edition of the FSR is organized as follows: **Chapter 1** reviews recent international and domestic macro-financial developments. **Chapter 2** examines the financial position of households and business enterprises as well as trends in the construction and real estate sector while **Chapter 3** evaluates the financial condition and performance of the banking sector (conventional and Islamic).

Chapter 4 assesses the financial condition and performance of the conventional insurance industry and **Chapter 5** reviews recent trends on the equity market. **Chapter 6** focuses on stability issues relating to the payment and settlement systems. **Annex 1** presents selected Financial Soundness Indicators (FSIs) for the various segments of the banking sector.

Unless indicated otherwise, this report analyzes data covering the period between end-March 2009 and end-September 2009.

Executive Summary

Overall assessment

Although the global financial crisis generated liquidity pressures and led to losses on mortgage-related assets for some banks, the Bahraini financial system did not experience a *systemic* crisis. However, after some lag, the sector is now suffering significant second-round effects, in the form of higher delinquency rates on bank loans. A sharp slowdown in bank lending and broad money growth has resulted in lethargic economic activity for most of 2009. Consequently, we have seen an increase in the level of non-performing loans across all banking segments.

While Bahraini banks presently have ample capital cushions to cope with any loan losses, further deterioration in asset quality may impose much greater pressure on bank balance sheets, further delaying the resumption of normal lending activities to the private sector. In a typical vicious cycle, the lack of lending to the private sector could keep economic activity sluggish, possibly creating further delinquencies on outstanding loans.

International and domestic macroeconomic trends

The global economic and financial situation has improved considerably since the last *Financial Stability Report*. Systemic risks in the global financial system have been reduced substantially and growth in the world economy has turned positive again. On the back of expansionary fiscal and monetary policies plus the recovery in commodity prices, global output is expected to grow by 3.1% in 2010, compared to a 1.1% contraction in 2009. Downside risks remain however, especially with regards to the slow pace of reform in financial systems and the danger of a stalled-growth if fiscal stimulus programs end without the full recovery of private demand.

In the GCC, economic activity is down sharply as the credit crunch has hit the region after some lag. An average real GDP growth of only 0.7% is forecast for GCC countries in 2009, compared to 6.4% in 2008. In Bahrain, a similar picture emerges, with real GDP growth of 3% projected for 2009 down from 6.1% in 2008.

The non-financial sector

Due largely to lower projections for nominal domestic output in 2009, debt ratios for *households* and *businesses* rose during the review period. Financing conditions are however easing, with lending rates on both personal and business loans trending downwards. Nonetheless, a combination of slow job creation and declines in average wages suggest that the household sector may find it difficult to meet debt obligations in the coming months. The *construction and real estate sector* is still struggling to recover from the cooling effects of the global financial crisis, as evidenced by a 31% fall in the number of construction permits issued between 2009:Q1 and 2009:Q3.

The banking sector

As economic activity slowed substantially during 2009, the Bahraini banking sector began to experience second-round effects of the global financial turmoil, mainly in the form of deterioration in asset quality. Non-performing loans/facilities have increased across all banking segments, with the situation especially notable in Islamic wholesale banks where non-performing facilities now represent 10.7% of total facilities.

Although banks continue to enhance their capital positions, balance sheets will come under increased pressure in the coming months if the economy remains sluggish, bringing further deterioration in loan quality. Additional downside risks stem from the fact that all banking segments continue to show high levels of asset concentration and income prospects are not particularly bright for many banks (especially wholesale banks) in the current operating environment.

The recent declaration of a debt standstill by Dubai World and the possible “association effects” on Bahrain may also make the operational environment more difficult for internationally active Bahraini banks,

perhaps in the form of higher costs of accessing liquidity in global markets.

The insurance industry

There are no financial stability concerns in the insurance industry. Solvency margins are substantial and companies continue to share risks more broadly with re-insurance companies. Net income remains positive, on the back of a substantial rise in net investment income. The level of receivables has also been reduced, reversing the increase reported in the last *Financial Stability Report*.

Equity markets

Like other GCC equity markets, the Bahraini Stock Exchange has suffered from the global financial crisis, with declines in market capitalization and in the main price index. Although there are now signs of a recovery in the market as investor confidence makes a tentative return, the available data indicates that the Bahraini market fared worse than other GCC markets during 2009 and is struggling to shake off the effects of the crisis. The situation in Bahrain may be due to lingering investor concerns about prospects for the financial sector, since financial stocks are prominent in the BSE All-Share Index.

Payments and settlement system

The various components of Bahrain's payments and settlement framework continue to function efficiently. The RTGS in particular remains a robust system for processing retail and wholesale payments in Bahrain. Credit, liquidity and operational risks are minimal and there are no financial stability concerns at this time.

1. International and Domestic Macro-Financial Developments¹

Key Points

Global economy recovers slowly from recession

Pace of financial sector repair is slow

In the wake of the global recession, inflation rates remain low

Bahrain witnesses a slowdown in bank lending and economic activity

From a financial stability perspective, a review of international macroeconomic trends is important because globalization has increased the potential for cross-border transmission of economic and financial shocks. This is particularly relevant to Bahrain, as a small, open economy with a fixed exchange rate and fully open capital account.

In addition, developments in the domestic macroeconomic environment have a strong influence on financial stability as adverse movements in key macroeconomic indicators can increase various types of risk facing financial institutions or lead to the emergence of serious vulnerabilities. Indeed, lessons of experience with episodes of financial crisis have shown that macroeconomic shocks have often preceded financial crises.

¹ This chapter draws on various projections and analysis contained in the IMF's *World Economic Outlook*, October 2009 and *Global Financial Stability Report*, October 2009.

Global recession is ending

Available data indicates that growth in the world economy has turned positive again. In the advanced countries, several policy measures such as large fiscal stimulus packages, cuts in interest rates and “quantitative easing” by central banks have combined to stave off a prolonged recession. Further, relatively strong growth in Asian emerging economies plus the recovery in commodity prices have helped to boost the global economy. As a result, following a 1.1% contraction in 2009, global output is expected to expand by roughly 3.1% in 2010 (Table 1.1). As a group, the *advanced economies* are expected to grow by 1.3% in 2010, reversing a 3.4% contraction in 2009. *Emerging and developing economies* will grow by 5.1% in 2010, driven mainly by strong growth in China and India.

Table 1.1: Global Output Growth—2007-2010 (% changes)

	2007	2008	2009*	2010*
World	5.2	3.0	-1.1	3.1
Advanced Economies	2.7	0.6	-3.4	1.3
United States	2.1	0.4	-2.7	1.5
Euro Area	2.7	0.7	-4.2	0.3
Japan	2.3	-0.7	-5.4	1.7
Emerging and Developing Economies	8.3	6.0	1.7	5.1
Developing Asia	10.6	7.6	7.6	6.2
---China	13.0	9.0	8.5	9.0
---India	9.4	7.3	5.4	6.4
Middle East	6.2	5.4	2.0	4.2
Africa	6.3	5.2	1.7	4.0

*IMF projections

Source: International Monetary Fund, *World Economic Outlook*, October 2009.

Nonetheless, the pace of recovery is expected to be slow and there are concerns that the recovery may stall as the impact of fiscal stimulus packages diminish while the level of private consumption and investment spending remains depressed. The “sick” financial sectors in many countries may also impose a drag on growth as banks are slow to resume lending to the private sector.

The successful restructuring of impaired financial systems is therefore a necessary condition for putting the global economy on a sustained path to a full recovery.

Slow pace of financial sector repair

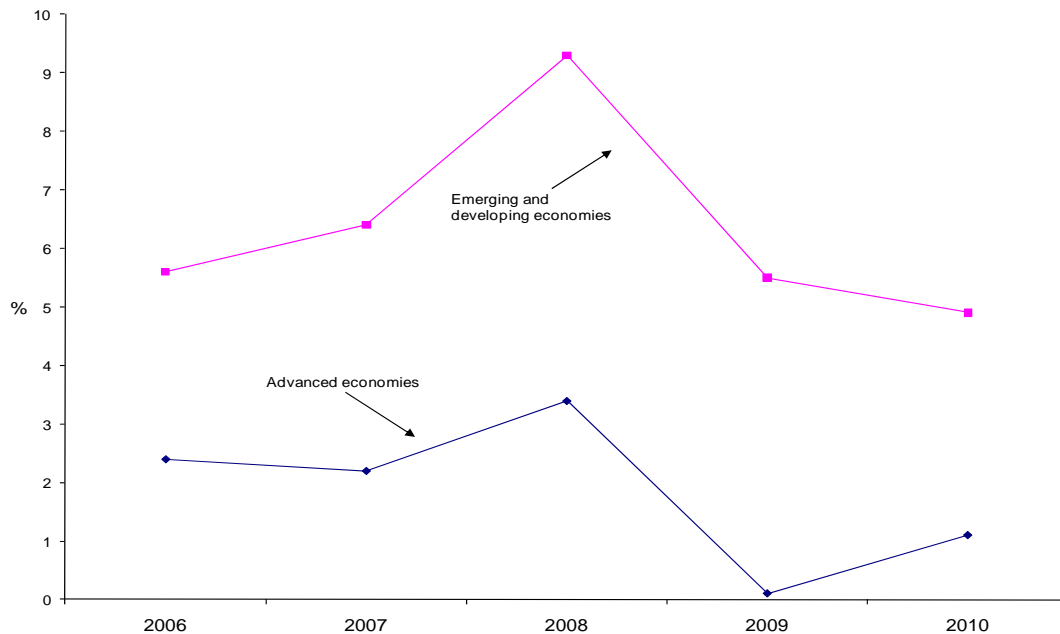
Although systemic risks in the global financial system have been reduced substantially since the last *Financial Stability Report*, there are still signs of impairment in several areas. While many banks have successfully rebuilt their capital cushions, the process of de-leveraging is not yet complete and the pace of lending to the private sector remains slow. Increasing delinquencies on private sector loans in several countries are also putting pressure on bank balance sheets.

It is therefore imperative that the ongoing restructuring of bank balance sheets be completed successfully. Impaired and illiquid assets need to be removed completely from bank books so that normal financial intermediation is resumed. Progress is also needed on proposals for regulatory reforms to enhance the resilience of financial systems to future shocks. Worryingly, as memories of the crisis begin to fade, there are signs that much-needed regulatory reform may be diluted or not even materialize. Despite substantial public outrage to the regulatory and institutional failings that created the crisis, very little progress has been made in putting in place much-needed regulatory and institutional reforms.

Global recession brings low inflation

Due to the deterioration of the global economy in the last quarter of 2008, there has been a sharp fall in global consumer prices. Following a 3.4% rate in 2008, consumer price inflation in the advanced countries for 2009 is projected at 0.1%, with a 1.1% rate anticipated in 2010 (Chart 1.1). While inflation in emerging markets rose from 6.4% in 2007 to 9.3% in 2008, moderation to 5.5% is anticipated in 2009, with a further fall to 4.9% in 2010.

Chart 1.1: Global Consumer Prices, 2006-2010 (annual % change)*



*2009 and 2010 IMF projections

Source: International Monetary Fund, *World Economic Outlook*, October, 2009

GCC economies affected by the crisis

As oil prices plummeted from a peak of \$147 per barrel in mid-2008 to roughly \$30 per barrel by early 2009, economic activity slowed down substantially in the GCC countries. Financial systems in some of the countries were also directly impacted by the global financial crisis, creating domestic shortages of liquidity and necessitating substantial government support for financial institutions. Stock markets also experienced large losses. In addition, we witnessed a sharp deceleration of net capital inflows into the region as global liquidity dried up and risk aversion spread through financial markets around the world.

As a result, a real GDP growth of only 0.7% is forecast for the GCC countries in 2009, compared to 6.4% in 2008 (Table 1.2). Output from the oil sector will be particularly hard-hit, with the sector expected to contract by 5.2% in 2009. One benefit of the slowdown is the easing of inflationary pressures, with consumer price inflation falling from a high average of 10.8% in 2008 to 3.7% in 2009. The growth of broad money has also slowed considerably, from 20% in 2008 to 7.9% in 2009.

Table 1.2: Selected GCC Economic Indicators, 2007-2010

	2007	2008	2009*	2010*
Real GDP growth (%)	5.0	6.4	0.7	5.2
--Oil (%)	0.9	5.8	-5.2	5.5
--Non-oil (%)	7.0	6.6	3.2	4.4
Inflation (%)	6.3	10.8	3.7	3.8
Broad money growth (%)	27.2	20.0	7.9	8.6
Fiscal balance (% of GDP)	17.6	27.4	5.3	10.4
Exports of Goods and Services (\$ billions)	595.8	820.5	574.3	704.6
Imports of Goods and Services (\$ billions)	385.5	513.8	478.2	516.3
Current account balance (% of GDP)	24.8	26.3	6.3	14.2
Gross Official Reserves (\$ billions)	422.4	522.9	557.1	640.3

**IMF projections*

Source: International Monetary Fund, Regional Economic Outlook: Middle East and Central Asia, October 2009.

The external accounts will also be impacted, with the overall GCC current account surplus projected to shrink markedly from 26.3% of GDP in 2008 to only 6.3% in 2009.

GCC governments have responded to the crisis by expanding public spending substantially, especially on infrastructure projects. This has helped to fill the gap created by falling private demand. This policy has helped to mitigate the impact of the crisis on the real economy in the region. The use of counter-cyclical fiscal spending, the recent recovery in oil prices and the return of positive global growth should combine to put the GCC economies on a stronger footing in the coming months.

Hence, forecasts indicate that real GDP growth should recover to 5.3% in 2010, with the oil sector growing by 5.5%, reversing the contraction witnessed in 2009. Inflation will remain subdued at 3.8% and the current account surplus is forecast to reach a robust 10.6% of GDP.

Global crisis impacts the Bahraini economy

Table 1.3 below presents IMF projections for key macroeconomic indicators in Bahrain (2009-2010). As in other GCC countries, Bahrain is expected to experience a sharp slowdown in real GDP growth in 2009. A 3% growth rate is forecast, compared to 6.1% in 2008 and 8.1% in 2007. Broad money growth is expected to fall sharply from 18.4% in 2008 to 2.7% in 2009, contributing to the sluggish pace of economic activity. In the current environment of weaker domestic demand and lower global commodity prices, inflation has remained relatively low at around 3%, with a 2.5% rate forecast for 2010.

Table 1.3: Selected Economic Indicators for Bahrain, 2007-2010

	2007	2008	2009*	2010*
Real GDP growth (%)	8.1	6.1	3.0	3.7
--Oil (%)	1.1	1.2	0.1	0.1
--Non-oil (%)	9.2	6.9	3.5	4.2
Inflation (%)	3.3	3.5	3.0	2.5
Broad money growth (%)	40.8	18.4	2.7	12.3
Fiscal balance (% of GDP)	3.2	8.0	-4.7	-0.7
Exports of Goods and Services (\$ billions)	17.2	21.1	15.6	18.0
Imports of Goods and Services (\$ billions)	12.3	15.7	12.3	14.0
Current account balance (% of GDP)	15.8	10.6	3.7	6.2
Gross Official Reserves (\$ billions)	4.1	3.8	4.1	5.7

**IMF projections*

Source: International Monetary Fund, Regional Economic Outlook: Middle East and Central Asia, October 2009.

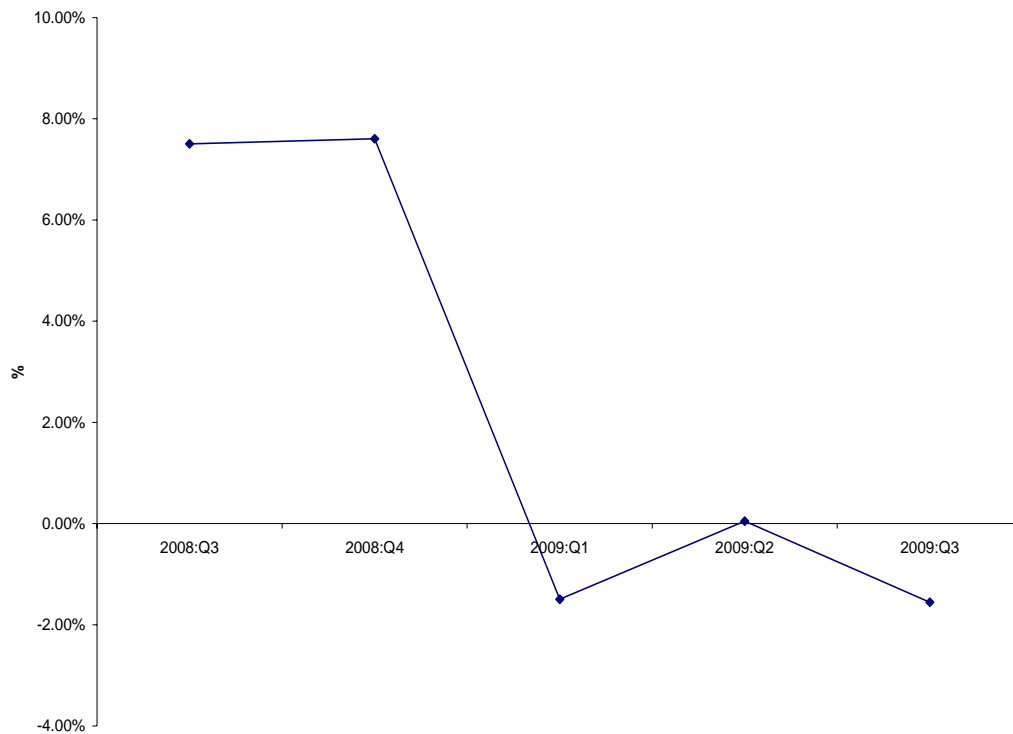
With oil receipts accounting for over 75% of government revenues, the collapse in oil prices in 2008 put Bahrain's fiscal accounts under pressure. A fiscal deficit amounting to 4.7% of GDP is projected for 2009, in contrast to a surplus of 8% in 2008. A large part of the resulting financing requirement was raised through a \$750 million international *Sukuk* issue in June 2009 and the government is also expanding its domestic borrowing program to tap available liquidity in the Bahraini debt markets.

Bahrain's external accounts have also been impacted by the fall in commodity prices. The current account surplus shrank from 15.8% of GDP in 2007 to 10.6% in 2008, with a 3.7% figure expected for 2009.

Projections from the IMF suggest that real GDP growth should rise to 3.7% in 2010, marginally higher than the 3% of 2009. However, significant downside risks remain and the fulfillment of these forecasts will depend largely on the resumption of normal credit flow into the real economy.

As evident from Chart 1.2 below, private sector credit growth turned negative in 2009:Q1 and has been struggling since to regain positive territory.

Chart 1.2: Growth Rate of Private Sector Credit (% change)



Source: Central Bank of Bahrain

2. The Non-Financial Sector

Key Points

Household and business debt ratios rise.

Sharp fall in net job creation.

Activity remains subdued in the construction and real estate sector.

The assessment of financial stability requires an evaluation of the financial condition and performance of non-financial entities: households, business enterprises, as well as the construction and real estate sector. Households and business enterprises are the major customers of financial institutions. Not only are they sources of deposits, they represent major sources of demand for financial sector products and services. The financial condition and performance of financial institutions therefore depend to a large extent on the financial condition of their customers (households and enterprises) and their vulnerabilities to changes in the economic environment.

The construction and real estate sector receives special attention because this sector is usually highly sensitive to developments in macroeconomic conditions and financial institutions in Bahrain have direct and indirect exposures to the sector.

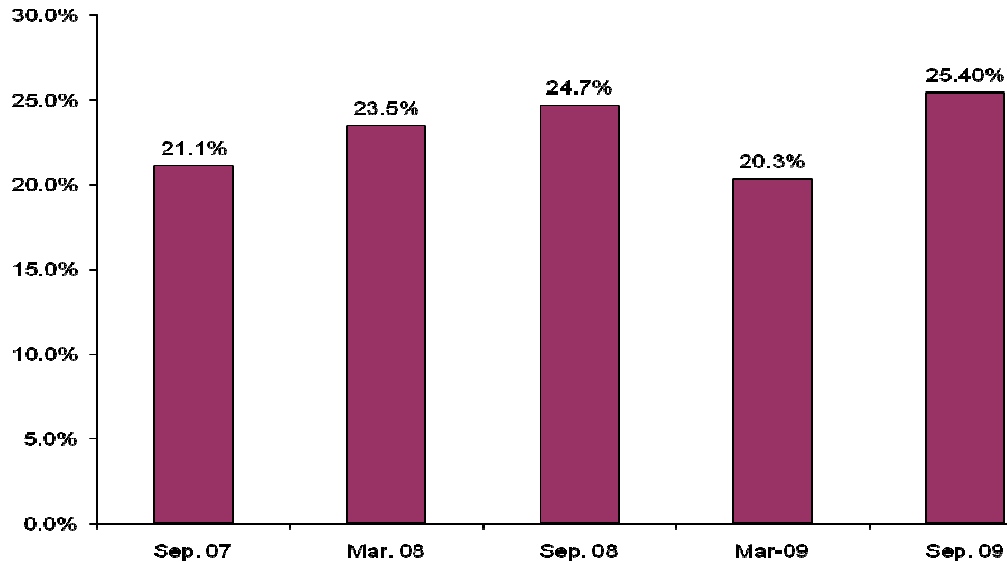
2.1. Households

Debt ratio rises

Between March 2009 and September 2009, the ratio of personal loans to GDP rose from 20.3% to 25.4%, largely due to lower projected nominal GDP for 2009 (Chart 2.1). Economic activity has remained sluggish as a result of the credit crunch, notwithstanding the recent recovery in oil prices. However, in a reverse of the situation observed back in March 2009, personal loans rose by 2.7% between March and September 2009,

indicating some willingness of banks to start lending again (Chart 2.2). Financing conditions also appear to be easing, with personal loan rates generally trending downward since 2009:Q2 (Chart 2.3).

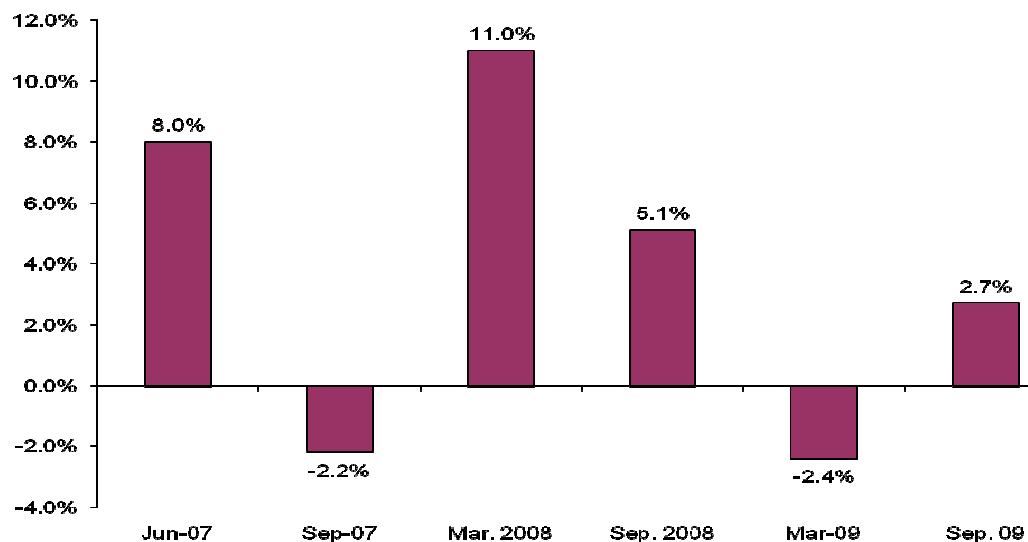
Chart 2.1: Personal Loans and advances (% of Nominal GDP)**



** 2009 nominal GDP is IMF projection

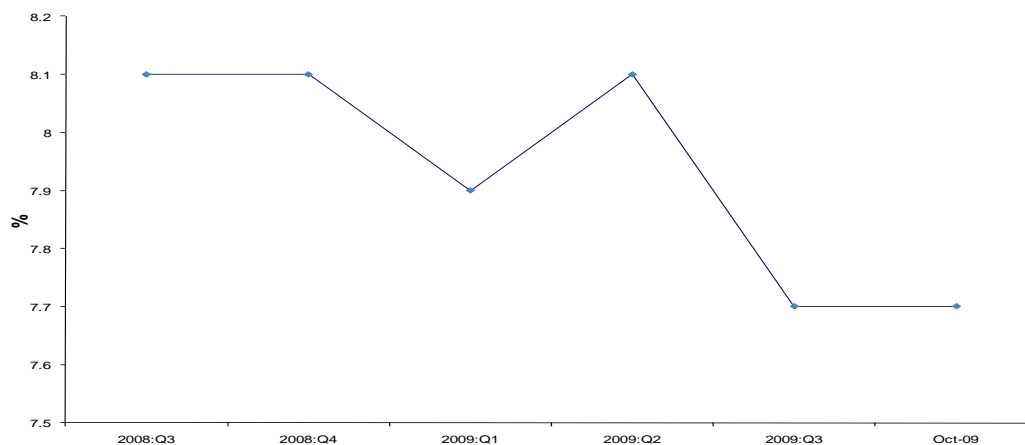
Source: Central Bank of Bahrain

Chart 2.2: Growth Rate of Total Personal Loans and Advances (%)



Source: Central Bank of Bahrain

Chart 2.3: Retail Banks – Average Interest Rates on Personal Loans (%)



Source: Central Bank of Bahrain

Negative trends for household income risks

Household income is a principal source of funds to service and repay debt. Trends in employment could therefore be used to gauge the level of household income risks. As at end-2009:Q3, the overall employment level in Bahrain stood at 485,834, compared to the 483,777 recorded at the end of 2009:Q1. This net addition of 2,057 jobs over the period represents a dramatic fall in job creation in Bahrain. To put this in sharper perspective, the same period of 2008 witnessed a net addition of 48,294 jobs. These numbers indicate that the credit crunch has impacted the real sector significantly.

Trends in wages have also been negative. As at end-September 2009, average private sector wages stood at BD266 per month, compared to BD269 per month in March 2009 (Table 2.1). Also, average monthly public sector wages fell from BD802 per month in March 2009 to BD778 per month in September 2009.

Table 2.1: Average Monthly Wages (BD)

	2008:Q2	2008:Q3	2008:Q4	2009:Q1	2009:Q2	2009:Q3
Private Sector	248	248	264	269	266	266
Public Sector	782	770	797	802	805	778

Sources: General Organisation for Social Insurance and Civil Service Bureau

Overall, the combination of slow job creation and declines in average wages suggest that the household sector may struggle to continue meeting outstanding debt obligations. We may therefore begin to see increased delinquencies on personal loans in the coming months if the pace of economic activity remains at the current sluggish levels².

2.2. Business Enterprises

Business debt ratio rises

Similar to the situation for household debt, the business debt ratio also rose over the review period (March to September 2009), influenced largely by a fall in projected nominal output for the year. The ratio of business loans to GDP increased from 55.2% to 67.2% (Chart 2.4). Banks are still reluctant to lend to the business sector, going by the 0.4% fall in total business loans and advances between March and September 2009 (Chart 2.5, next page).

Chart 2.4: Business Loans and Advances (% of Nominal GDP)



Source: Central Bank of Bahrain

² We can already see an upward trend in non-performing loans for all banking segments (see Chapter 3).

However, financing conditions appear to be easing, with business loan rates generally trending downward since 2008:Q4 (Chart 2.6).

Chart 2.5: Growth Rate of Total Business Loans and Advances (%)

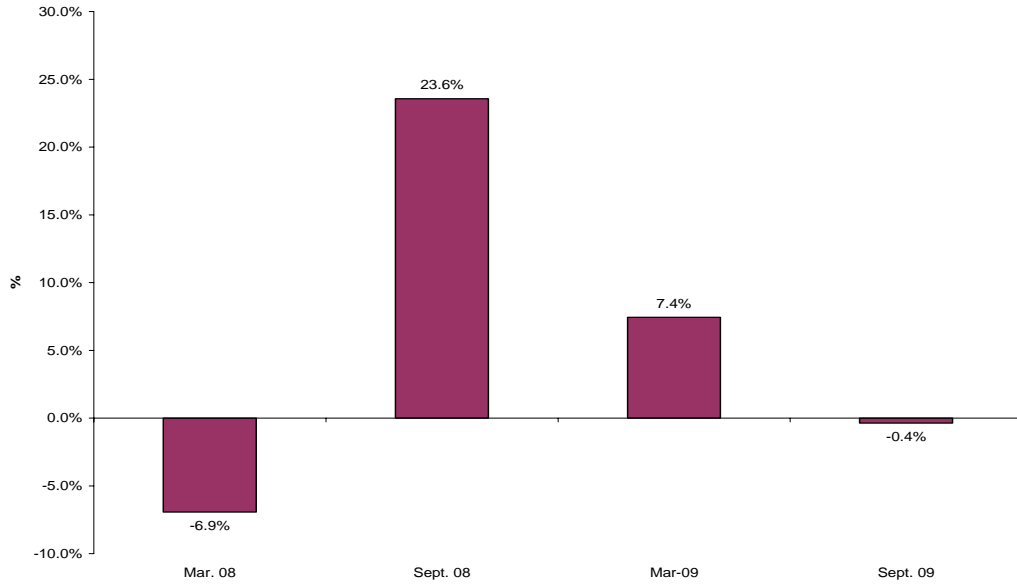
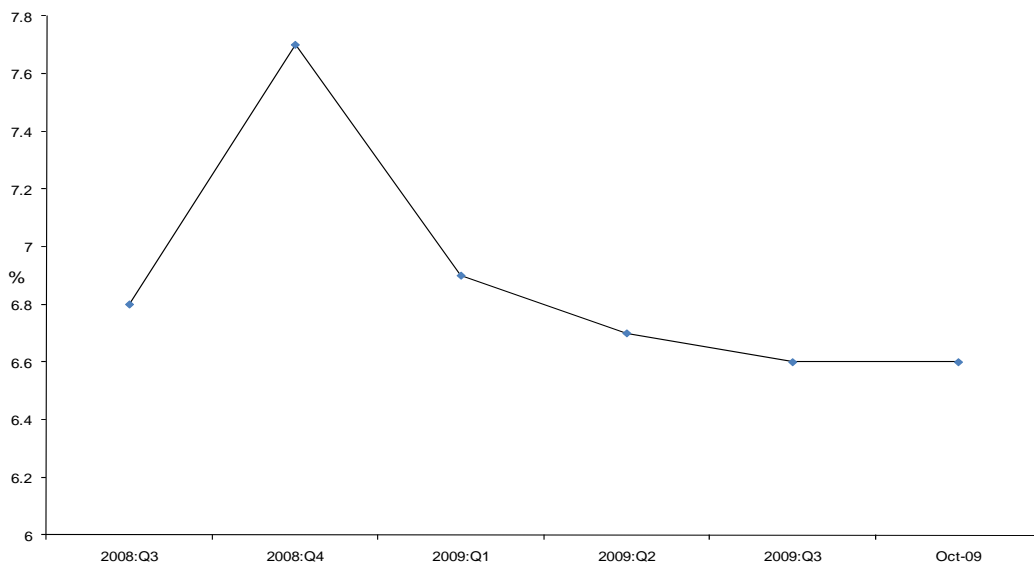


Chart 2.6: Retail Banks – Average Interest Rates on Business Loans (%)



Source: Central Bank of Bahrain

2.3. Construction and Real Estate

Increase in licenses issued for construction and real estate

The number of licenses issued for construction, real estate and associated activities rose from 369 during 2009:Q1 to 443 in 2009:Q2 (Table 2.2). However, there was a decline in the number of licenses issued during the third quarter (426), compared to 2009:Q2 (443). This suggests that the construction and real estate sector is still struggling to mount a sustained recovery from the effects of the global crisis.

Additional evidence of this assessment is provided by the 31% fall in the number of construction permits issued from 923 during 2009:Q1 to 638 during 2009:Q3 (Table 2.3).

Table 2.2: Commercial Licenses Issued for Construction and Real Estate

	2008:Q1	2008:Q2	2008:Q3	2008:Q4	2009:Q1	2009:Q2	2009:Q3
Construction	149	221	162	171	166	179	204
Real Estate, Rentals and Associated Activities	294	280	268	244	203	264	222
Total	443	501	430	415	369	443	426

Source: Ministry of Municipality Affairs and Agriculture

Table 2.3: Selected Construction Permits by Type

	2008:Q1	2008:Q2	2008:Q3	2008:Q4	2009:Q1	2009:Q2	2009:Q3
Demolition and New construction	36	48	28	17	26	10	16
New construction	816	1146	903	818	896	764	619
Reclamation	7	16	6	7	1	3	3
Total	859	1210	937	842	923	777	638

Sources: Ministry of Municipality Affairs and Agriculture

OVERALL ASSESSMENT OF THE NON-FINANCIAL SECTOR

The debt ratio for both *households and businesses* has increased, largely due to the projected fall in national output for 2009. However, financing conditions have eased, with lending rates trending downward for both personal and business loans. Nonetheless, the combination of slow job creation and declines in average wages suggest that the household sector may struggle to continue meeting outstanding debt obligations. We may therefore see increased delinquencies on personal and business loans in the coming months if the pace of economic activity remains at the current sluggish levels.

For the *construction and real estate sector*, a 31% fall in the number of construction permits issued between 2009:Q1 and 2009:Q3 and the third quarter decline in the number of licenses issued for activities in the sector suggest that the sector is still struggling to mount a sustained recovery from the effects of the global crisis.

3. Financial Condition and Performance of the Banking Sector

Key Points

Bahraini banks boost capital positions further.

Non-performing loans increase across all banking segments.

Profitability increases for retail banks (conventional and Islamic), but wholesale banks (conventional and Islamic) experience losses.

This chapter analyzes the banking sector under the following categories: conventional retail banks (section 3.1), conventional wholesale banks (section 3.2), Islamic retail banks (section 3.3), and Islamic wholesale banks (section 3.4). Section 3.5 provides an overall assessment of the banking industry. Unless specified otherwise, the analysis in this chapter is based on consolidated financial data (Bahraini and non-Bahraini operations), as at end-September 2009.

Annex 1 presents selected *Financial Soundness Indicators (FSIs)* for the different banking segments.

3.1. Conventional Retail Banks

Retail banks further boost capital cushion³

In the uncertain environment created by the recent global financial crisis, retail banks in Bahrain have continued to enhance their capital positions. As at end-September 2009, the aggregate capital adequacy ratio for locally-incorporated retail banks stood at 19.8%, compared to the 16.2% registered at the end of March 2009. In line with the increase in total

³ The capital adequacy ratio relates total capital to risk-weighted assets. The discussion excludes overseas retail banks, which do not have prescribed capital levels or ratios.

regulatory capital, the core capital ratio (ratio of Tier 1 capital to risk-weighted assets) rose to 15.8%, from 12.6% in March 2009. Improvements in capital adequacy ratios were achieved by a combination of direct addition to capital as well as a reduction in risk assets. With bank lending still far below pre-crisis levels, it appears capital cushions are being boosted in a bid to strengthen balance sheets and enhance resilience to any future shocks.

Higher non-performing loans

As economic activity remained sluggish in the aftermath of the global financial crisis, loan delinquencies have been rising over the past year. As at end-September 2009, non-performing loans (NPLs) for conventional retail banks amounted to 6.2% of gross loans, slightly higher than the 5.4% reported for end-March 2009. Although local retail banks continue to show poorer asset quality than their overseas counterparts, the rise in NPLs occurred across both license categories. For *local retail banks*, the average NPL ratio rose from 6% of gross loans in March 2009 to 7% by September 2009, while the NPL ratio for *overseas retail banks* rose from 3% in March 2009 to 4.2% in September 2009.

Available data on the sectoral breakdown of impaired loans indicates that most sectors experienced an increase in impairment between March 2009 and September 2009 (Table 3.1). Notable was the jump in NPLs for the “financial” category, from 2.9% of gross loans in March 2009 to 7.2% in September 2009, undoubtedly due to the adverse impact of the global crisis on financial institutions.

**Table 3.1: Retail Banks’ NPL Ratios by Sector
(% of gross loans to the sector)**

	March 2009	September 2009
Consumer and Personal	2.8	4.5
Government	1.4	1.2
Construction/Real estate	2.5	3.7
Manufacturing	1.7	2.6
Mining & Quarrying	0.0	0.0
Agric, Fishing and Forestry	39.6	44.0
Financial	2.9	7.2
Trade	5.6	7.0
Services	1.0	1.7

Source: Central Bank of Bahrain

“Trade” also showed an increase from 5.6% to 7% over the same period. A very high NPL ratio of 44% was recorded in the “agriculture, fishing and forestry”, up from 39.6% in March. However, we do not consider this to be of much concern, given that this category accounts for only 0.3% of retail banks’ total loans and advances.

Asset concentration ratios rise again

The loan portfolio of retail banks remain concentrated, with an increase in concentration levels over the period under review. As at end-September 2009, the top recipient of loans from *locally-incorporated retail banks* (“construction/real estate”) accounted for 31.8% of total loans, up from 23.9% in March 2009 (Table 3.2). Also, the top two recipient sectors (“construction/real estate and “consumer/personal”) jointly represented 53.4% of loans in September 2009, compared to 43.8% in March 2009.

Notably, there was a sharp increase in the share of “construction/real estate” over the period from 23.9% to 31.8%, while the share of the “manufacturing” sector dropped from 17.2% to 12.6%.

**Table 3.2: Distribution of Local Retail Banks’ Lending
(% shares)****

	Sept. 2008	Mar. 2009	Sept. 2009
Consumer and Personal	25.2	19.9	21.6
Government	4.3	2.7	3.9
Construction/Real estate	28.9	23.9	31.8
Manufacturing	10.5	17.2	12.6
Mining & Quarrying	1.6	1.6	0.5
Agric, Fishing and Forestry	0.4	0.3	0.4
Financial	10.4	11.2	11.4
Trade	8.2	9.9	8.2
Services	10.5	13.3	9.6

Source: Central Bank of Bahrain

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

End-September 2009 numbers also show higher concentration risks for *overseas retail banks* (Table 3.3). The top recipient of loans was the “services” sector with 35.4% of total loans, displacing the “manufacturing” sector which was the top recipient in March 2009 with 27.8%. The top two recipients of loans (“services” and “manufacturing”) jointly accounted for 55.6% of total loans, compared to 51.3% in March 2009.

Table 3.3: Distribution of Overseas Retail Banks’ Lending (% shares)*

	Sept. 2008	Mar. 2009	Sept. 2009
Consumer and Personal	5.1	9.3	11.3
Government	0.4	2.2	1.0
Construction/real estate	9.1	11.8	12.8
Manufacturing	37.2	27.8	20.2
Mining & Quarrying	0.4	1.3	0.2
Agric, Fishing and Forestry	0.3	0.3	0.1
Financial	12.7	11.6	7.9
Trade	9.8	12.2	11.1
Services	25.0	23.5	35.4

Source: Central Bank of Bahrain

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

Improvements in retail bank profitability

As at end-September 2009, return-on-assets (ROA) for locally-incorporated banks was 0.9%, higher than the 0.4% recorded for March 2009. For overseas banks, ROA was 1.3%, compared to 0.6% in March 2009. Return-on-equity (ROE) for locally-incorporated banks rose to 8.1%, from 5.7% in March 2009.

A breakdown of data on retail banks’ earnings shows that the recovery in earnings was driven by a sharp improvement in the net interest position, with net interest income rising from 58.3% of total income in March 2009 to 66.1% in September 2009. However, if asset quality continues to deteriorate, the need for additional provisions is likely to eat into future bank earnings.

Liquidity position tightens

Between March 2009 and September 2009, retail bank deposits declined by 15.2%, influenced largely by a 23% drop in bank deposits (non-bank deposits fell by 10%). The overall loan-deposit ratio for the segment consequently rose to 77.7%, compared to 68.4% in March 2009. Also, liquid assets as a proportion of total assets fell marginally to 18.0% (from 18.4% in March), while liquid assets as a proportion of short-term liabilities also declined from 30.9% in March 2009 to 28.6% in September. However, the ratio of non-bank deposits to total deposits rose to 66.8%, compared to 63.4% in March 2009, indicating an increase in the proportion of stable funds available to retail banks.

3.2. Conventional Wholesale Banks

Further improvement in capital adequacy⁴

As at end-September 2009, the regulatory capital adequacy ratio for locally-incorporated wholesale banks stood at 21.0%, compared to 20.4% in March 2009. The core capital adequacy position (ratio of Tier 1 capital to risk-weighted assets) also rose from 17.8% to 18.3%. Improvements in capital adequacy ratios were achieved by a combination of direct addition to capital as well as a reduction in risk assets.

Increase in non-performing loans

The upward trend in capital cushions is welcome as asset quality is deteriorating for wholesale banks. As at end-September 2009, loans classified as non-performing (NPLs) amounted to 4.5% of gross loans, up from the 1.6% recorded in March 2009. Locally-incorporated wholesale banks show an NPL ratio of 6.2%, higher than the 3.5% of March 2009. Overseas wholesale banks had an NPL ratio of 3.7%, higher than the 0.7% witnessed in March 2009.

⁴ The capital adequacy ratio relates total capital to risk-weighted assets. The discussion excludes overseas wholesale banks, which do not have prescribed capital levels or ratios.

Available data on the sectoral breakdown of impaired loans shows a jump in the impairment rate for the “trade” sector from 0.6% in March 2009 to 8.2% in September 2009 (Table 3.4). Increases were also recorded for “financial” (from 1% to 4.8%) and “construction/real estate” (from 0.3% to 4.1%). In contrast, we witnessed a sharp fall in the impairment rate on “consumer/personal” loans, from 11.5% in March to 2.5% by September.

**Table 3.4: Wholesale Banks’ NPL Ratios by Sector
(% of gross loans to the sector)**

	March 2009	September 2009
Consumer and Personal	11.5	2.5
Government	0.01	0.1
Construction/Real estate	0.3	4.1
Manufacturing	1.1	1.2
Mining & Quarrying	0.1	0.01
Agric, Fishing and Forestry	2.7	1.9
Financial	1.0	4.8
Trade	0.6	8.2
Services	0.4	1.4

Source: Central Bank of Bahrain

Loan portfolios remain concentrated by sector

An examination of lending patterns as at end-September 2009 shows that for *locally-incorporated wholesale banks*, the top recipient of loans (“manufacturing”) accounted for 29% of total loans, up from 27.2% in March (Table 3.5). Also, the top two sectors (manufacturing and services) accounted for 48.2% of total lending, slightly higher than the 47.5% recorded for March.

Table 3.5: Distribution of Local Wholesale Banks’ Lending (% shares)*

	Sept. 2008	Mar. 2009	Sept. 2009
Consumer and Personal	3.3	3.3	2.4
Government	2.2	2.5	2.1
Construction/Real estate	12.3	13.0	13.7
Manufacturing	25.0	27.2	29.0
Mining & Quarrying	1.6	1.1	1.6
Agric, Fishing and Forestry	0.8	0.6	1.1
Financial	20.6	20.3	17.5
Trade	15.7	14.1	13.4
Services	18.5	17.8	19.2

Source: Central Bank of Bahrain

*Figures may not add to a hundred due to rounding

In *overseas wholesale banks*, the top recipient of loans in September 2009 was the “services” sector, with 31.6% of total loans (vs. 31.7% in March) (Table 3.6). The top 2 sectors (services and financial) jointly represented 54.9% of total loans, slightly higher than the 53.6% recorded for March 2009.

Table 3.6: Distribution of Overseas Wholesale Banks’ Lending (% shares)*

	Sept. 2008	Mar. 2009	Sept. 2009
Consumer and Personal	0.3	0.3	0.5
Government	6.5	7.0	7.4
Construction/Real estate	9.4	8.5	9.6
Manufacturing	22.1	21.1	18.2
Mining & Quarrying	2.6	3.2	2.7
Agric, Fishing and Forestry	0.4	0.3	0.6
Financial	21.4	21.9	23.3
Trade	6.1	5.9	6.1
Services	31.1	31.7	31.6

Source: Central Bank of Bahrain

*Figures may not add to a hundred due to rounding

Negative earnings for wholesale banks

In a reversal of the earnings picture in March 2009, conventional wholesale banks experienced net losses (as a group) in the period up to September 2009, due to a deterioration in the earnings of overseas wholesale banks⁵. Return-on-assets (ROA) for the group was a *negative* 0.3%, compared to a *positive* 0.2% in March 2009. ROA for local wholesale banks was a positive 0.1% (down from 0.5% in March 2009), while ROA for overseas wholesale banks was a *negative* 0.7% (vs. positive 0.03% in March 2009). ROE for local wholesale banks was 1%, down from 3.9% in March 2009. Wholesale bank earnings are under severe pressure due to a substantial rise in operating costs over the period.

Mixed picture on liquidity

As at end-September 2009, the overall loan-deposit ratio for conventional wholesale banks stood at 81.5%, up from 79.8% in March 2009. The loan deposit ratio for *overseas wholesale banks* was 90.2% (compared to 87% in

⁵ There was a sharp increase in provision charges for overseas wholesale banks.

March 2009), while the loan-deposit ratio for local wholesale banks rose more modestly to 67.3% from 64% in March.

On a positive note, liquid assets for wholesale banks represented 20.4% of total assets in September 2009, a significant improvement from the 14.6% level attained in March. Further, 31.5% of wholesale bank deposits were from non-bank sources, up from the 27.4% observed in March 2009.

3.3. Islamic Retail Banks

Boost in capital positions

In a reversal of the recent trend of falling capital levels, the capital adequacy ratio of Islamic retail banks rose to 24.5% by the end of September 2009, up from 22.4% in March 2009. Correspondingly, the Tier 1 capital ratio also rose to 22.2%, compared to 21.8% in March. Improvements in capital adequacy ratios were achieved principally through direct additions to capital as the level of risk-weighted assets rose slightly over the period.

Increase in non-performing facilities

The asset quality of Islamic retail banks has deteriorated, with non-performing facilities (NPFs) in September 2009 standing at 5% of total facilities, versus 3.5% in March. A look at the sectoral breakdown of non-performing facilities indicates that the “trade” sector now shows the highest level of NPF (9.8%), following by “manufacturing” and “personal/consumer finance” (9.5% each).

High asset concentration

As is the case with conventional retail banks, asset concentration risks continue to be an issue with regard to Islamic retail banks. As at end-September 2009, the top recipient of financing (construction/real estate) accounted for 33.7% of total financing, down from 37% in March. However, the top two recipients of financing (construction/real estate and financial) jointly represented 60.8% of total financing as at end-September 2009, much higher than the 48% recorded for March 2009.

Improvement in earnings

The return on assets (ROA) for Islamic retail banks rose to 0.8% in September 2009, from 0.5% in March. Over the same period, the return on equity increased from 3.5% to 5%. Available data shows that 73% of Islamic retail banks' income were in the form of net income from own funds, current accounts and other banking activities, while 18.5% of income came from jointly financed accounts and Mudarib fees. Operating costs are relatively high at 70.2% of operating income, up from 56.6% in March 2009.

Liquidity picture worsens

The volume of liquid assets available to Islamic retail banks fell to 16.5% in September 2009, from 21% in March. At the same time, the ratio of total facilities to deposits rose from 74.6% in March 2009 to 79.2% in September.

3.4. Islamic Wholesale Banks

Improvement in capital position

As at end-September 2009, the regulatory capital adequacy ratio (CAR) for Islamic wholesale banks stood at 22.7%, down from the 25.2% figure for March 2009. The core capital ratio (ratio of Tier 1 capital to risk-weighted exposures) also declined from 25.2% to 22%. The declining ratio was due mainly to a rise in risk-weighted assets. Although the current level is still well-above regulatory requirements, this is the only banking segment showing a fall in capital adequacy ratio over the review period.

Sharp rise in non-performing facilities (NPFs)

As at end-September 2009, NPFs in Islamic wholesale banks stood at 10.7%, compared to the 5.3% recorded for March 2009. A look at the sectoral breakdown of non-performing facilities raises some concerns, with the NPF ratio for "manufacturing" at 18.5%, "financial" at 12.6% and "trade" recording 9.5%.

Reduced asset concentration

As at end-September 2009, the “services” sector displaced “financial” as the top recipient of financing from Islamic wholesale banks, accounting for 21.8% of total financing facilities. The top sector in March 2009 represented 30% of financing facilities. Also, the top two recipient sectors in September 2009 (services and financial) jointly represented 47.1% of total financing, compared to 51% for the top-2 in March.

Negative earnings

The earnings performance of Islamic wholesale banks continues to be a concern. As a group, they registered net losses in the period to September 2009, with return on assets deteriorating to -0.3% from -0.2% in March. Return on equity (ROE) also worsened from -1% in March 2009 to -1.2% in September 2009.

Mixed picture on liquidity

As at end-September 2009, liquid assets of Islamic wholesale banks represented 21.3% of total assets, down from 24.6% in March. However, Islamic wholesale banks successfully reduced the facilities-deposit ratio, from 108% in March to 86.6% in September 2009.

OVERALL ASSESSMENT OF THE BANKING SECTOR

As economic activity slowed substantially during 2009, the Bahraini banking sector is experiencing second-round effects of the global financial turmoil, mainly in the form of deterioration in asset quality. Non-performing loans/facilities have increased across all banking segments, with the situation especially serious in Islamic wholesale banks where the NPF ratio is now in double-digits (10.7%).

Although banks continue to enhance their capital positions, balance sheets may come under increased pressure in the coming months if economic activity remains sluggish, bringing additional deterioration in loan quality.

Additional downside risks come from the fact that all banking segments continue to show high levels asset concentration risks and income prospects are not particularly bright for many banks (especially wholesale banks) in the current operating environment.

The recent declaration of a debt standstill by Dubai World and the possible “association effects” on Bahrain may also make the operational environment more difficult for internationally active Bahraini banks, in the form of higher costs of accessing liquidity in global markets.

4. Financial Condition and Performance of the Insurance Industry⁶

Key Points

Solvency margins exceed business requirements substantially

Decline in the level of insurance receivables

Growth in net income as investment income rises

Improved capital and solvency positions

Capital levels for the Bahraini insurance sector rose during the review period, from 21.9% of assets in March 2009 to 23.8% as at end-September 2009. As has been the case for the past three years, available capital exceeds required margins of solvency for both general and life business lines.

Insurance receivables fall while re-insurance ceded rises slightly

With the global financial crisis abating, the insurance industry has experienced an improvement in the promptness of premium payments. As a result, the level of insurance receivables declined from 72% of gross premiums in March 2009 to 54.1% in September 2009. The risk retention ratio (net premiums/gross premiums) declined slightly from 74.8% in March 2009 to 74.2% in September 2009.

⁶ Please note that this chapter focuses only on conventional insurance companies and excludes companies licensed to do business in Saudi Arabia.

Net income increases

Net income for insurance companies increased over the period, due largely to a 40% rise in net investment income. This more than compensated for an increase in the expense ratio (ratio of expenses to earned premiums) from 24.5% in March to 28.6% in September 2009.

OVERALL ASSESSMENT OF THE INSURANCE SECTOR

There are no financial stability concerns in the insurance industry. Solvency margins remain substantial and companies continue to share risks more broadly with re-insurance companies. While the expense ratio rose between March and September 2009, an increase in net investment income has helped to keep net income positive.

5. Performance of Equity Markets

Key Points

Significant year-on-year decline in market capitalization, similar to the trend in other GCC markets

However, during 2009, other GCC markets have showed stronger signs of recovery than Bahrain's.

Nonetheless, some sectors such as "insurance" recorded increases in market capitalization between May and October 2009

Market activity is likely to remain subdued for a few more months

Significant decrease in market capitalization

As at end-October 2009, market capitalization of the Bahrain Stock Exchange (BSE) stood at BD6.3 billion, equivalent to 94% of projected 2009 nominal GDP (Table 5.1). This level of market capitalization is about 5.5% lower than the level as at end-May 2009 but 38.9% down *year-on-year*.

Table 5.1: Market Capitalization on the Bahrain Stock Exchange (BD Million)

	Oct. 2008	May 2009	Oct. 2009	May 2009 – Oct. 2009 % change	Oct. 2008 – Oct. 2009 % change
Commercial banks	3535.2	2,321.0	2,335.1	0.6	-33.9
Investment	4971.7	2,820.1	2,382.0	-15.5	-52.1
Insurance	209.0	196.5	1,67.4	-14.8	-19.9
Services	1390.3	1,142.6	1,219.9	6.8	-12.3
Industrial	16.0	13.9	17.5	25.9	9.4
Hotel and Tourism	154.1	154.2	160.9	4.3	4.4
TOTAL	10276.2	6,648.3	6,282.9	-5.5	-38.9

Source: Bahrain Stock Exchange

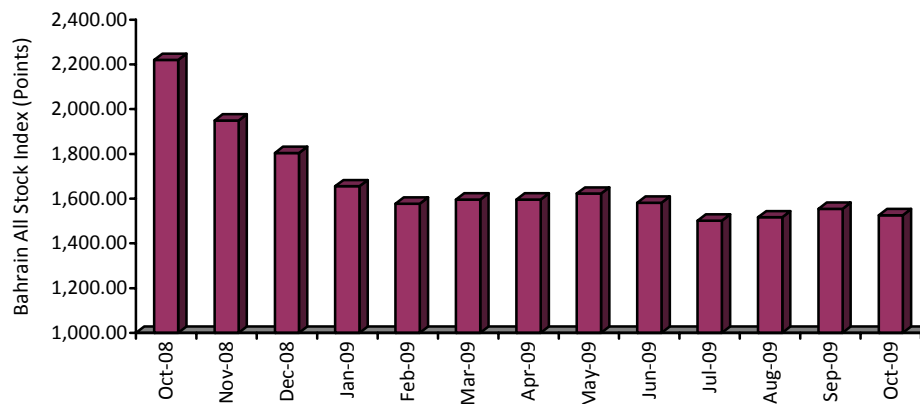
Undoubtedly, this trend reflects the negative impact of the global financial crisis on financial markets across the globe and in the GCC in particular. A breakdown of market capitalization by sector indicates that only the “Industrial” and “hotel and tourism” sectors recorded year-on-year gains of 9.4% and 4.4% respectively. The largest decline occurred in the “Investment” sector, where market valuation fell by 52.3%.

However, there are signs of recovery in some sectors, with the “Industrial” sector registering a 25.9% increase in capitalization between May and October 2009 and more modest gains for “services” (6.8%), “hotel and tourism” (4.3%) and “commercial banks” (0.6%). These gains were however overwhelmed by the substantial declines in “investment” (-15.5%) and “insurance” (-14.8%).

Downward trend in market index

A look at year-on-year data shows that the Bahrain All Share Index lost a total of 694.34 points (a 31.3% decrease) between October 2008 and October 2009 (Chart 5.1). November 2008 was a particularly bad month, during which the Index lost a total of 271 points. Although a turnaround seemed to have begun in March 2009, the Index has fluctuated somewhat between June and end-October 2009, when it stood at 1525.83 points, still far below the peaks attained in 2008.

Chart 5.1: Recent Trends in the BSE All-Share Index, Oct. 2008-Oct. 2009



Source of Data: Bahrain Stock Exchange

GCC Market Trends

A look at market indices for Gulf stock markets indicates significant year-on-year falls in market capitalization in Kuwait (-24.9%), Dubai (-25.3%), and Abu Dhabi (-40%)(Table 5.2). In contrast, there were double-digit gains for the Saudi market (13.2%) and the Muscat exchange (15.5%). The Doha Index also showed a small gain of 3% year-on-year. However, if we concentrate on the period between May and October 2009, it appears that only the Bahraini and Kuwaiti markets are still struggling to overcome the worst effects of the crisis, showing losses of 5.9% and 9.8% respectively. All the other markets in the GCC recorded increases in their price indices over the same period.

Table 5.2: Stock Market Indices in GCC counties

	Oct. 2008	May 2009	Oct. 2009	May 2009 – Oct. 2009 change (%)	Oct. 2008 – Oct. 2009 change (%)
Bahrain All Share Index	2,220.17	1,622.15	1,525.83	-5.9	-31.3
Tadawul All Share Index	5,537.82	5,893.34	6,268.55	6.4	13.2
Kuwait Market Index	9,789.3	8,150	7,347.5	-9.8	-24.9
Doha Stock Market 20 Index	6,928.00	6,980.76	7,135.08	2.2	3.0
Dubai Financial Market Index	2942.03	1878.09	2,197.52	17.0	-25.3
Abu Dhabi Index	5,037.85	2,679.41	3,023.10	12.8	-40.0
Muscat Securities Market Index 30	5,500.320	6,209.960	6,354.920	2.3	15.5

Sources: Bahrain Stock Exchange, Saudi Stock Exchange, Kuwait Stock Exchange, Dubai Financial Market, Abu Dhabi Securities Exchange, and Muscat Securities Market

Drop in price-earning ratios

As at October 2009, the price-earning ratio (P-E ratio) for the stock market stood at 7.28, down from the 7.81 attained in May 2009 and the 10.07 in October 2008 (Table 5.3, next page). While the “investment” and “insurance” sectors experienced decreases in their P-E ratios between May and October 2009, all other sector saw increases in P-E ratios over the period.

Table 5.3: BSE—Price-Earning Multiples

	Oct. 2008	May 2009	Oct. 2009
Commercial banks	13.22	9.80	9.83
Investment	9.35	6.44	4.93
Insurance	9.10	19.42	19.32
Services	7.74	7.25	7.74
Industrial	8.73	7.35	9.29
Hotel and Tourism	8.99	7.77	8.11
Total Market	10.07	7.81	7.28

Source: Bahrain Stock Exchange

Aggregate trading levels remain low

Trading continues to be thin on the BSE, with the turnover ratio (value of trading as a share of market capitalization) at around 0.3%, up from the 0.1% registered in September 2008. The bulk of the value of shares traded were in the “Services” sector, whose share of traded shares (by value) surged from 22.1% in October 2008 to 54.3% by October 2009 (Table 5.4).

While the “Investment” sector represents a substantial 39.2% of the value of shares traded, this is much lower than the 50% share it registered in May 2009. However, the biggest change occurred in the “Commercial banks” sector, where the share of total trading plummeted from 29.4% in May 2009 to only 5.9% in October 2009.

**Table 5.4: BSE—Value of Shares Traded by Sector
(% shares of total trading)***

	Oct. 2008	May 2009	Oct. 2009
Commercial banks	31.2	29.4	5.9
Investment	41.5	50.0	39.2
Insurance	1.8	0.0	0.5
Services	22.1	20.5	54.3
Industrial	0.0	0.0	0.2
Hotel and Tourism	3.2	0.1	0.0

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

Source: Bahrain Stock Exchange

OVERALL ASSESSMENT OF THE EQUITY MARKET

The global financial crisis has impacted the year-on-year performance of the Bahraini Stock Exchange, with substantial declines in market capitalization and in the main price index. This trend however, is not unique to Bahrain as other GCC markets were also affected. There are now signs of a recovery in the market as investor confidence begins to return, albeit tentatively. Available data however indicates that during 2009, several other GCC markets fared better than Bahrain, where the market is still struggling to shake off the effects of the crisis. The situation in Bahrain may be due to lingering investor concerns about prospects for the financial sector, since financial stocks are prominent in the BSE All-Share Index.

6. Payment and Settlement Systems

Key Points

Decline in the volume and value of transfers through the RTGS

Volume and value of cheques processed through the ACS also decreased

Number of ATM withdrawals rose but the value declined

Overall, credit, liquidity, legal and operational risks remain low

Payment and settlement systems are central to the smooth operation of the financial sector and the efficient functioning of the economy at large. Not only do they facilitate trade in goods and services, they are also critical for transactions in financial assets. Hence, disruptions to payment systems have the capacity to transmit shocks and trigger widespread financial and economic disturbances. Therefore, an assessment of the safety and soundness of payment and settlement systems is important for the evaluation of risks to financial stability.

6.1. Key Trends in Payment and Settlement Systems

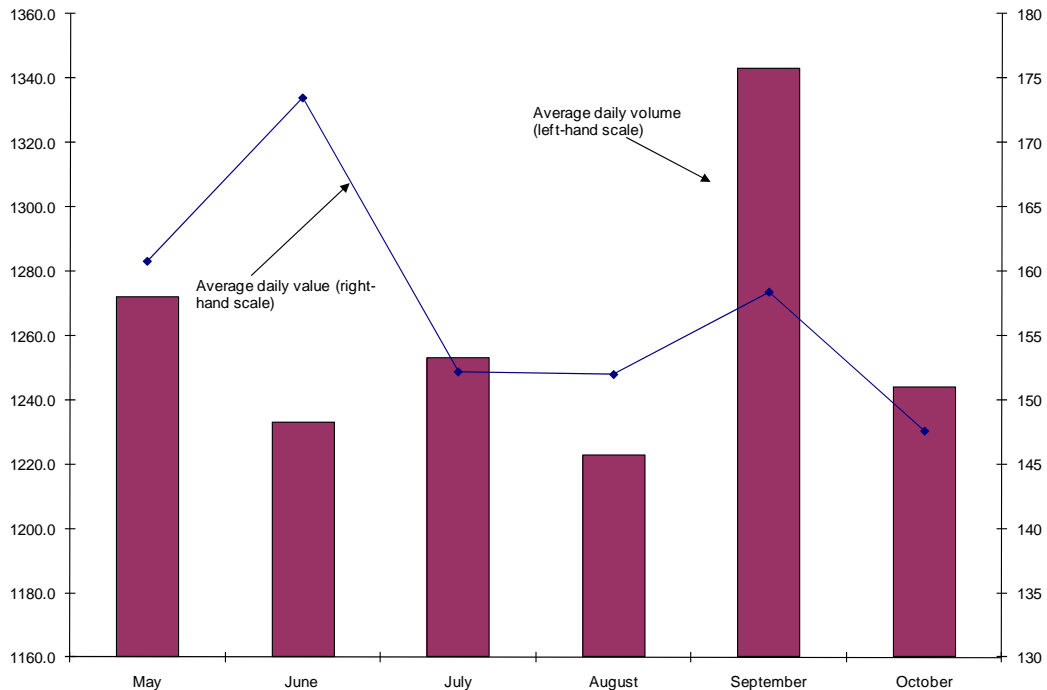
The current payments and settlement infrastructure in Bahrain comprises of five main components: i) the Real Time Gross Settlement System (RTGS); ii) the Automated Cheque Clearing System (ACS); iii) the ATM clearing system; iv) the Scripless Securities Settlement System (SSSS); and v) the clearing, settlement and depository system for the Bahrain Stock Exchange (BSE). This section describes recent trends in the *RTGS, ACS and ATM components* of the payments system.

Real Time Gross Settlement System (RTGS)

The RTGS is Bahrain's dedicated system for processing large-value, inter-bank payments. However, the RTGS also processes small-value retail payments for bank customers.

Chart 6.1 shows the volume and value of payments passing through the RTGS system between May 2009 and October 2009. Over this period, the *average daily volume of transfers* fell from 1272 in May 2009 to 1244 in October 2009, a decrease of 2.2%. In value terms, the decline was more substantial, with transfers decreasing from a daily average of BD160.8 million in May 2009 to BD147.6 million in October 2009, an 8.2% fall.

Chart 6.1: RTGS System: Average Daily Volume and Value of Payments Processed, May 2009 to October 2009

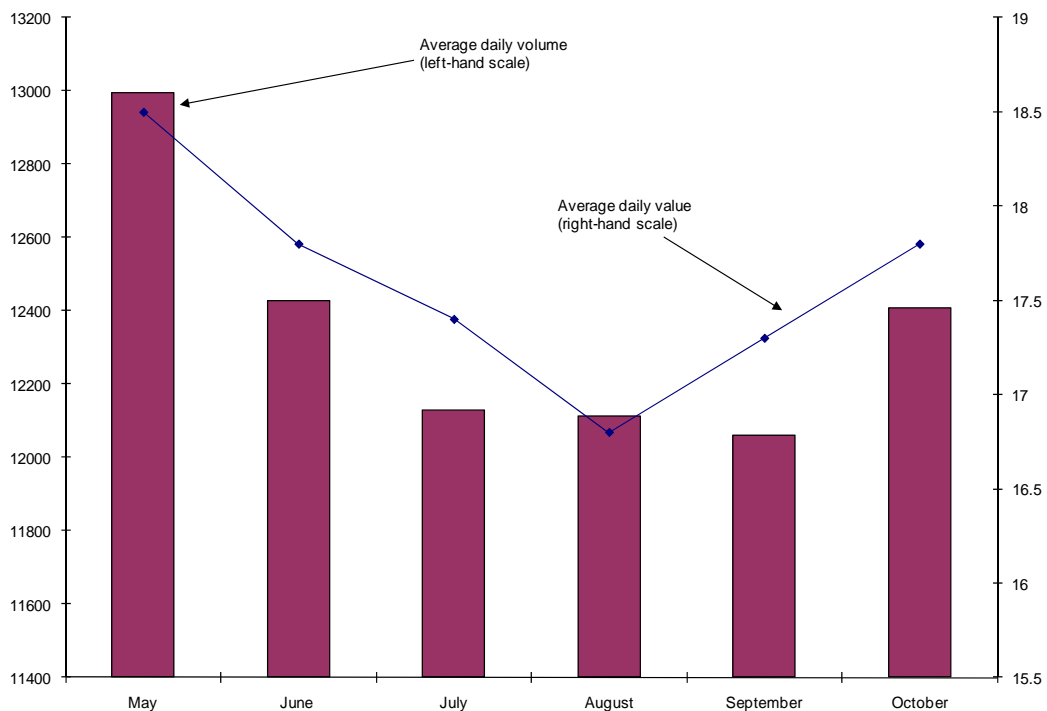


Source: Central Bank of Bahrain

The Automated Cheque Clearing System (ACS)

In the period between May 2009 and October 2009, the *average daily volume* of cheques processed through the Automated Cheque Clearing System (ACS) declined from 12,995 to 12,409, a decrease of 4.5% (Chart 6.2). The *average daily value of cheques* also fell from BD18.5 million in May 2009 to BD17.8 million in October 2009.

Chart 6.2: ACS System: Average Daily Volume and Value of Payments Processed, May 2009 to October 2009

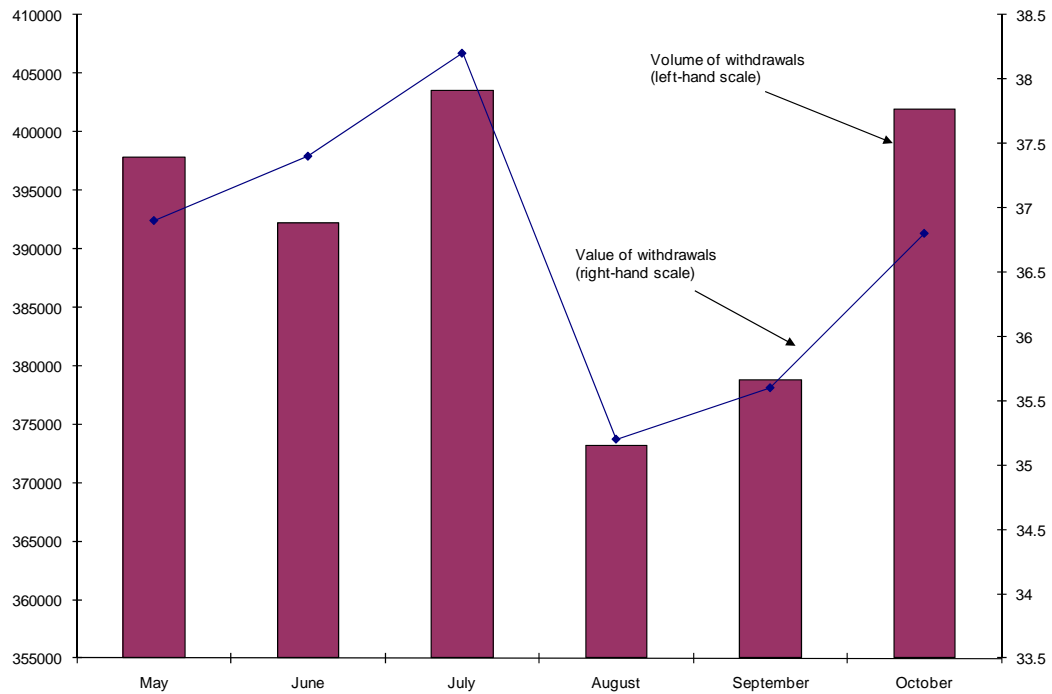


Source: Central Bank of Bahrain

ATM Clearing System

Between May 2009 and October 2009, the *number of withdrawal transactions* processed through the ATM Clearing System increased from 397,861 to 401,904 (2.5% growth) (Chart 6.3, next page). However, in *value terms*, total withdrawals processed decreased slightly from BD39.7 million in May to BD36.8 million in October (1.6% fall).

Chart 6.3: Number and Value of ATM Transactions, May 2009 to October 2009



Source: The Benefit Company

OVERALL ASSESSMENT OF THE PAYMENTS AND SETTLEMENTS SYSTEM

The various components of Bahrain's payments and settlement framework continue to function efficiently. The RTGS in particular remains a robust framework for processing retail and wholesale payments in Bahrain. Credit, liquidity and operational risks are minimal and there are no financial stability concerns at this time.

Annex 1
Banking Soundness Indicators

Annex Table 1
Selected Financial Soundness Indicators—Conventional Retail Banks
(End of period)

	September 2008	March 2009	September 2009
<i>Capital Adequacy</i>			
Total capital adequacy ratio (%) **	15.5	16.2	19.8
Tier 1 capital adequacy ratio (%) **	10.9	12.6	15.8
Leverage (assets/capital)(times)**	8.7	9.9	7.1
<i>Asset Quality</i>			
Non-performing loans (% of gross loans)	3.7	5.4	6.2
Specific provisions (% of NPLs)	37.0	37.9	46.7
Loan concentration (share of top-2 sectors) (%)	43.3	43.8	44.9
<i>Earnings</i>			
ROA Local retail banks (%)	1.1	0.4	0.9
ROA Overseas retail banks (%)	1.2	0.6	1.3
ROE Local retail banks (%)	9.0	5.7	8.1
Net interest income (% of gross income)	58.0	58.3	66.1
Net fees & commissions (% of gross income)	20.0	16.8	18.5
Operating expenses (% of gross income)	44.4	43.9	59.4
<i>Liquidity</i>			
Liquid assets (% of total assets)	30.6	18.4	18.0
Liquid assets (% of short-term liabilities)	45.4	30.9	28.6
Loan-deposit ratio (%)	65.0	68.4	77.7
Deposits from non-bank sources (% of total deposits)	55.0	63.4	66.8

** *Locally-incorporated banks only*

Source: Central Bank of Bahrain

Annex Table 2
Selected Financial Soundness Indicators – Conventional Wholesale
Banks
(End of period)

	September 2008	March 2009	September 2009
<i>Capital Adequacy</i>			
Total capital adequacy ratio (%) **	18.0	20.4	21.0
Tier 1 capital adequacy ratio (%) **	16.0	17.8	18.3
Leverage (assets/capital)(times)**	6.2	5.9	5.2
<i>Asset Quality</i>			
Non-performing loans (% of gross loans)	1.1	1.6	4.5
Specific provisions (% of NPLs)	35.4	40.1	42.0
Loan concentration (share of top-2 sectors) (%)	49.7	50.3	49.5
<i>Earnings</i>			
ROA Local wholesale banks (%)	-0.8	0.5	0.1
ROA Overseas wholesale banks (%)	0.4	0.03	-0.7
ROE Local wholesale banks (%)	-5.4	3.9	1.0
Net interest income (% of gross income)	57.4	113.9	65.9
Net fees & commissions (% of gross income)	32.4	10.7	24.0
Operating expenses (% of gross income)	98.0	29.0	108.3
<i>Liquidity</i>			
Liquid assets (% of total assets)	16.0	14.6	20.4
Liquid assets (% of short-term liabilities)	29.9	29.6	36.7
Loan-deposit ratio (%)	88.0	79.8	81.5
Deposits from non-bank sources (% of total deposits)	40.0	27.4	31.5

** *Locally-incorporated banks only*

Source: Central Bank of Bahrain

Annex Table 3
Selected Financial Soundness Indicators—Islamic Retail Banks
(End of period)

	September 2008	March 2009	September 2009
<i>Capital Adequacy</i>			
Total capital adequacy ratio (%) **	28.0	22.4	24.5
Tier 1 capital adequacy ratio (%) **	24.4	21.8	22.2
Leverage (assets/capital)(times)**	5.0	6.7	5.8
<i>Asset Quality</i>			
Non-performing facilities (% of gross facilities)	3.8	3.5	5.0
Specific provisions (% of NPFs)	23.3	46.2	44.0
Concentration of facilities (share of top-2 sectors) (%)	59.0	48.0	60.8
<i>Earnings</i>			
ROA (%)	5.0	0.5	0.8
ROE (%)	31.4	3.5	5.0
Net income from own funds, current accounts and other banking activities (% of operating income)	77.5	77.4	72.9
Net income from jointly financed accounts and Mudarib fees (% of operating income)	11.0	23.1	18.5
Operating expenses (% of operating income)	34.5	56.6	70.2
<i>Liquidity</i>			
Liquid assets (% of total assets)	18.0	21.0	16.5
Facilities-deposit ratio (%)	70.0	74.6	79.2
Current accounts from non-banks (% of non-capital liabilities, excl. URIA)	16.4	14.3	16.5

** *Locally-incorporated banks only*

Source: Central Bank of Bahrain

Annex Table 4
Financial Soundness Indicators—Islamic Wholesale Banks
(End of period)

	September 2008	March 2009	September 2009
<i>Capital Adequacy</i>			
Total capital adequacy ratio (%) **	24.6	25.2	22.7
Tier 1 capital adequacy ratio (%) **	22.0	25.2	22.0
Leverage (assets/capital)(times)**	7.6	4.4	4.5
<i>Asset Quality</i>			
Non-performing facilities (% of gross facilities)	7.0	5.3	10.7
Specific provisions (% of NPFs)	44.4	38.9	34.4
Concentration of facilities (share of top-2 sectors) (%)	52.0	51.0	47.1
<i>Earnings</i>			
ROA (%)	1.5	-0.2	-0.3
ROE (%)	11.3	-1.0	-1.2
Net income from own funds, current accounts and other banking activities (% of operating income)	50.4	79.8	69.3
Net income from jointly financed accounts and Mudarib fees (% of operating income)	47.0	21.9	31.1
Operating expenses (% of operating income)	43.9	87.8	82.2
<i>Liquidity</i>			
Liquid assets (% of total assets)	19.0	24.6	21.3
Facilities-deposit ratio (%)	53.1	108.0	86.6
Current accounts from non-banks (% of non-capital liabilities, excl. URIA)	75.0	21.6	26.6

** *Locally-incorporated banks only*

Source: Central Bank of Bahrain

END