Financial Stability Directorate

مصرف البحرين المركزي
Central Bank of Bahrain

Financial Stability Report

August 2015

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Production: Financial Stability Directorate
Central Bank of Bahrain
PO Box 27, Manama
Kingdom of Bahrain

www.cbb.gov.bh

The Financial Stability Report (FSR) is a semi-annual report prepared by the Financial Stability Directorate. It is available in PDF format in the Publications and Data section at http://www.cbb.gov.bh.

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Preface

A key objective of the The Central Bank of Bahrain (CBB) is to ensure the continued soundness and stability of financial institutions and markets. As the single regulator for the Bahraini financial system CBB attaches utmost importance in 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 centre and ensuring that the sector continues to contribute significantly to growth, employment and development in Bahrain.

> *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.*

This objective is the primary responsibility of CBB's Financial Stability Directorate, which conducts regular surveillance of the financial system to identify areas of concern and undertakes research and analysis on issues relating to financial stability. 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.

The FSR is prepared regularly for the CBB management, reviewing recent trends and identifying areas of concern which require supervisory and policy attention. Financial Soundness Indicators (FSIs) are used to monitor the financial sector on a continuous basis.

This new edition of the FSR is organized into six chapters divided into two parts part as follows:

- Part I: looks at national and international developments:
    - Chapter 1 reviews recent international financial developments.
    - Chapter 2 examines the recent developments in Bahrain's financial sector and also households.
- Part II: looks at the developments in the banking sector:
    - Chapter 3 evaluates the financial condition and performance of conventinoal banks
    - Chapter 4 evaluates the financial condition and performance of Islamic banks.
- Part III: looks at the developments in equity market and payment and settlement systems.

- Chapter 5 reviews recent trends on the equity market.
- Chapter 6 focuses on stability issues relating to the payment and settlement systems.

Unless indicated otherwise, Chapter 3 and Chapter 4 of the report analyzes data covering the period between end-September 2014 and end-March 2015.

Executive Summary

Global Macro Financial Environment Overview

The global economy has shown a weaker-than-expected performance in the first half of 2015. Despite large scale quantitative easing programs in most advanced economies to prop up economic growth, global recovery remains weak and fragile. The primary challenge for the global economy is to return to a sustainable path of economic recovery. The Greek crisis and the uncertainty over the timing of normalizing monetary policy in the US continue to pose an additional challenge for global economic recovery.

The first half of 2015 exhibited important economic developments in advanced economies and emerging markets. In the US, economic conditions have improved remarkably, driven mainly by consumer confidence, which was reflected by strong demand in the retail sector. The appreciation of the US dollar and continued low oil prices eased the economic recovery in the US. Normalization of monetary policy is widely anticipated by the international markets, with speculation suggesting an interest rate-hike in September 2015.

The Euro area continues to be troubled with the Greek crisis. After a prolonged period of negotiations and an aversion of the Greek Exit, many other challenges continue to weigh in on policy makers in the Euro area, most notably, the threat of deflation. Growth in the Euro area remains disproportionate. France, Italy, Spain, Ireland, and Portugal recorded positive growth rates in the first quarter of 2015, while Germany, the largest economy in the Euro area, experienced a negative growth rate. In response to all these challenges, the ECB has pledged to inject more liquidity and implement further structural reforms to support the Eurozone economy.

The MENA region has recorded a positive sign of recovery but growth rate was lower than expected. This is mainly due to the political turmoil in MENA region, notably in Libya, Yemen, Iraq, and Syria. The sharp drop in oil prices dampened the fiscal balances for oil exporting countries in MENA. On the other hand, the drop in oil prices improved the external trade balance for oil-importing countries, as it freed more capital to be reallocated for other imports.

The Non-Financial Sector Overview

Bahrain has emerged as a major regional financial center. This has been essential to the development of its economy and the financial sector has come to play a significant role in economic activity and employment creation.

The insurance industry has progressed effectively during the past few years, which has grown into a regional hub. Insurance contribution increased remarkably from over the decade. The boom in Islamic banking and Islamic financial services make Bahrain a very attractive destination for Islamic finance.

The Bahraini financial and banking sector is still performing well and represented 15 % of GDP in 2014. The assets of the retail banking sector rose from BD 18.6 billion in 2007 to BD 30.25 billion in the first quarter of 2015. Wholesale banking assets stood at USD 110.6 billion as of end the first quarter of 2015.

Retail banking total assets continued growing since December 2012 moving from BD 26.9 billion to BD 27.5 billion as of end-September 2013 to reach BD 30.6 billion in May 2015 (see Chart 2-2). This increase in retail banking assets was driven by domestic assets which contributed to 52.6% of total assets at May 2015, up from 46.2% at end-September 2013.

Outstanding personal loans, used as a proxy for household borrowing, for the period shows that the household debt burden rose, increasing throughout the period from November 2014 to May 2015. Personal loans as a percentage of GDP increased steadily from November 2014 to May 2015 and so did outstanding business loans.

Conventional Banks

The financial soundness indicators show that conventional retail and wholesale banks did not experience any deterioration to their capital positions. Capital adequacy ratios for conventional retail banks decreased to reach 17.6% compared to the previous quarter. Capital adequacy ratio for locally-incorporated wholesale banks was 21.5%. Loan delinquencies have shown decreases for conventional retail and increases for wholesale banks reaching 3.5% and 6.0% respectively. Loan concentration remains for conventional retail and wholesale banks despite some decrease in some sectors.

As at end-March 2015, return-on-assets (ROA) was 0.7% compared to 0.4% in March 2014 for conventional retail banks. Return-on-equity (ROE) for locally-incorporated retail banks was 4.4% in March 2015 compared to 4.0% in March 2014. ROA for the conventional wholesale banking sector was at 0.2% in March 2015, a decrease from the 0.5% in March 2014. ROE for local wholesale banks decreased from 2.5% to 1.6%. For conventional retail banks and wholesale banks liquid assets as proportion of total assets increased to 26.7% and 24.7% respectively.

Islamic Banks

The financial soundness indicators show that capital positions increased for Islamic retail banks while it declined for Islamic wholesale banks. The capital adequacy ratio of Islamic retail banks increased to 16.1% in March 2015 and decreased to 20.5% for Islamic Wholesale banks.

Non-performing facilities (NPFs) for Islamic retail banks decreased to 11.0% in March 2014 from 12.6% in September 2014. For Islamic Wholesale banks, NPFs decreased from 5.0% to 4.7% over the same period. Facilities concentration has remained almost the same for retail Islamic banks while it slightly increased for wholesale Islamic banks. The earnings picture looks the same for Islamic retail banks in March 2015 with ROA remaining the same at 0.1% while ROE decreased to 1.0% compared to results in March 2014. ROA for wholesale banks remained relatively unchanged while ROE decreased to 1.0% for the same period. Moreover, Islamic retail liquidity position was relatively unchanged with the liquid asset ratio slightly decreasing to 13.4% from 13.5% and decreasing for Islamic wholesale banks to reach 19.5%. The facilities to deposit ratio decreased for Islamic retail and Islamic wholesale banks.

Performance of Equity Markets

A look at year-on-year data shows that the Bahrain All Share Index decreased by 59.78 points (4.1%) between June 2014 and June 2015 (Chart 5-1). Market capitalization of the Bahrain Bourse stood at BD 8.0 billion (Table 5-1). This level of market capitalization is 3.2% lower than the level as at end-December 2014 and 0.7% lower year-on-year. As June 2015, the price-earnings ratio (P-E ratio) for the stock market stood at 9.83, a decrease from the 10.29 attained last year in June 2014 and the 10.41 in December 2014.

The bulk of the value of shares traded in June 2015 was the "Services" sector whose traded shares (by value) represented 45.9% of total shares traded up from 6.5% in June 2014.

The performance of the GCC Markets in the first two quarters of 2015 was mixed. Saudi Tadawul index was the biggest gainer among the GCC markets, increasing by 11.4% from December 2014. However, the GCC indices have not yet fully recovered from the levels attained in June 2014 as a result of their exposure to the oil price declines. All GCC indices experienced varying degrees of declines in comparison to the level attained in June 2014

Payments and Settlement System

The various components of Bahrain's payments and settlement framework continue to function efficiently. The payment system in Bahrain can be classified as retail and wholesale payments. Retail payments include cheques, credit transfers, and debit and credit card transactions. Wholesale payments refer to the real time gross settlement system to process inter-bank payments.

In the period between December 2014 and June 2015, the average daily volume of cheques processed through the Automated Cheque Clearing System (ACS) decreased by 6.1% from 14,168 to 13,332 (year-on-year decrease of 3.1%). The average daily value of cheques decreased by 5.9% from BD 44.1 million in December 2014 to BD 41.5 million in June 2015 (year-on-year decrease of 0.9%).

The number of withdrawal transactions processed through the ATM Clearing System increased by 1.1% from 863,244 to 873,164 (year-on-year growth was 11.0%)(Chart 6-2). Similarly, in value terms, total withdrawals processed increased by 6.3% from BD 86.9 million to 92.4 million (year-on-year growth was 12.1%).

Between December 2014 and June 2015, the average daily volume of transfers decreased by 4.6% from 2929.7 to 2793.0 (21.7% year-on-year increase). In value terms, the average daily value of transfers witnessed a 29.4% increase from BD 188.9 million in December 2014 to BD 244.4 million in June 2015 (18.9% year-on-year increase).

Part I:

Developments in the International and Domestic Financial Markets

1. Developments in the International Financial Markets

Chapter
1

Key Points

- Since the February 2015 Financial Stability Report, the global economy does not return to a sustainable path to recovery
- Concern on Greece bailout has amplified volatility in global financial markets
- Political tensions have also impacted the global economic growth and recovery
- The U.S. dollar continued to appreciate against many major and emerging market currencies amid divergent monetary policy expectations
- The future adjustment in monetary policies by major developed countries, particularly QE, remains an important risk factor for global growth and financial stability.

1.1 Overview

Since the February 2015 Financial Stability Report, the global economy has shown weaker-than-expected performance in first semester of 2015 and recovery remains a challenge in many economies. Despite the large scale of quantitative easing programs in most advanced economies, global economic recovery is still weak and fragile and the global economy did not return to a sustainable path to recovery. Weaker growth coincides with uncertainty on Greece's exit from the Eurozone and political tensions all around the world have all together worsened the global economic conditions. Furthermore, the uncertainty over the timing of normalization of monetary policy by the US Federal Reserve has also created some tensions and fears in emerging economies. All these issues have amplified volatility in global financial markets generating additional challenges for the emerging market and developing economies as well.

During the previous six months, the global economic and financial condition was marked by some important events in advanced countries and emerging market economies as well. These events could be summarized as follow:

- In the US, economic conditions have improved remarkably in the first semester of 2015 driven by dynamism of the retail sector, which recorded a strong demand as consumer confidence improved. Recovery was supported by a fall in oil price and the appreciation of the US dollar. Furthermore, the US real estate market has recently shown signs of recovery in both volume and price and the US economy have witnessed an upsurge in home sales and non-residential investments. Regarding the monetary policy, the Federal Reserve has already announced in its willingness to normalize the US monetary policy by reducing the pace of its asset purchase program. Hence, the Fed is currently preparing for a smooth exit from the unconventional monetary policies to conventional one but the timing remains undefined yet.

- In Euro area, some countries- notably peripheral countries- have shown courageous sign of recovery. For example Italy, after a long period of recession, has finally recorded a positive growth rate during the first quarter of 2015. Spain, Ireland and Portugal have also realized positive growth rate in the same period. The depreciation of the single currency along with the drop of oil price have boosted exports activities and improved the trade balance for peripheral countries. While France has shown a speeder-than-expected growth in the first quarter of 2015, the German economy, the largest European economy and most important Europe's growth engine, contracted. To sum-up, growth among EU countries remains disproportionately and the gaps in economic performance remain large. Facing the pressure, the ECB continues injecting more liquidity in the economy and it pledged implementing further structural reforms to support the Eurozone economy. However, fears on the Greek bailout could raise new challenges for Europe and ECB alike.

- Japan’s economy declined in the first quarter of 2015 as high public debt inherited from the past creates major macroeconomic and fiscal challenges. Growth nearly stalled and the recovery has been slowed by the crisis legacies. The slowdown of Japanese economic activities has pushed the exchange rate over ¥125/US$ in mid-June 2015, its highest level since 2008.

- In emerging market economies, lower potential growth is the dominating factor. For these economies as a whole, potential growth was revised down in 2015 by the IMF. Weaker exports, lower commodity prices and political uncertainty are the principal reason explaining the shrinking of their economies. China is sustaining high growth, but its growth is expected to slow in the coming period. India has recovered from its relative slump; thanks in part to effective policies and a renewal of confidence, growth rate reached 7.5% in the first quarter of 2015 (OECD, 2015). In contrast, uncertain investment prospects in Russia had already lowered growth before the Ukraine crisis, and the crisis has made growth prospects worsen. Uncertain prospects and low investment are also weighing on growth in Brazil and the country has been in recession for the consecutive 4^{th} quarter since Q2/2014.

- The MENA region, as an important bloc of the world economy, has recorded a positive sign of recovery but growth rate was lower than expected. This is mainly due to the political and economic turmoil in the MENA region, notably in Libya, Yemen, Iraq and Syria, that makes the stability of the MENA region uncertain. While the sharp decrease in oil prices raised some challenges for oil-exporting countries, it improved the trade and fiscal balance of MENA oil importing countries.

- GCC countries are a central bloc of the MENA region; they have recorded strong economic performances boosted by large infrastructure projects and improvement in non-oil sector growth. This performance has strengthened the positions of GCC banks which remain well capitalized and profitable.

- In Bahrain, banks remain quite profitable and well capitalized, and their reported non-performing loan ratios remain low. However, the recent sharp drop in the prices of oil and some other commodities, should it become persistent, will weigh on the overall GCC economy.

In the following section, we analyze recent trends in the global economy and look at the evolution of major financial and economic indicators during the previous six months.

1.2 Global Macro-financial Environment

After a short period of prosperity, the global economic and financial conditions have weakened and potential growth rates are being revised downward by major international organizations, i.e. the IMF and OECD. This new trend has affected the global demand and makes the full recovery a challenging task for some advanced economies. The slowdown of economic activity and the persistence of uncertainty have raised downside risks.

Financial market sentiment remained positive with high equity prices, and spreads on Credit Default Swaps have continued to decline and yields on 10 Year Sovereign Bonds remain low relative to historical norms. However, global risk appetite increased, but market volatility was generally moderate and under controls.

1.3 Recent Trends in the Global Economy

A. Economic Performance

Since the February 2015 report, global economic activity slowed slightly but it remained subdued and growth remained uneven across countries and regions as well.

Across major advanced economies, the recovery was strongest in the US, prompting the gradual removal of monetary policy stimulus. Similarly, the Australian, Canadian and UK economies had shown courageous signs of recovery during the recent period.

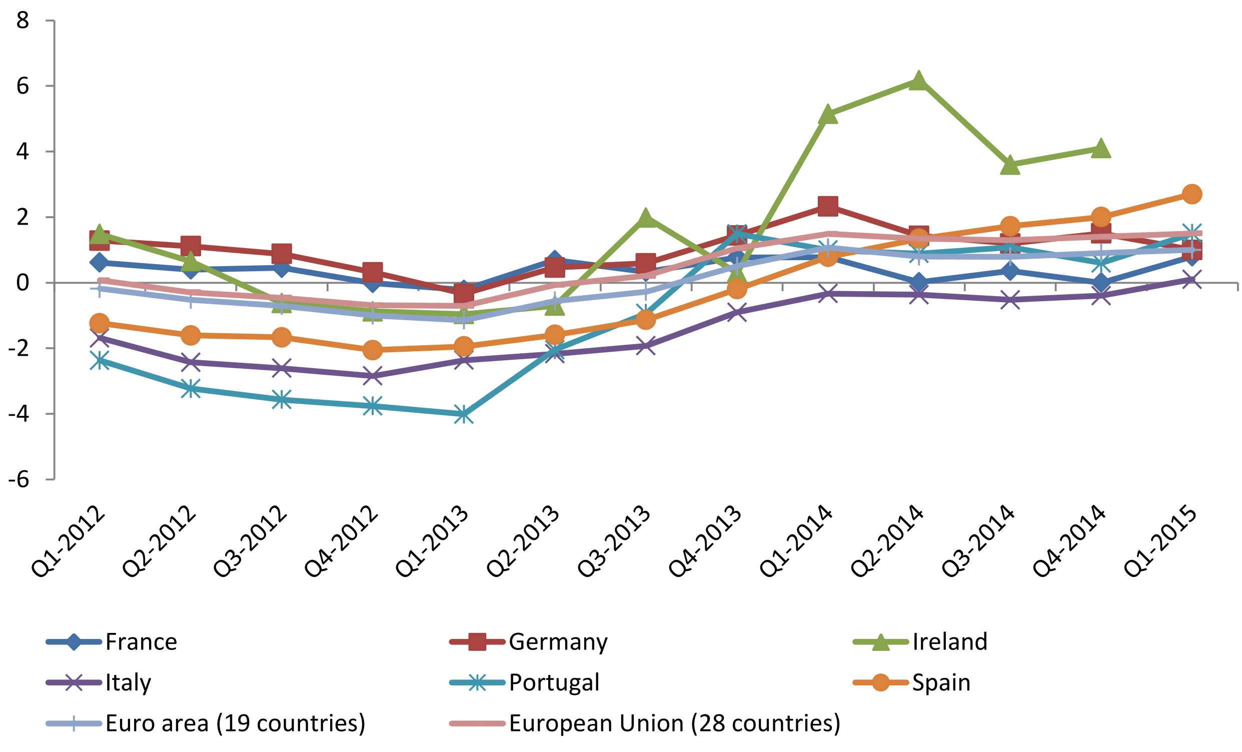
In contrast, the recovery in Europe remains fragile. Economic activity in the Euro area stalled since the second quarter with weaknesses in some Euro economies and increased geopolitical tensions. Concerns about the Greece exit (Grexit henceforth) and the very low level of inflation and the medium-term growth outlook have led the ECB to step up its further unconventional monetary policy stimulus by injecting exceptional liquidity.

The recent OECD's data shows that since the fourth quarters of 2013, the Euro Area (19 countries) has been experiencing a positive and continuous growth. In the first quarter of 2015, Euro Area (19 countries) has achieved a growth by 1% the highest level since the past four quarters. Similarly, the Eurozone (28 countries) had achieved 1.5% of growth in the first quarter of 2015. This level is the highest since 2009.

The risks surrounding the economic outlook for the Euro Area are evaluated to be on the downside as the risk of deflation weigh on the growth of the euro area. To boost further the Eurozone economic recovery, the European Central Bank announced in June 2014 a variety of new easing actions for the Euro area including: forward guidance that policy rates will remain at present or lower levels for an extended period of time; a negative deposit rate at the European central bank; operations to support bank lending to households (excluding residential mortgages) and non-financial corporations; and plans to explore purchases of asset-backed securities.

At a country level study, Spain has surprisingly achieved the highest best performance as GDP growth reached 2.7% in the first quarter of 2015. The level is the highest since the onset of the financial crisis and it shows a very courageous sign of recovery and the dynamism of the Spanish economic performance. Portugal has also achieved and outstanding economic growth in the first quarter of 2015 as growth rate was 1.5%; also the highest since the subprime crisis. Turning now to Italy, it finally realized a positive growth after a long period of recession. We can conclude from the OECD's figures that some of the PIIGCS economies have finally had positive growth rates since the beginning of the year and have left the recession back and their economies have finally recovered from the previous crises. Regarding the two most important economic powers in the Eurozone, France has realized a positive growth moving to 0.8% of growth in the first quarter of 2015 from 0% in the last quarter of 2014 and Germany, the largest economy in the Eurozone has experienced a slowdown in economic activities with GDP growth standing at 1 % in the first quarter of 2015 from 1.5% in the last quarter of 2014.

Chart 1-1: Real GDP Growth in Selected Europeans countries (Quaterly%) Seasonally adjusted*



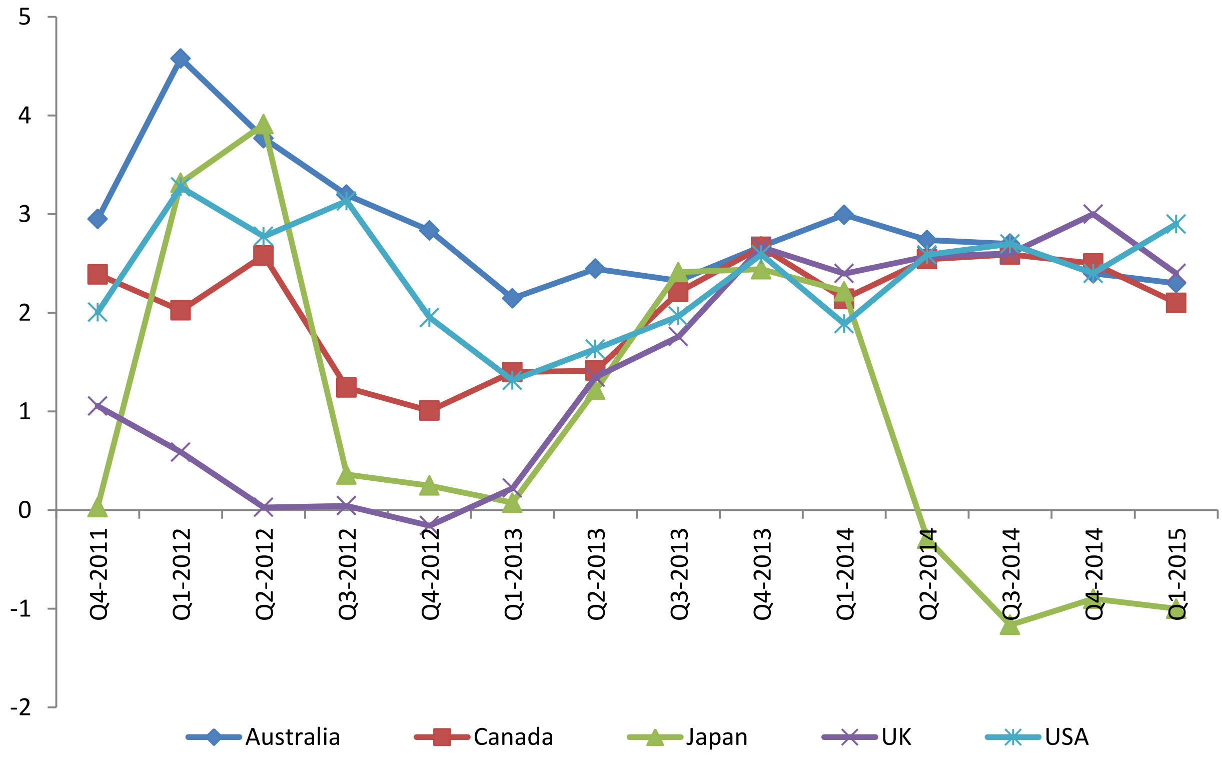
Growth rate compared to the same quarter of previous year, seasonally adjusted
Source: OECD Quarterly National Accounts

Regarding non-European countries (Chart 1-2), the economic conditions improved slightly, especially in the USA, which recorded a positive GDP growth of 2.9% in the first quarter of 2015 where economic activity has remained robust. This good performance was supported by strong private consumption and business investment along with a continued progress in the labour market and the housing sector. Monetary policy is expected to remain highly accommodative during 2015, while fiscal policy will be less restrictive than in the previous year. The external conditions for the United States economy are expected to improve, but only slightly, as foreign demand from major trade partners is expected to remain relatively weak.

In the UK, GDP grew by 2.4% in the first quarter of 2015, supported by The Bank of England quantitative easing programs. Recently, the Monetary Policy Committee (MPC) indicated that as the economic conditions improved and that Bank Rate was likely to rise only progressively and to a level below its pre-crisis average.

For Japan, after an outstanding performance in end-2013 and a 2.2% of GDP growth realised in the first quarter of 2014, the country fell unexpectedly into recession in the third and fourth quarter of 2014 and the growth rate was also negative in the first quarter of 2015 (-1%).

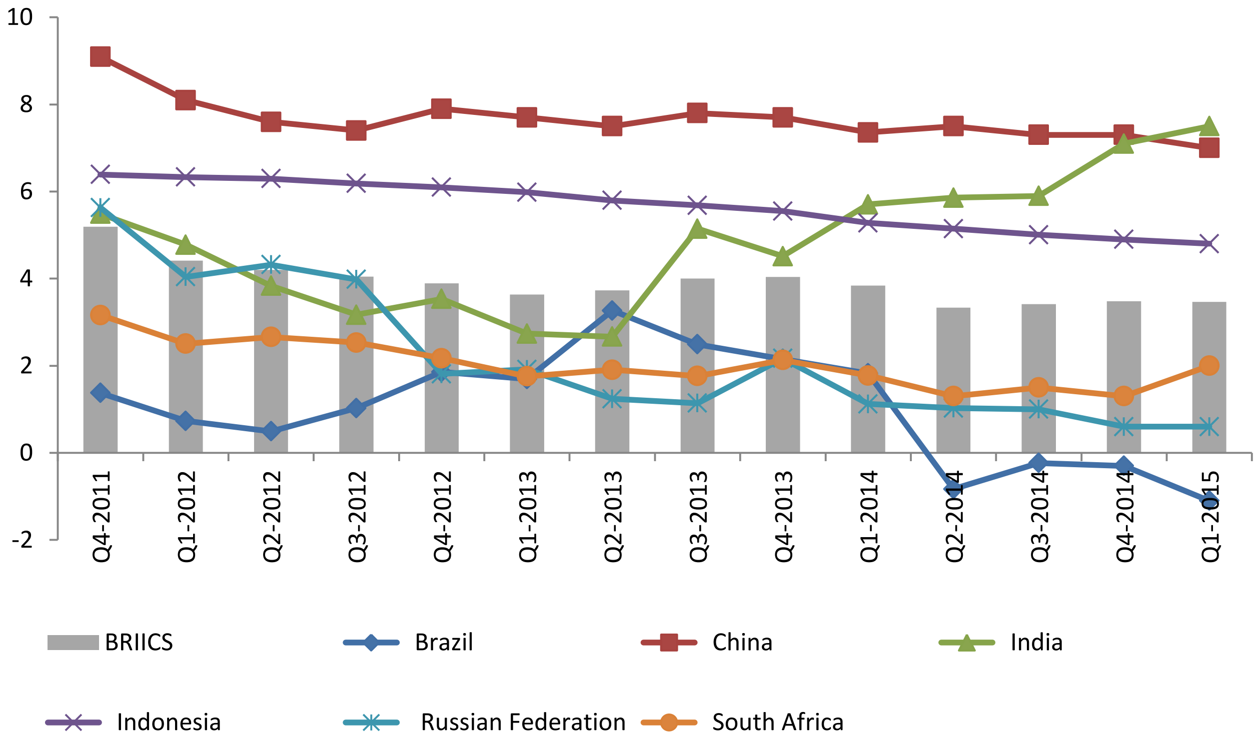
Chart 1-2: Real GDP Growth in Advanced Economies (Quaterly%)*



** Growth rate compared to the same quarter of previous year, seasonally adjusted*
Source: OECD Quarterly National Accounts

As for emerging economies (Chart 1-3), they have experienced a fairly broad-based slowdown since the first quarter of 2014. In the first quarter of 2015, the BRICS countries' (Brazil, Russia, India, China, and South Africa) growth was positive (3.5%) but it is far from its previous levels (10.8% in 2007). The Russian economy has witnessed slowdown in economic activities and realised a modest growth rate (+0.6%). This is mainly due the political tension along with the drop of oil price that heavily weighed on its and economy. While India's economy continues to perform well, Brazil's economic performance slowed in the first quarter of 2015 as it fell into recession for the third consecutive quarter. In China, the interactions among the ongoing correction in real estate markets, the highly indebted local governments, and the financial sector continue to pose a significant downside risk.

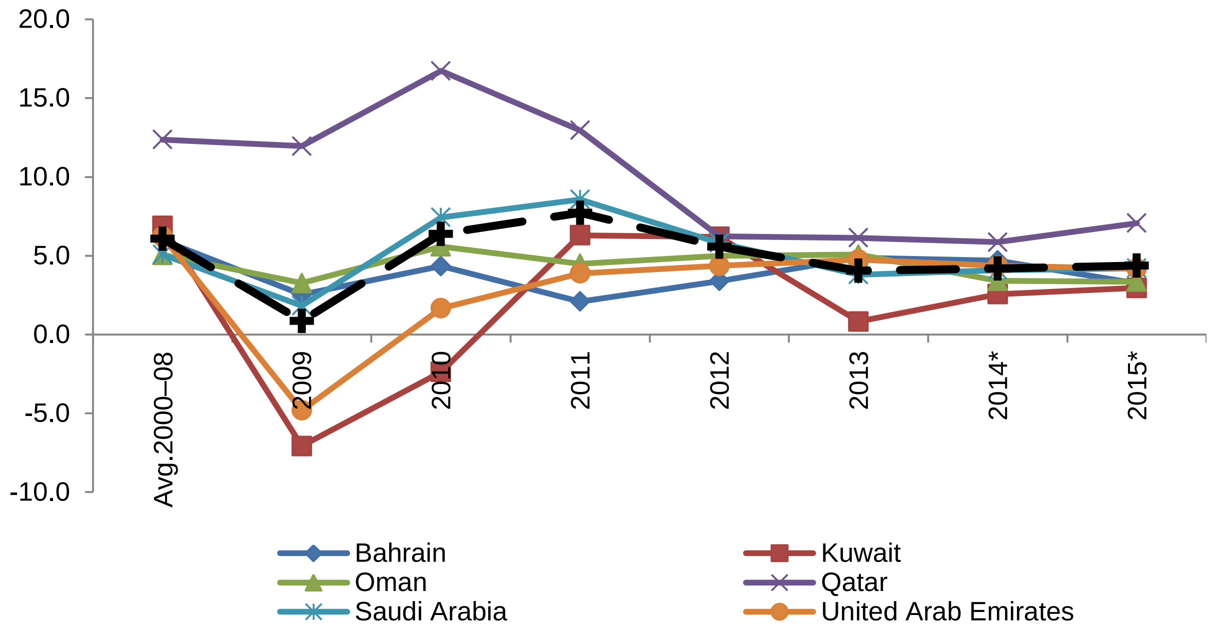
Chart 1-3: Quaterly Real GDP Growth in BRIICS (Quaterly%)*



**Growth rate compared to the same quarter of previous year, seasonally adjusted*
Source: OECD Quarterly National Accounts

Despite the continuing uncertainty in the global economy, the GCC economies experienced growth at a level of 3.6% in 2014. The projections for 2014 and 2015 show that the regional economy will continue to grow at a moderate rate of growth of 3.4% and 3.2% respectively. At the individual country level, Qatar experienced the highest growth rate at 6.1% followed by Bahrain at 4.7%, UAE and KSA at 3.8% then Oman at 2.9%, finally Kuwait grew by 1.3% in 2014.

Chart 1-4: Real GDP Growth in GCC Countries (Annual percent change)



**Denotes forecast.*
Source: IMF MENAP Regional Economic Outlook, October2014.

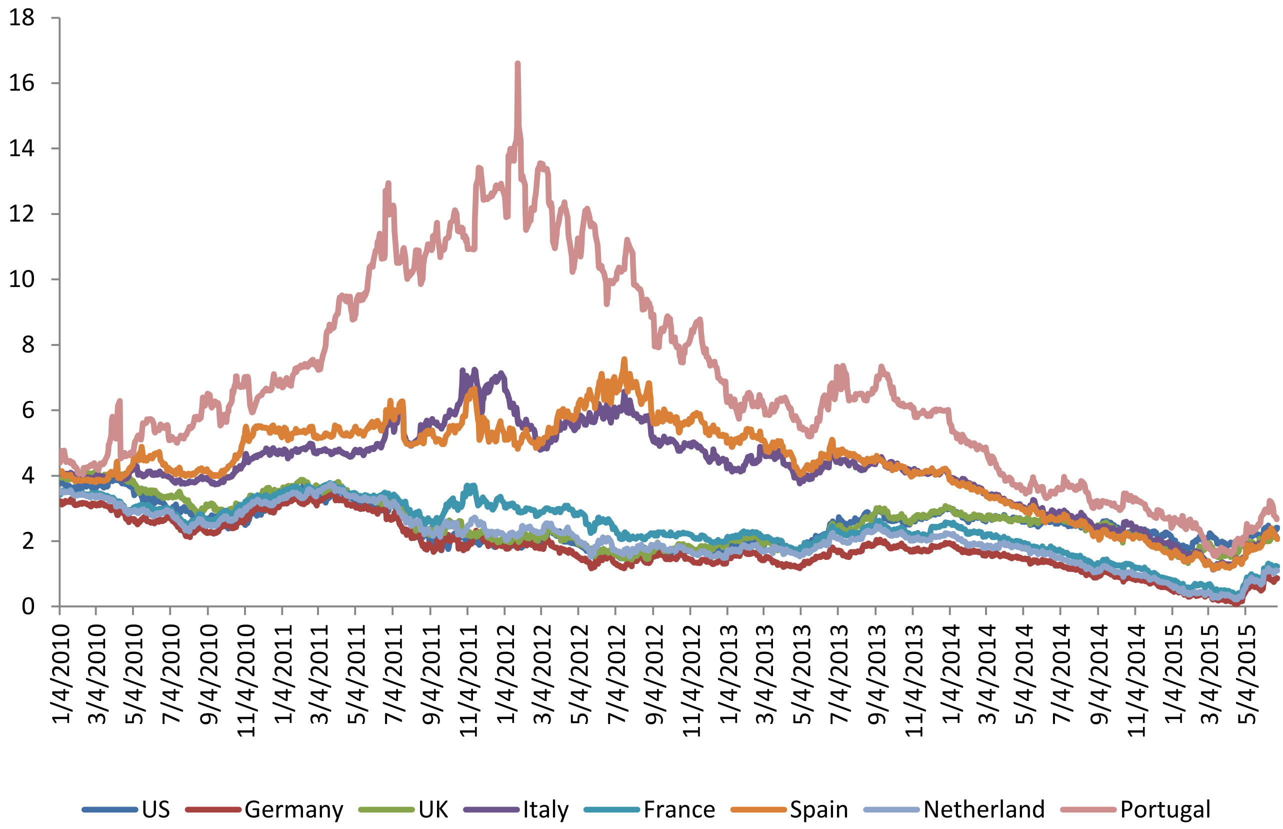
Despite the trouble in the MENA region and the drop in oil prices, the member states of the GCC have been on a stable growth path. The ongoing economic performance in GCC countries is currently facing the challenge of oil price which declined by 50% since June 2014 and which will impact the authorities 'spending power. However, the massive foreign reserves accumulated during the past few years are expected to be used to mitigate some of the impact on growth due to significant losses of oil revenues.

B. Financial Markets

Chart 1-5 highlights the change in Yields on ten-year sovereign bonds in some European countries and the US. The graph clearly shows the reaction of the market following the decision of The Federal Open Market Committee to taper the pace of its asset purchases early summer 2013. Sovereign bond yields rose and this has triggered market volatility and caused depreciation of some currencies, notably those of emerging market economies.

Since the last Financial Stability Report, yields decreased to historical levels. As we can see in Chart 1-5, at a ten-year maturity, Spanish and Italian government bond yields have fallen to their lowest level in Euro area history, while yields on Portuguese bonds have fallen to pre-crisis levels. Spreads on yields of ten-year bonds over the Bund have fallen to four-year lows for Portugal, and three-year lows for Spain and Italy. The fall in Yield is the result of the highly accommodative monetary policy (quantitative easing program) by major central banks that have calmed the volatility of stock market and reduced the systemic risk. The recent actions by the central banks and policymakers have narrowed modestly the spreads on euro area periphery government bonds. Low Yield reflects a subdued inflation expectations and the outlook for modest economic growth in most economies.

Chart 1-5: Yields on 10 Year Sovereign Bonds



Source: Bloomberg

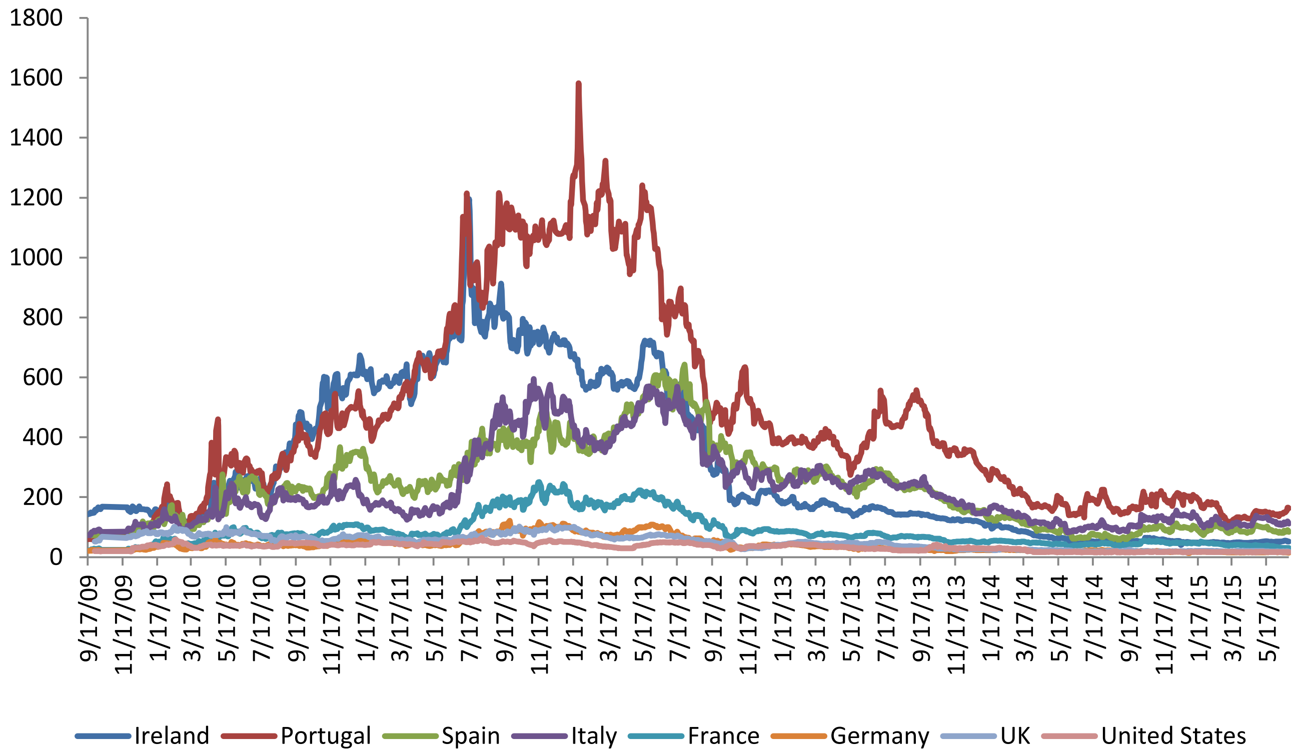
CDS spreads are a fundamental metric of default risk. Broadly, a higher spread on the CDS implies a greater risk of default for the reference entity. Chart 1-6 provides information as to how financial markets perceive the risk of default on corporate and sovereign debt. It illustrates spreads on five-year CDS in some European countries and the US since 2009.

Prior to the crisis, CDS spreads were low for all of the referenced countries, showing that investors placed low probabilities on these countries defaulting on their debt. The policy measures launched by the European Central Bank have declined the financing cost and increased liquidity and profitability of banks.

After a short increase during the third quarter of 2013, spreads on Credit Default Swaps for peripheral euro area countries have continued to fall over the last few months following a rapid rise in US long-term interest rates. Their levels now are well below the peaks observed in 2011 and 2012 (see chart 1-6). Yet risk premia remain neighboring to the levels reached during the financial turmoil of 2008. This will recover financing conditions for many banks and deposit flows will stabilize.

Furthermore, the average five-years CDS spreads declined considerably (Chart 1-6) in most advanced economies. In the US, UK, Germany and France spreads on Credit Default Swaps remained low since 2009 despite public debt levels that are comparable to or above those of southern Euro area member states.

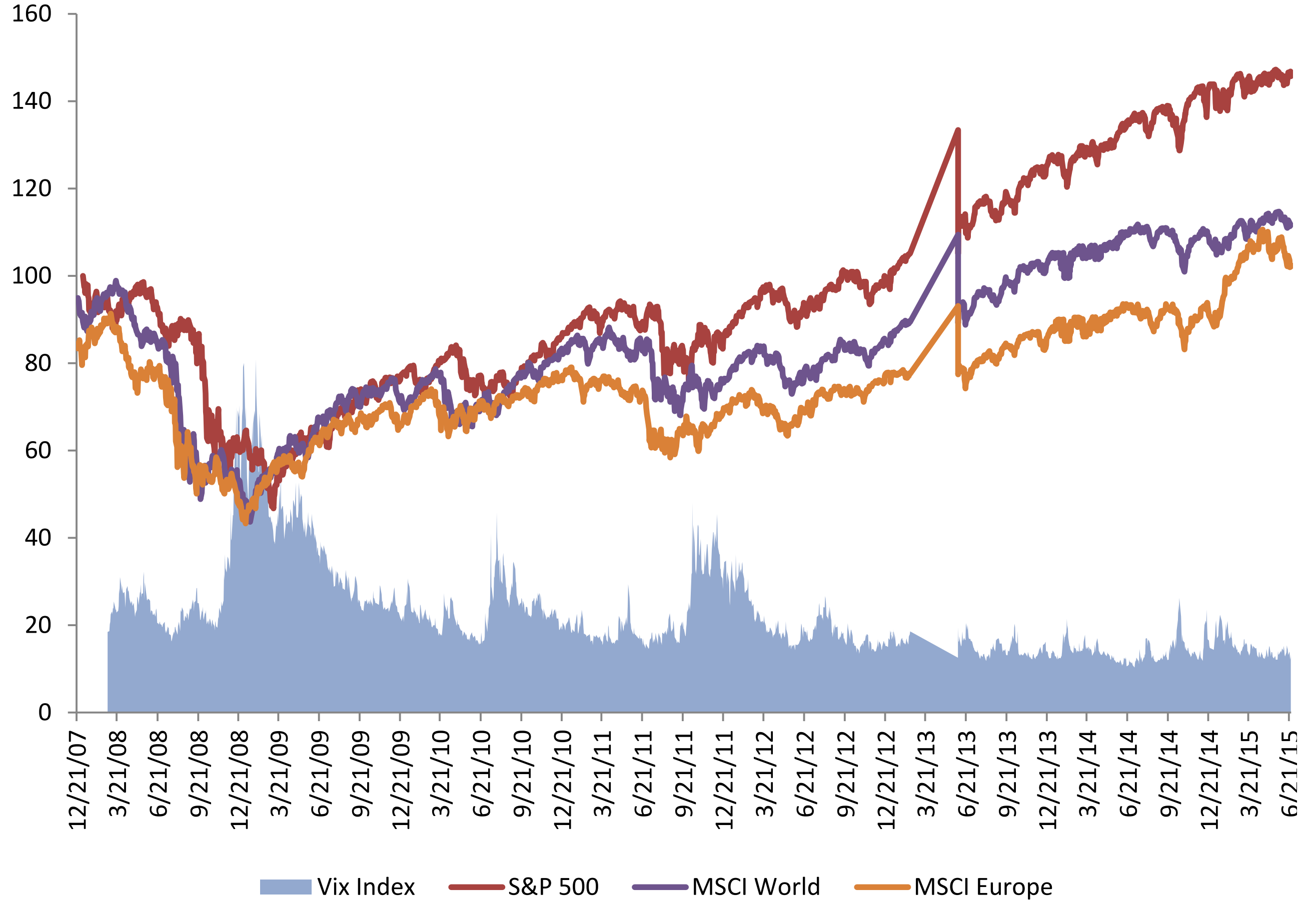
Chart 1-6: Five Year Spreads on Credit Default Swaps



Source: Bloomberg

Regarding global equity markets, chart 1-7 shows that following a period of uncertain sentiments during the summer 2013; optimism returned to global equity markets. This is due to exceptional policy measures and quantitative easing programs undertaken in some advanced economies that had an immediate impact on equity markets.

Chart 1-7: Global Equity Market Indices (Re-indexed to January 2008)



Source: Bloomberg

C. Volatility of the major currencies

The modest economic performance of the Eurozone economy and persistent uncertainty on the future of Greek within the Euro area have added some pressure on the European single currency. Furthermore, the geo-political concerns in Russia-Ukraine have also weighed on the power of the Euro. As a result, all these factors have devaluated the value of the single currency against its most important competitor. The Euro (EUR) fell to its lowest level against the US Dollar (USD) in over 11 years hitting a low so far of 1.1008 on the interbank market. From December to June 2015, the Euro lost 8.5% of its value against the US Dollar as it moved from 1.20$ to 1.10$ in this period (chart 1.8). The depreciation of the single currency had some implications for countries that pegged their currency to Euro. For example the Swiss National Bank (SNB) decided on January 15th to remove the currency bottom of 1.20 Swiss francs per euro that had been in place since September 2011. The decision has led to a sharp volatility of the Swiss franc and the Swiss stock market as well. To sum-up, the single European currency was influenced by the unfavorable growth and interest rate differentials as compared with the US outlook but it should boost competitiveness and export activities.

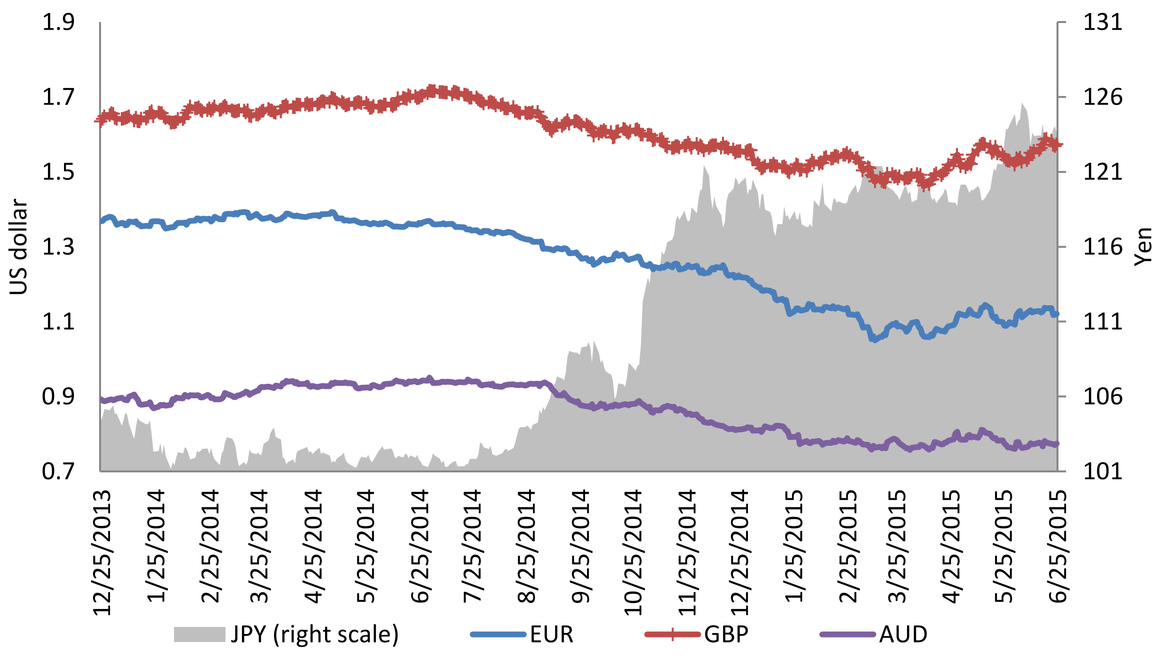
Since our February report, the British pound (GBP) appreciated slightly against the US dollar. The Pound has appreciated following better than expected UK earnings data as earnings increased by 6.8%. According to the Bank of England the Bank was unanimous in voting to hold its interest rate at 0.50% and its asset purchase facility at £375bn. Notably the Bank is now expecting UK consumer prices to pick up pace by the end of the year. This has pushed the Pound through 1.57 against the US Dollar and through 1.39 against the Euro.

In the first semester of 2015, Japanese yen (JPY) appreciated slightly against the US dollar and it was traded between 117 yen per dollar and 123 yen per dollar. However, in June 5th 2015, JPY/USD hit the 125.86 mark which was its highest level since June 2002. Several reasons could explain the decline of the Japanese currency including: rapid declines in Japanese interest rates, deteriorating Japanese growth; relative improvement in US economy expectations of higher US rates ahead.

Finally, Australian dollar depreciated slightly during the past six months, it was traded at 0.81US$ in January 2015, and it is at 0.77US$ in June 2015. The Australian dollar has not dropped below 80 US cents since mid-2009 and the Australian National Bank expects it to fall to fall further in summer 2015.

To conclude, the stronger U.S. dollar is the result of a mixture of factors including relative interest rates, balance of trade, and perceived safe-haven status.

Chart 1-8: Various Currencies Against US dollar



Source: Bloomberg

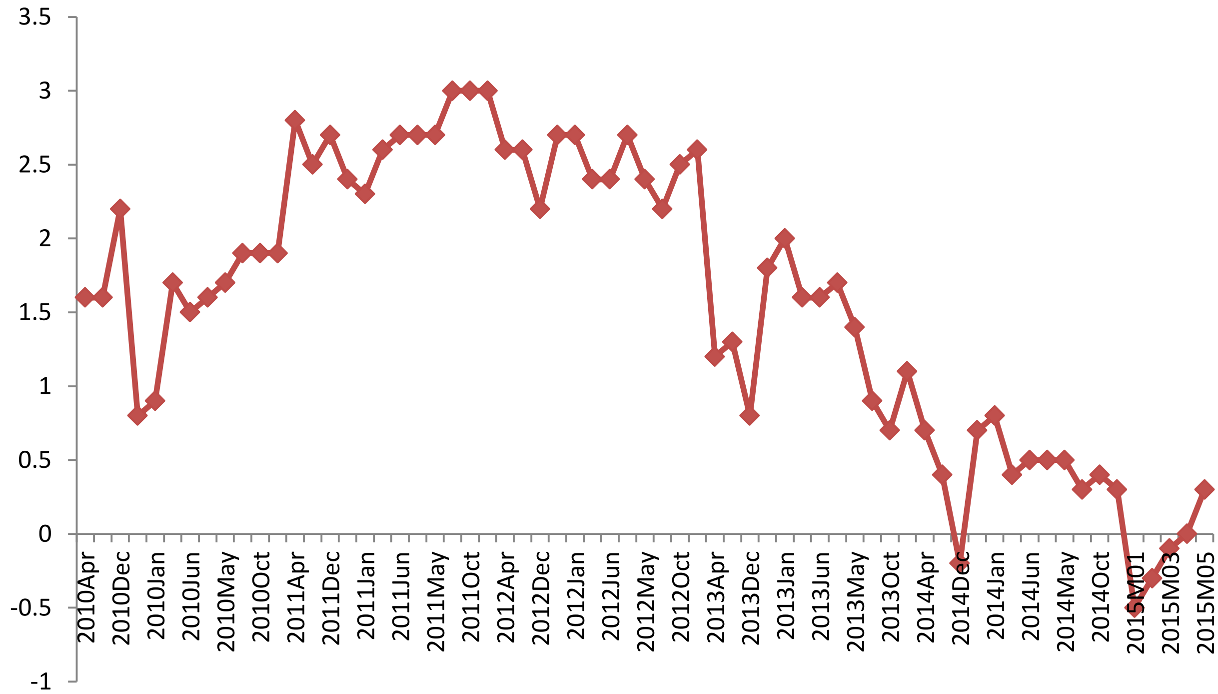
D. The Eurozone: The Grexit and the persistence of low inflation

Recent data reveals that the euro area financial markets have slightly improved during the past few months especially for peripheral countries. Data also reveal the strengthening of bank balance sheets in Europe. The recent Euro area economic and financial performance was supported by thoughtful efforts for driving economic recovery, progress with structural reforms in fragile euro area economies and the continuous guidance of the European Central Bank.

On March 9th 2015, the European Central Bank (ECB) started its new government bond-buying programme including purchases of covered bonds and asset-backed securities, with the aim to boost growth and lift inflation in the ailing Eurozone. The ECB plans to spend €60bn per month on buying sovereign bonds until at least September 2016 and until the ECB's Governing Council sees a sustained adjustment in the path of inflation. Indeed, euro-area headline inflation entered negative territory in December 2014 and remained below zero for the first three months of 2015.

Inflation in the Eurozone stood at -0.5% (year on year) in January 2014 (see Chart 1-9). It has been persistently declining for almost a year, and constantly undershooting forecasts. In the first quarter of 2015, inflation in Euro area was negative and started to be positive in April 2015.

Chart 1-9. Overall inflation in the euro area (HICP)



Source: European Commission (Eurostat) and European Central Bank data

The Eurozone is now obviously diverging from many advanced economies notably the US and UK where inflation remains positive and closes to target. One of the reasons explaining the low inflation environment in Europe is the strong preference of economic agents for holding money and government bonds rather than financial or real assets. The persistence of very low inflation and weak economic growth has pushed the ECB to purchase Eurozone government bonds to minimize the risk of a slide into deflation. According to the October World Economic Outlook (IMF 2014b), the Eurozone inflation rate "is expected to remain substantially below the ECB's price stability objective through at least 2019.

To conclude, risks to the Euro area persist. Banking systems continue to face financial stress and the regional economy continues facing various challenges especially: high unemployment and price declines in some countries that could increase the real burden of debt service. All these problems associated with the global uncertainty may lead the European banks to face new challenges and new risks, which suggests that an improved situation does not mean the end of the crisis and uncertainty. Moreover, as we described previously, Europe's (17 and 27 countries) GDP growth remains low and high unemployment continue to weigh negatively on the global financial market. The weak economic performance in Europe, combined with potentially a period of low interest rates and continued weak market growth remain key concerns in European and international markets. Moreover, the fiscal imbalances in PIIGS countries (Portugal, Italy, Ireland, Greece, and Spain) remain unsustainably high, with the prospect of painful deleveraging persisting for a number of years. Ensuring sustainable economic growth is the only path to restore confidence of investors, but until now it remains the principal challenge for European policymakers.

2. Developments in Bahrain's Financial and non-Financial Sector

Chapter

2

Key Points

- The volume of credit regains momentum and reached BD7.297 million in May 2015
- The Bahraini financial sector performed effectively with no major financial stability concerns
- The wholesale banking sector has witnessed a drop in its total assets from USD 196.3 billion in 2007 to USD110.6 million as of end May 2015.
- Household debt ratio increased.
- Business debt ratio stable.
- Construction permits increased and commercial licenses dropped

2.1 Overview

The aim of this chapter is to assess the recent development of the Bahraini financial sector during the past few months and to appraise whether the local banking and financial sector are remains resilient since our last evaluation. 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.

2.2 Bahrain's Banking sector

Over the past decades, Bahrain emerged as a major regional financial center. This has been essential to the development of its economy and the financial sector has come to play a significant role in economic activity and employment creation.

In May 2015, the banking sector in Bahrain was made up of 103 banks, categorized as follows:

- 28 retail banks (including 6 Islamic retail banks); 13 locally incorporated and 15 branches of foreign banks
- 76 wholesale banks (including 17 Islamic wholesale banks)

There are also 291 non-banking financial institutions operating in Bahrain, including investment business firms, insurance companies (including Takaful and Re-Takaful firms), and specialized licenses.

The insurance industry has progressed effectively during the past few years, which has grown into a regional hub. Insurance contribution increased from 1.9% to 2.5% of GDP over the decade. Particularly strong growth over the last five years has been in medical insurance (which now accounts for 15% of total premiums). Long-term insurance (life and savings products) has also grown rapidly. The insurance market in Bahrain now comprises 25 locally-incorporated firms and 11 overseas firms carrying out insurance, reinsurance, takaful and retakaful. These institutions offer all basic and modern insurance services such as medical and health insurance, long-term insurance (life and savings products). The expansion in the takaful sector (Sharia compliant insurance) has been particularly impressive, with gross contributions rising from $5 million in 2001 to more $110 million in 2013.

In Bahrain, the first Islamic commercial Bank, Bahrain Islamic Bank, was established in 1979 and since that, Bahrain has become the home to the Accounting and Auditing Organization for Islamic Financial Institutions, International Islamic Financial Market, Liquidity Management Centre and Islamic International Rating Agency, and the Bahrain Institute of Banking and Finance. In 2014, the Global Islamic Finance Report (GIFR) reveals that Bahrain was ranked fourth over 40 countries by Islamic Finance Country Index (IFCI).

2.2.1 The size of the banking sector

Bahrain's banking sector represented 13.5 times of GDP in 2007. Despite the global financial turmoil, the size remained large and amounted to 11.5 times of GDP from 2008 until 2010.

In 2013, the size of the banking sector fell by almost 50% to become 5.9 times of GDP. According to the table below, the wholesale banking sector has witnessed the largest drop moving from 8.1 times of GDP in 2010 to 3.2 in the fourth quarter of 2014 and to 3.26 times of GDP in Q1/2015. Further, Table 2-1 shows that the size of the retail banking sector decreased slightly during the same period and it recorded an increase in the first quarter of 2015 to become 2.4 times the GDP.

Despite the contraction in the banking size, the Bahraini financial and banking sector are still performing well and represent 15% of GDP in 2014 (CIO Bulletin). There are no major or minor effects of the drop of the overall size of the banking sector in the economy of Bahrain. This shows that the weight of wholesale banks in Bahrain is less compared to domestic banks and that retail banks in Bahrain are the main driver of financial sector growth in the Kingdom.

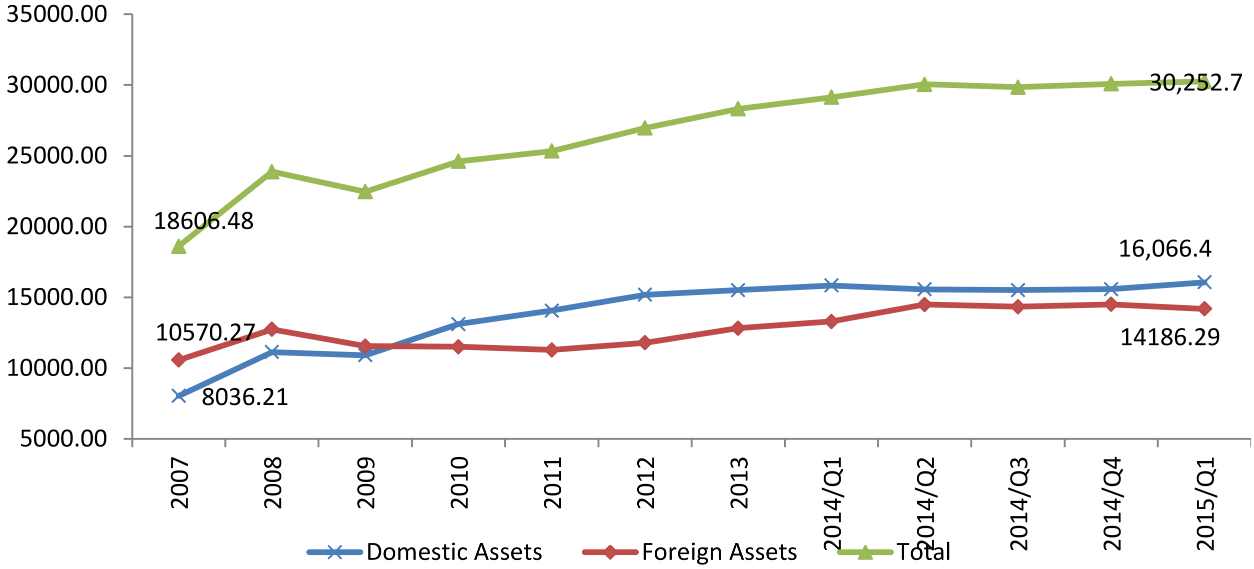
Table 2-1: Evolution of the size of the Banking sector in Bahrain since 2007

	2007	2010	2011	2012	2013/Q4	2014/Q4	2015/Q1
Size of the Banking sector (times GDP)	13.4	11.5	6.8	6.9	5.9	5.58	5.64
Consolidated Balance Sheet of Retail Sector (USD billion)	49.5	65.4	67.3	71.7	75.3	80.0	80.46
As times of GDP	2.69	3.38	2.32	2.47	2.3	2.36	2.37
Consolidated Balance Sheet of Wholesale Sector (USD billion)	196.3	157.7	129.0	127	116.7	109.28	110.6
As times of GDP	10.7	8.1	4.5	4.4	3.6	3.22	3.26

Source: CBB Statistical Bulletin

Bahrain's financial sector has faced a number of shocks over the past seven years from the sub-prime crisis to the recent political events. The banking sector managed to perform well despite these financial, social and economic shocks. In Bahrain, the retail banking sector has continued to expand. The assets of the retail banking sector rose from BD 18.6 billion in 2007 to BD 30.25 billion in the first quarter of 2015 (see Chart 2-1).

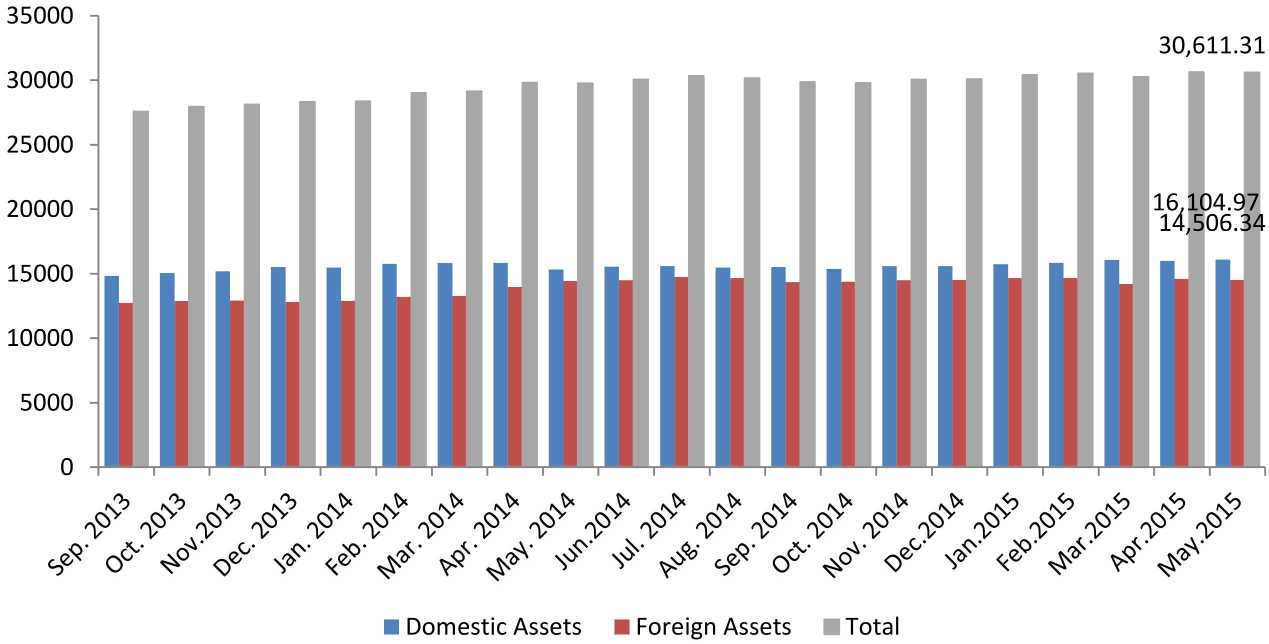
Chart 2-1: Retail Banks' Assets (BD million)



Source: Central Bank of Bahrain

It is worth mentioning that despite the global uncertainty and the troubles in MENA region, retail banking total assets continued growing since December 2012 moving from BD 26.9 billion to BD 27.5 billion as of end-September 2013 to reach BD 30.6 billion in May 2015 (see Chart 2-2). This increase in retail banking assets was driven by domestic assets which contributed to 52.6% of total assets at May 2015, up from 46.2% at end-September 2013.

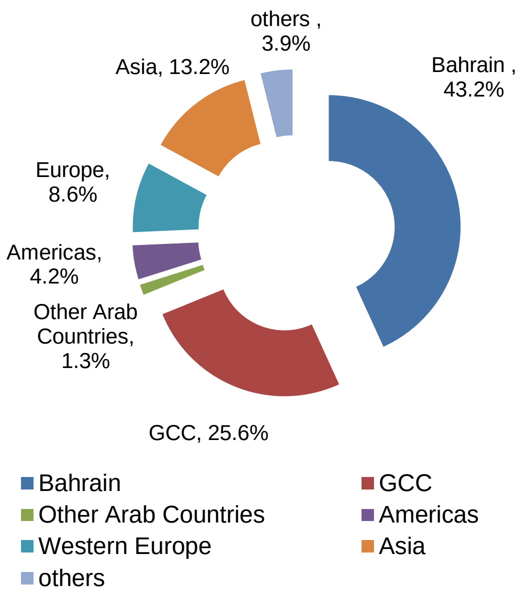
Chart 2-2: Categorization of Retail Banks' Assets (BD million)



Source: Central Bank of Bahrain

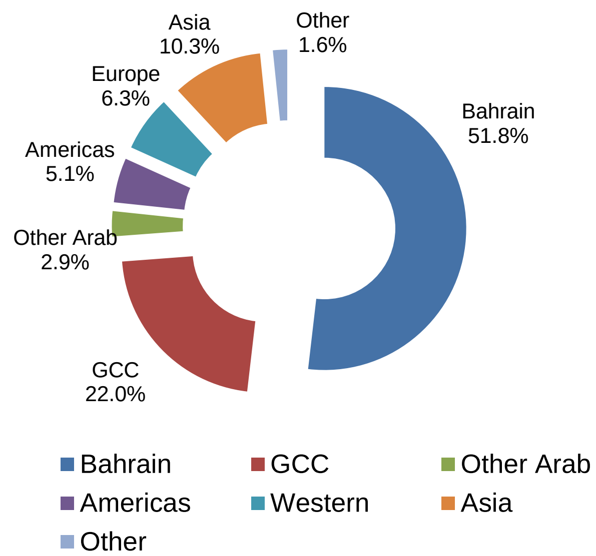
According to the charts below, it is crucial to notice that half of the 47.4% of foreign assets are GCC assets (20.6%). The level of Europe and American contribution in retail banking remains almost stable during the past eight years (+11.75%). This shows that the retail-banking sector in Bahrain is lightly exposed to foreign risk from U.S and Europe.

Chart 2-3: Retail Banks' Assets (%) by Geographical Classification (2007)*



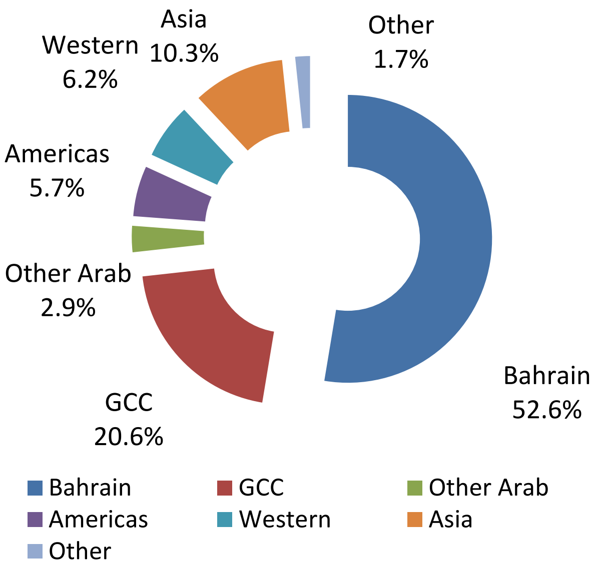
** For conventional and Islamic retail banks*
Source: Central Bank of Bahrain

Chart 2-4: Retail Banks' Assets (%) by Geographical Classification (Nov2014)*



** For conventional and Islamic retail banks*
Source: Central Bank of Bahrain

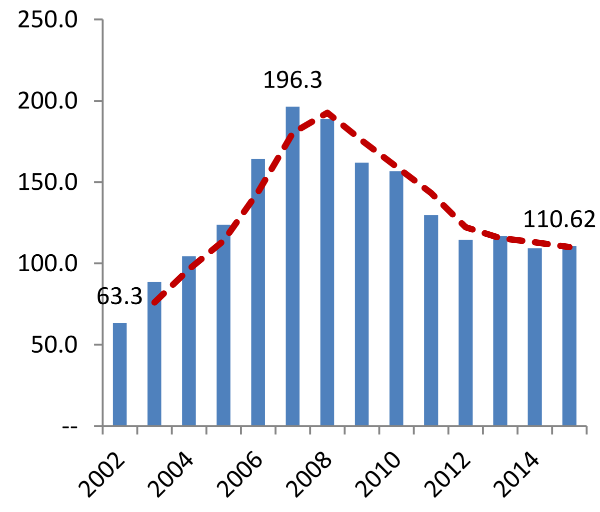
Chart 2-5: Retail Banks' Assets (%) by Geographical Classification (May 2015)*



** For conventional and Islamic retail banks*
Source: Central Bank of Bahrain

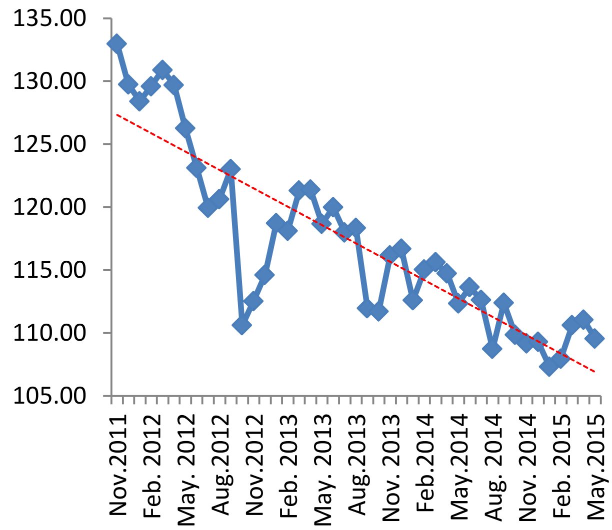
In contrast to the retail banking sector, the wholesale banking sector has witnessed a drop in its total assets from USD 196.3 billion in 2007 to USD 114.6 billion in 2012; hence a decrease of 41.6 %. Despite an improvement in the volume of total assets in the wholesale banking sector during the six months of 2014, reaching a peak of USD 115 million in May 2014, the volume became USD110.6 billion as of end May 2015 (See Charts 2-6 and 2-7).

Chart 2-6:* Wholsale Banks' Assets (USD Billion)



---. Mouving average trendline
** For conventional and Islamic wholesale banks*
Source: Central Bank of Bahrain

Chart 2-7: Wholsale Banks' Assets (USD Billion)*



--- Linear Trendline
** For conventional and Islamic wholesale banks*
Source: Central Bank of Bahrain

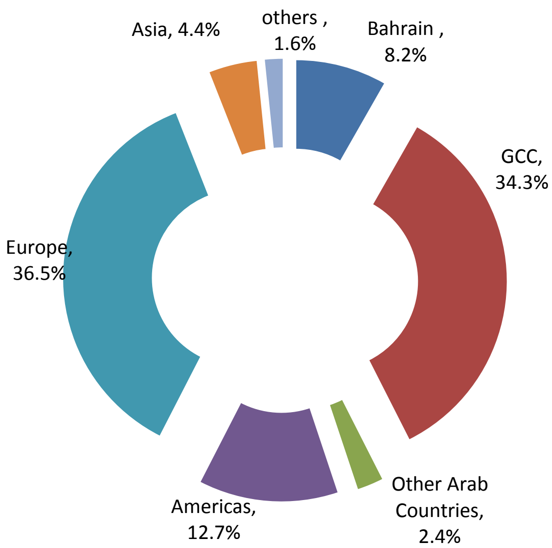
Looking at wholesale banking assets by geographical classification, it is important to note that the most significant drop is recorded in the GCC area, which fell from 34% in 2007 to 31% at end-May 2015 (see Charts 2-8, 2-9 and 2-10).

According to the geographical classification of wholesale banks' assets, we can see the main evidences below:

- The share of America's total assets decreased considerably since 2007 but it recently improved slightly to move to 9.0% in May 2015 from 7.7% of total assets in November 2014.
- The share of Europe's total assets is the most important share, and it remained stable and during the past eight years.
- There is a further increase of Asian assets which moved from 4.4% from 2007 till 2011 to 10.9% at end-May 2015.

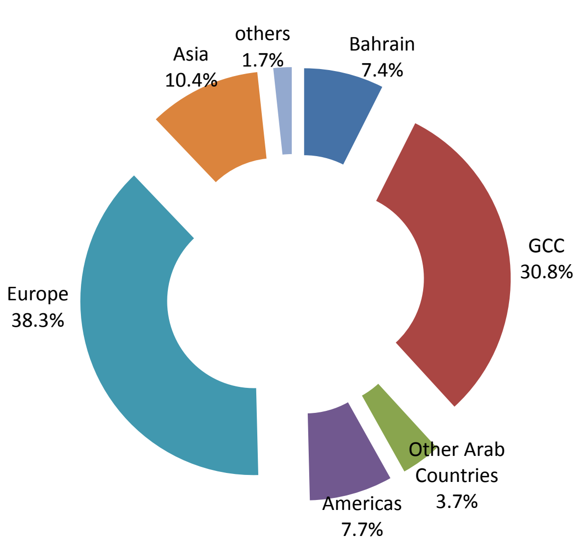
- GCC total assets dropped significantly during the past few years, but they represent almost the third of the wholesale banking sector. It is worth mentioning that the share of GCC in total assets mildly increased during the recent period moving from 30.8% in November 2014 to 31.3% of total assets in end-May 2015.

Chart 2-8: Wholesale Banks Assets by: Geographical Classification (2007) *



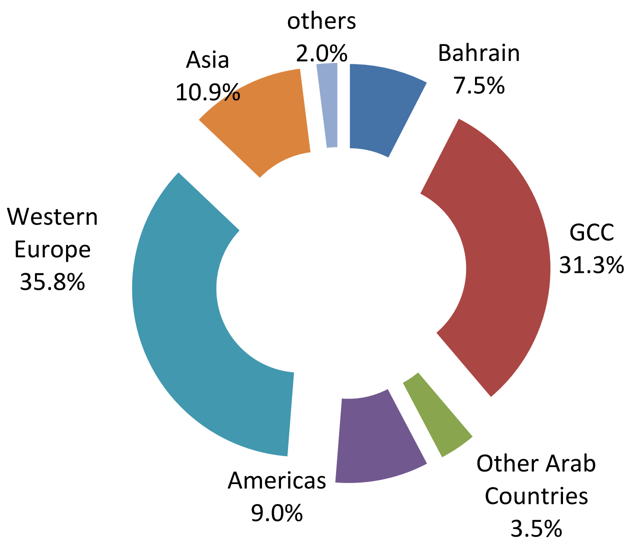
** For conventional and Islamic retail banks*
Source: Central Bank of Bahrain

Chart 2-9: Wholesale Banks Assets by: Geographical Classification (Nov.2014)* *



** For conventional and Islamic retail banks*
Source: Central Bank of Bahrain

Chart 2-10: Wholesale Banks Assets by Geographical Classification (May 2015)*



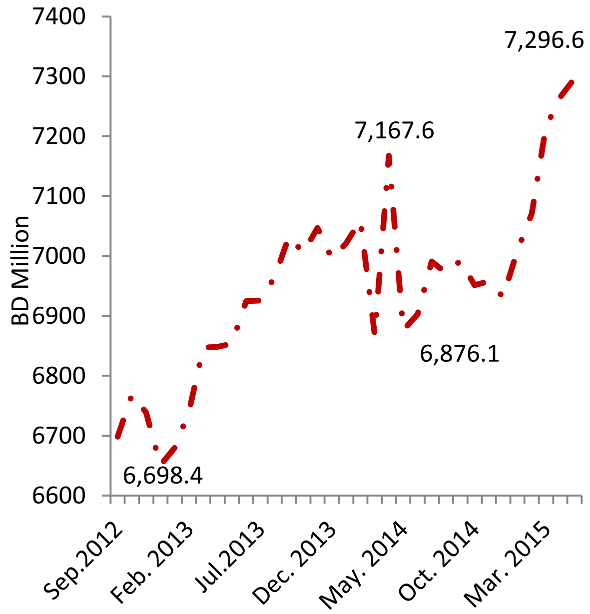
** For conventional and Islamic retail banks*
Source: Central Bank of Bahrain

2.2.2 Credit Developments

After a sudden drop in May 2014, the volume of credit regained momentum and reached BD7,297 million in May 2015 (Chart 2-11). The high credit growth reveals the recovery of the economic activities and the restore of confidence in the kingdom of Bahrain.

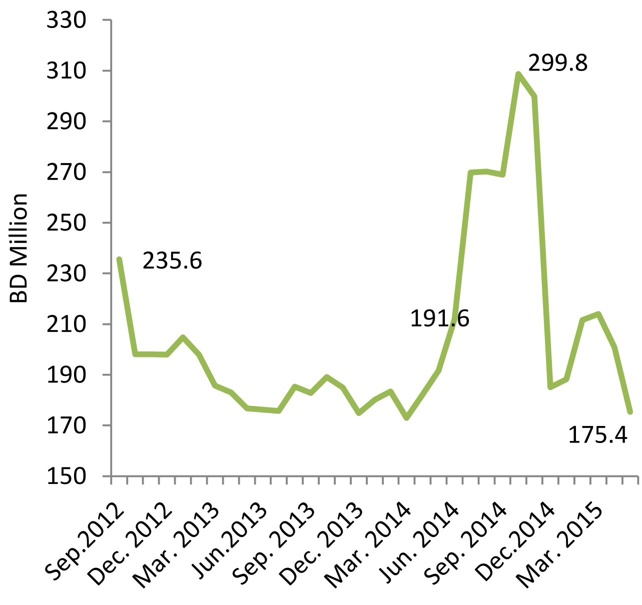
Regarding banks' lending to the general government, it increased significantly during the first three quarter of 2014, moving from BD 176 million in March 2014 to BD 299.8 million at end-November 2014 (chart 2-12) and then it decreased drastically to reach BD175 million at end-May 2015.

***Chart 2-11:* Credit to Private Sector (BD Million)**



Source: Central Bank of Bahrain

Chart 2-12:* Loans to General Government (BD Million)



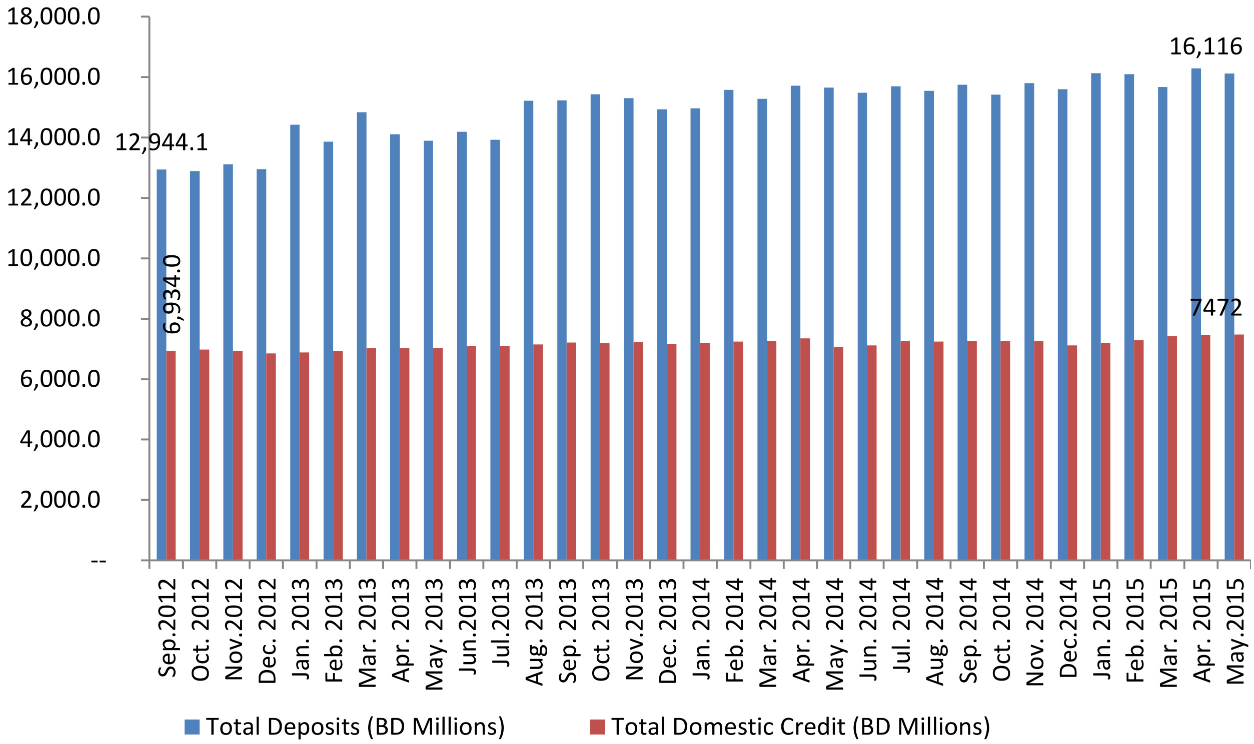
Source: Central Bank of Bahrain

*Excluding securities

Regarding total deposits, they reached BD16,116 million in May 2014, where 59% of them are total local deposits. Interestingly, this was followed by an increase in total domestic credits which moved from around BD 7,067 million in May 2014 to BD 7,472 million at end-May 2015 (chart 2-13).

Despite the high availability of liquidity, total domestic Credit remains moderate in Bahrain; it represents only 58.3 % of GDP as of the first quarter of 2015.

Chart 2-13: Total Deposits and total Domestic Credit (BD Million)

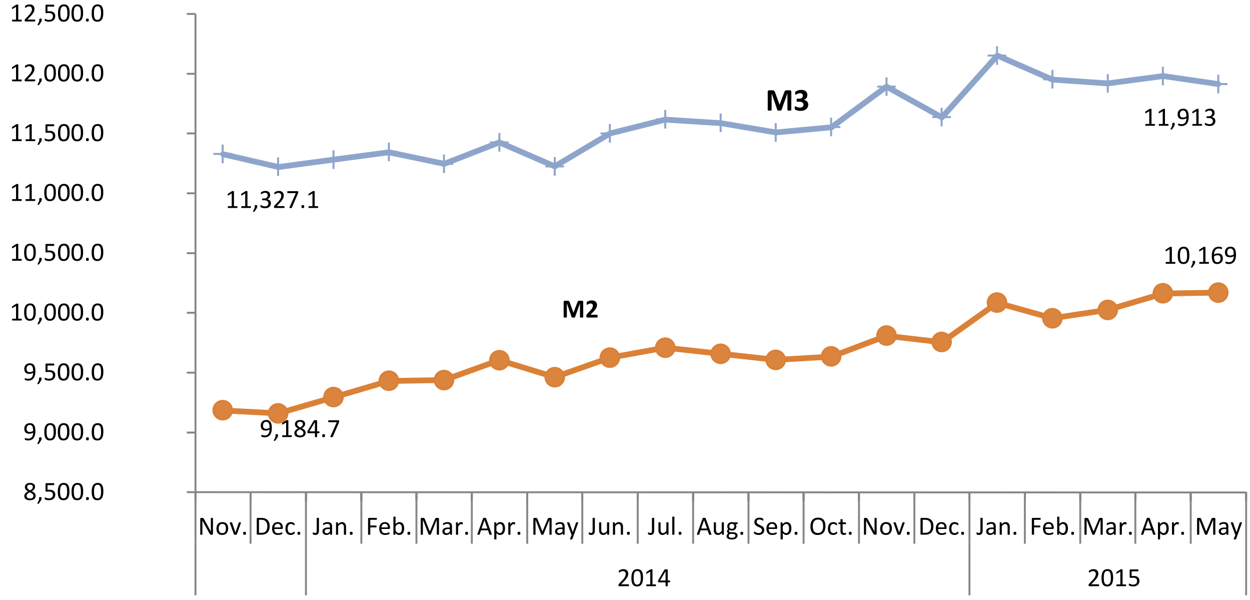


Source: Central Bank of Bahrain

2.3 Monetary indictors

Money supply has continued to grow since the second quarter of 2013. M2 stood at BD 10,169 million in end-May 2015, 7.5% higher than its value of May 2014. M3 was BD 11,913 million in end-May 2015, 6.1% higher than in May 2014 (Chart 2-14).

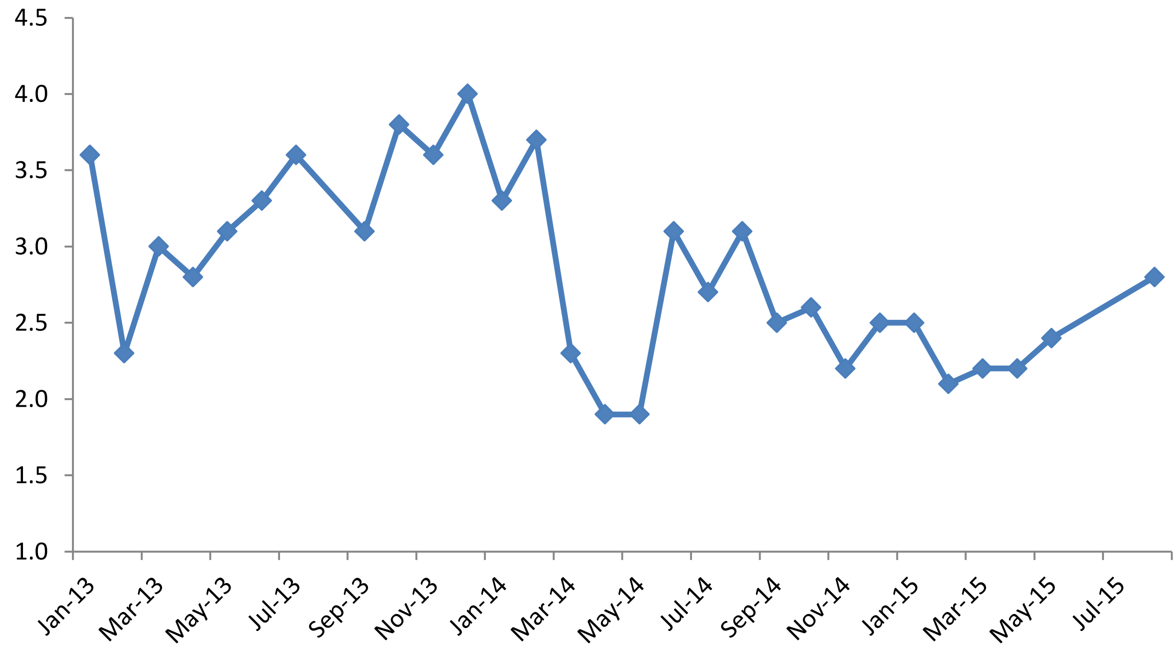
***Chart 2-14*: Money Supply (BD Billion) from May 2013 to May 2014**



Source: Central Bank of Bahrain

Generally speaking, the inflation rate in consumer prices has always been stable in Bahrain, moving from 2 to 3.5%. In the beginning of 2015, inflation in Bahrain was moderate. According to CIO (2015), inflation moved from 2.5% in January 2015 to 2.4% in May 2015. The most important decreases come from the “food and beverage”, “transport”, and “miscellaneous goods and services” which decreased by 1.3%, 1.2%, and 0.7% respectively.

Chart 2-15: Monthly Inflation in 2013-2014 (CPI%*)



**Growth rate compared to the same month of previous year, seasonally adjusted*
Source CIO Bahrain.

2.4 The Bahraini Households Sector

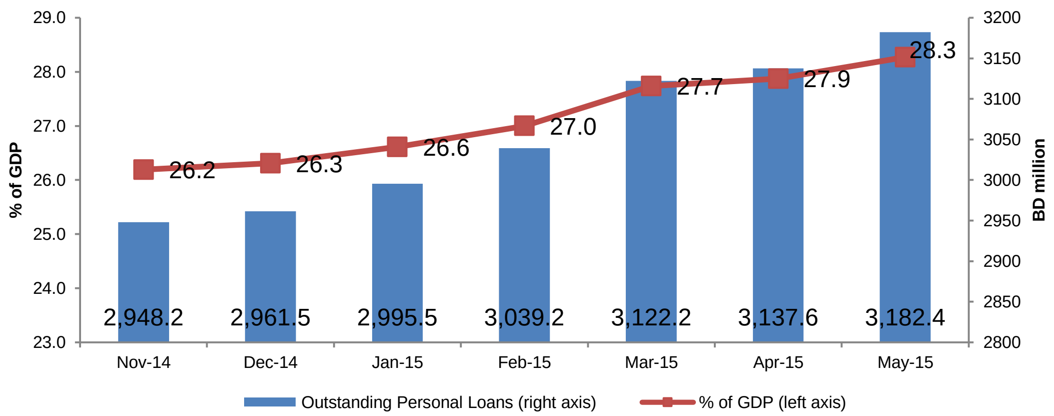
The household sector plays an important rold in financial stability and the overall economy. The household sector can allocate funds to financial assets through bank deposits and securities, and to non financial assets from land and other fixed assets. It can also receive funds from financial and non financial institutions.

The construction and real estate sector plays a huge importance on economic developments and is a good indicator of macroeconomic conditions in the country.

2.4.1 Household Debt Ratio

Outstanding personal loans, used as a proxy for household borrowing, for the period shows that the household debt burden rose, increasing throughout the period from November 2014 to May 2015 (Chart 2-16).

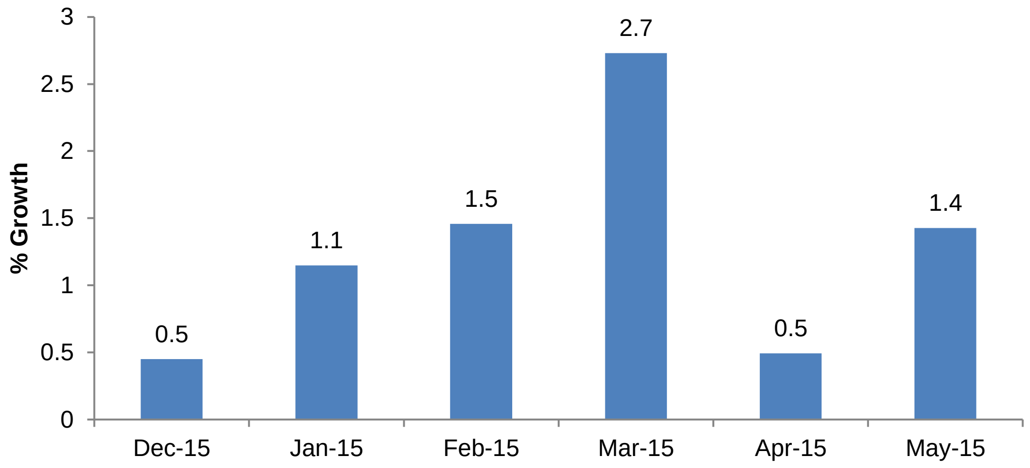
Chart 2-16: Personal Loans and Advances (Volume and % of GDP)



**Using 2014 GDP, provisional data*
Source: Central Bank of Bahrain

Personal loans as a percentage of GDP increase steadily from November 2014 to May 2015. Starting at 26.2% (BD 2,948.2 milllon) in November 2014 and capping at 28.3% in May, 2015 (BD 3,182.4 milllon). This is due to an increase in outstanding personal loans throughout the seven month period. Outstanding personal loans between November 2014 and September 2014 grew by 7.9%.

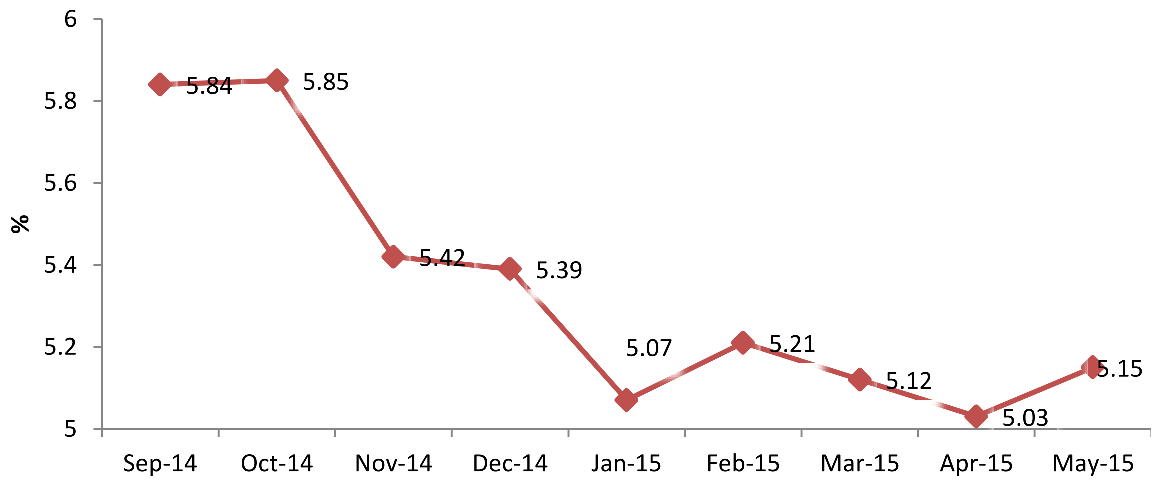
Chart 2-17: Growth Rate of Total Personal Loans and Advances (%)



**Using 2014 GDP, provisional data*
Source: Central Bank of Bahrain

Interest rate on personal loans reached its peak at 5.85% in October 2014 (Chart 2-18) and fluctuated throughout the nine month period, ending at 5.15% in May. Interest rates on secured and unsecured loans were constant throughout this period.

Chart 2-18: Retail Banks- Average Interest Rates on Personal Loans (%)

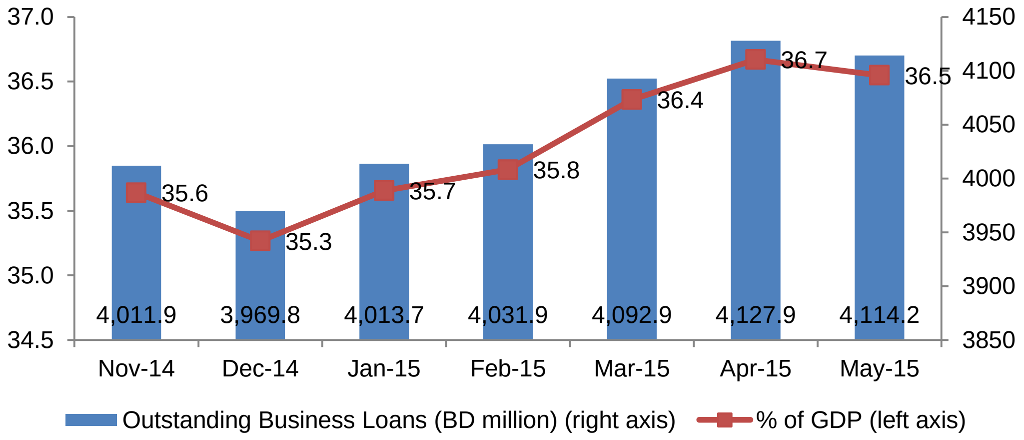


Source: Central Bank of Bahrain

2.4.2 The Bahraini Corporate Sector

Business loans and advances have seen a drop from November to December and then rose from December to April 2015 before a slight decline in May 2015 (Chart 2-19). Outstanding business loans averaged 36.0% of GDP increasing from 35.2% in November 2014 to 36.5% in May 2015.

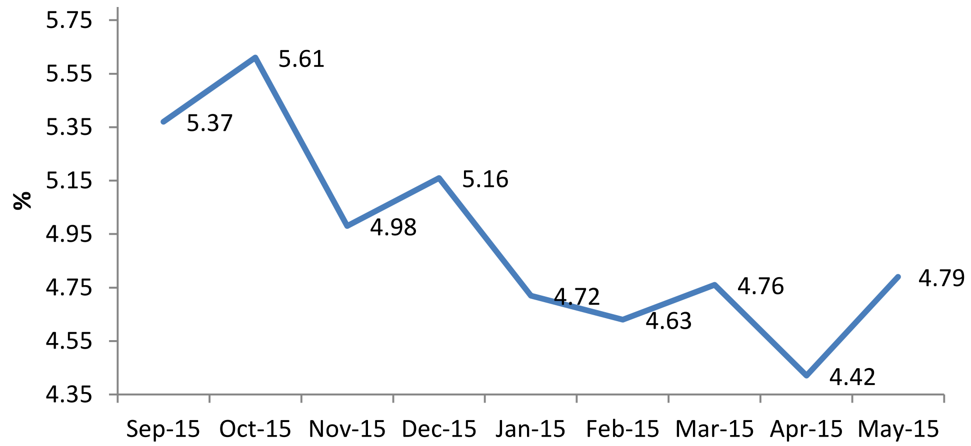
Chart 2-19: Business Loans and Advances (Volume and % of GDP)



Source: Central Bank of Bahrain

Average interest rates on business loans fluctuated throughout the nine months. It was at its peak in October 2015 at 5.62% and then reached its lowest rate in April 2015 at 4.42% (Chart 2-20). Interest rates on non-bank financial loans on transportation & communication loans remained steady during this period at 3.0%.

Chart 2-20: Retail Banks- Average Interest Rates on Business Loans (%)



Source: Central Bank of Bahrain

2.4.3 Construction and Real Estate

Commercial licenses issued for construction increased from Q1 to Q2 but dropped in Q3 of 2014, while the real estate sector has seen a decrease in licenses throughout the year, with 308 licenses issued, down from 408 licenses in Q1.

Table 2-2: Commercial Licenses Issued for Construction and Real Estate

	2013:Q4	2014:Q1	2014:Q2	2014:Q3
Construction	219	200	282	258
Real Estate, Rentals and Associated Activities	406	408	388	308
Total	**625**	**608**	**670**	**566**

Source: Ministry of Industry and Commerce

The total number of construction permits issued by the Ministry of Municipalites Affairs and Agriculture has seen an increase from Q1 2014 to Q3 2014, with a total of 738 permits at the end of the third quarter.

Table 2-3: Selected Construction Permits by Type

	2013:Q4	2014:Q1	2014:Q2	201:Q3
Demolition and New Construction	8	8	16	14
New Construction	562	545	649	723
Reclamation	36	1	1	1
Total	**606**	**554**	**666**	**738**

Sources: Ministry of Municipality Affairs and Agriculture

2.5 Overall assessment of the Bahraini Financial sector and non-Financial Sector

Despite the global uncertainty and weak economic condition in emerging markets, all the indicators presented and analyzed above reveal that the Bahraini banking sector is performing efficiently during the first semester of 2015. Bank loans continue their recovery and credit growth is expected to grow further pace in the coming year. Overall funding conditions have improved and demand for loans has accelerated in Bahrain.

Banks operating in Bahrain are well capitalized, funding and liquidity buffers are well above minimum required standards, and non-performing loans continue to drop. Regulatory changes in recent years have helped to improve prudential standards for retail and wholesale banks (conventional and Islamic). All these changes have been beneficial for financial stability and will further strengthen the position of Bahrain as a financial center.

In the following chapters, the performance of the Bahraini banking sector (retail, wholesale, conventional and Islamic) will be analysed in, Bahrain Bourse, as well as the developments in e-payment activities during the previous semester.

Part II:

Performance of the Banking Sector

3. Conventional Banks

Chapter 3

Key Points

- A decrease in capital positions of conventional retail and increase in conventional wholesale banks.
- Non-performing loans (NPLs) for conventional retail banks decreased while conventional wholesale banks increases.
- Loan portfolios in conventional retail and wholesale banks remain concentrated despite the decrease in some sectors.
- Expand in earnings for conventional retail banks and fall in conventional wholesale banks.
- Increase in liquidity for conventional retail banks and conventional wholesale banks.

3.1 Overview

This chapter analyses the banking sector under the following categories: conventional retail banks (section 3.2), conventional wholesale banks (section 3.3). Section 3.4 provides an overall assessment of the conventional 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 2014 and compared with end-March 2015. This chapter offers macroprudential analysis of the conventional banking sector based on a set of selected Financial Soundness Indicators (FSIs).[1]

Annex 1 presents selected *Financial Soundness Indicators* (FSIs) for the different banking segments. Annex 2 presents selected graphs showing the development of selected indicators over time.

[1] This chapter does not contain a section on stress testing. Stress Testing exercises are performed separately in an internal report to obtain information on the potential quantitative impact of hypothetical scenarios on selected Bahraini Systemically-Important Banks (SIB's).

NOTE: As part of CBB's implementation of Basel III, The CBB has made changes to its rulebook requiring all banks to report the capital ratios in compliance with Basel III effective January 2015. Therefore, the March 2015 capital ratios are Basel III compliant while previous quarters are Basel II compliant which may explain the changes in some FSI indicators. The existing minimum required target capital adequacy ratio of 12.5% remains in place but with adjustments to the definitions and contributions of the elements of capital.

3.2 Conventional Retail Banks

Decrease in capital adequacy [2]

Capital adequacy ratios for conventional retail banks decreased from 18.6% in September 2015 to 17.6% in March 2015. The core capital ratio (ratio of Tier 1 capital to risk-weighted assets) showed a slight increase from 15.0% in September 2014 to 15.6% in March 2015. The leverage ratio (ratio of assets over capital) showed a slight decrease of 0.3% from 8.3% in September 2014 to 8.0% in March 2015. The ratio of non-performing loans (NPLs) net remained decreased to reach 7.5%.

Table 3-1 Capital Provisions Ratios for Local Conventional Retail Banks

Indicator	Sept. 2014	March 2015
Capital Adequacy Ratio (%)	18.6	17.6
Tier 1 Capital Adequacy Ratio (%)	15.0	15.6
Leverage (assets/capital)(times)	8.3	8.0
NPLs net of provisions to capital (%)	8.9	7.5

Source: Central Bank of Bahrain

Decreases in non-performing loans

Non-performing loans decreased for the periods of September 2014 to March 2015 to reach 3.5%. The specific provisions as a proportion of NPLs showed an increase to 55.6% in March 2015 from 53.9% in September 2014.

Table 3-2: NPL Figures for Conventional Retail Banks

Indicator	Sept. 2014	March 2015
NPL's (% Gross)	3.8	3.5
NPL's Local Banks (% Gross)	4.7	4.3
NPL's Overseas Banks (% Gross)	1.8	1.8
Specific provisions (% of NPLs) *	53.9	55.6
Net NPL's (% of net loans)	1.8	1.6

Source: Central Bank of Bahrain

** Specific provisions as a percentage of NPL's are calculated as specific provisions divided by gross impaired loans minus interest in suspense.*

[2] 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.

The net NPLs of net loans decreased from 1.8% in September 2014 to 1.6% in March 2015. For *local retail banks*, the NPLs decreased to 4.3% in March 2015. For *overseas retail banks*, the NPLs remained unchanged at 1.8% in March 2015.

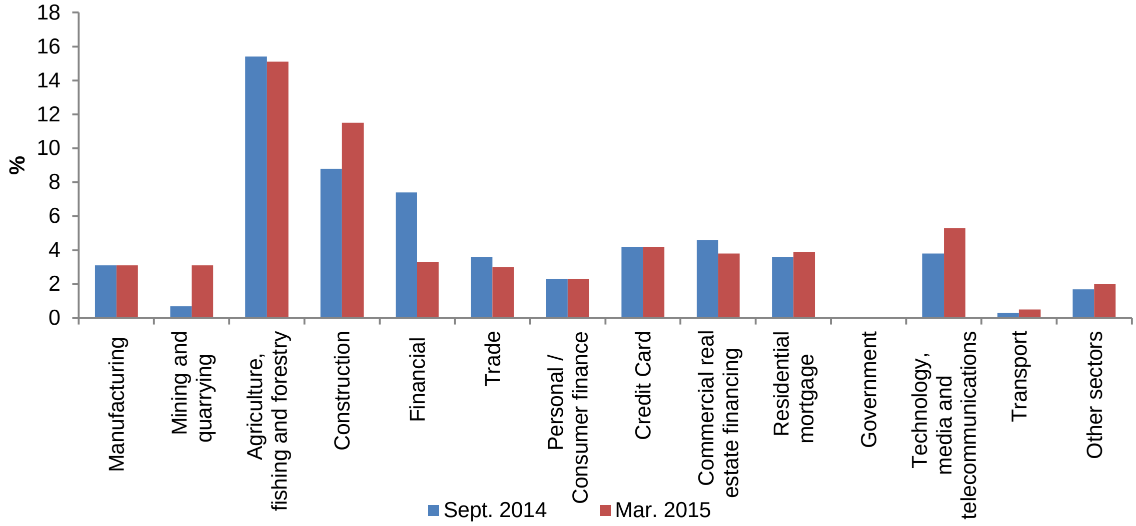
Available data on the sectoral breakdown of impaired loans [3] shows most sectors experiencing an increase in impairment, while some experience a decrease and others remaining unchanged (Table 3-3 and Chart 3-1). The highest decrease was in "financial" by 4.1% followed by "Commercial real estate financing" by 0.8%.

Table 3-3: Conventional Retail Banks' Impaired Loan Ratios by Sector (% of gross loans per sector)

	Sept. 2014	March 2015	Change
Manufacturing	3.1	3.1	0.0
Mining and quarrying	0.7	3.1	2.4
Agriculture, fishing and forestry	15.4	15.1	(0.3)
Construction	8.8	11.5	2.7
Financial	7.4	3.3	(4.1)
Trade	3.6	3.0	(0.6)
Personal / Consumer finance	2.3	2.3	0.0
Credit Card	4.2	4.2	0.0
Commercial real estate financing	4.6	3.8	(0.8)
Residential mortgage	3.6	3.9	0.3
Government	0.0	0.0	0.0
Technology, media and telecommunications	3.8	5.3	1.5
Transport	0.3	0.5	0.2
Other sectors	1.7	2.0	0.3

Source: Central Bank of Bahrain

Chart 3-1: Conventinoal Retail Banks' Impaired Loans by Sector (% of gross loans per sector)



Source: Central Bank of Bahrain

[3] Impaired loans include NPLs on which payments of interest or repayments of principal are 90 or more days past due and all loans and advances on which specific provisions have been made.

Loan portfolios remain concentrated

The loan portfolio of *locally incorporated retail banks* remains concentrated with the top recipient of loans being the "commercial real estate financing" sector accounting for 18.7% of total loans in March 2015, a decrease from the 19.2% in September 2014. The "manufacturing" sector represented 12.4% of total loans up from 12.3% followed by the "personal/consumer finance" sector at 12.3%, an increase from 11.9% to 12.3% over the same period.

Table 3-4: Distribution of Local Conventional Retail Banks' Lending (% total loans)*

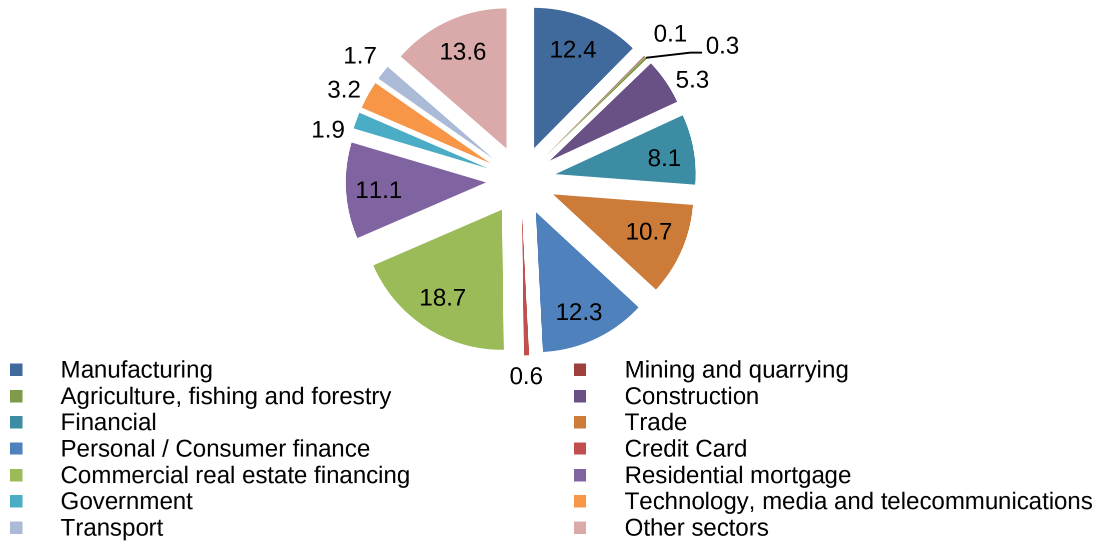
	Sept. 2014	March 2015	Change
Manufacturing	12.3	12.4	0.1
Mining and quarrying	0.2	0.1	(0.1)
Agriculture, fishing and forestry	0.2	0.3	0.1
Construction	5.3	5.3	0.0
Financial	7.7	8.1	0.4
Trade	10.6	10.7	(0.1)
Personal / Consumer finance	11.9	12.3	0.4
Credit Card	0.6	0.6	0.0
Commercial real estate financing	19.2	18.7	(0.5)
Residential mortgage	11.2	11.1	(0.1)
Government	2.6	1.9	(0.7)
Technology, media and telecommunications	2.4	3.2	0.8
Transport	1.7	1.7	0.0
Other sectors	13.9	13.6	(0.3)
Top two recipient sectors	**33.2**	**32.3**	**(0.9)**
Real Estate/ Construction Exposure**	**35.8**	**35.1**	**(0.7)**

Source: Central Bank of Bahrain
**Figures may not add to a hundred due to rounding*
*** Real Estate/ Construction exposure is calculated as the share of the Construction, Commercial real estate financing and Residential Mortgages sectors of total lending.*

The top two recipient sectors "commercial real estate financing" and "others"[4] jointly represented 32.3% of loans in March 2015, a decrease from the 33.2% in September 2014. Exposure to real estate/ construction was 35.1% of total lending in March 2015, a decrease from the 35.8% registered in September 2014.

[4] The "others sectors" category includes sectors such as "private banking", "services", "tourism", and "utilities".

Chart 3-2: Distribution of Conventional Local Retail Banks' Lending (% of total loans)



Source: Central Bank of Bahrain

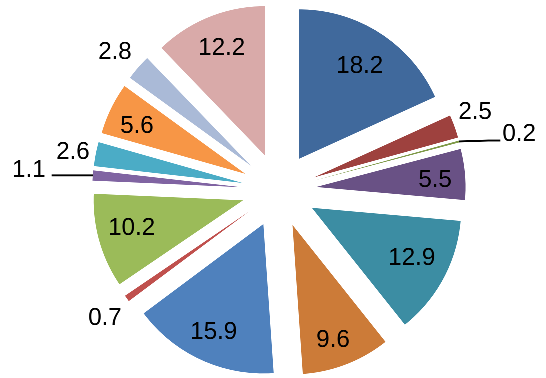
The numbers as of end-March 2015 continue to show high concentration of risk for *overseas retail banks* (Table 3-5 and Chart 3-3). The top recipient of loans was the "Manufacturing" sector with 18.2% of total loans in March 2015, a decrease from the 19.2% in September 2014.

Table 3-5: Distribution of Overseas Conventional Retail Banks' Lending (% total loans)*

	Sept. 2014	March 2015	Change
Manufacturing	19.2	18.2	(1.0)
Mining and quarrying	2.8	2.5	(0.3)
Agriculture, fishing and forestry	0.2	0.2	0.0
Construction	6.2	5.5	0.7
Financial	8.3	12.9	4.6
Trade	8.1	9.6	1.5
Personal / Consumer finance	16.3	15.9	(0.4)
Credit Card	0.7	0.7	0.0
Commercial real estate financing	9.9	10.2	0.3
Residential mortgage	1.2	1.1	(0.1)
Government	2.8	2.6	(0.2)
Technology, media and telecommunications	6.1	5.6	(0.5)
Transport	2.6	2.8	0.2
Other sectors	15.6	12.2	(3.4)
Top two recipient sectors	**35.3**	**34.1**	**(1.2)**
Real Estate/ Construction Exposure**	**17.3**	**16.8**	**(0.5)**

Source: Central Bank of Bahrain
*Figures may not add to a hundred due to rounding
** Real Estate/ Construction exposure is the share of the Construction, Commercial real estate financing and Residential Mortgages sectors of total lending.

Chart 3-3: Distribution of Conventional Overseas Retail Bank's Lending (% of toal loans)



Source: Central Bank of Bahrain

The top two recipients of loans ("manufacturing" and "personnel/Consumer finance") jointly accounted for 34.1% of total loans. Exposure to real estate/ construction was 16.8% of total lending in March 2015, a decrease from the 17.3% in September 2014.

Increase in retail bank profitability

As at end-March 2015, return-on-assets (ROA) increased to 0.7% from 0.4% in March 2014. ROA for *locally-incorporated banks* increased from 0.4% in March 2014 to 0.5% in March 2015. For *overseas banks*, ROA increased from 0.6% in 2014 to 1.3% in March 2015. Return-on-equity (ROE)[5] for *locally-incorporated banks* increased from 4.0% in March 2014 to 4.4% in March 2015.

Net interest income (as a % of gross income) decreased from 68.1% in March 2014 to 67.4% in March 2015. On the other hand, operating expenses as a proportion of gross income decreased from 41.2% in March 2014 to 27.1% in March 2015.

Table 3-6: Profitability of Retail Banks (%)

	March 2014	March 2015
ROA *	0.4	0.7
ROA Locally Incorporated Banks	0.4	0.5
ROA Overseas Banks	0.6	1.3
ROE**	4.0	4.4
Net interest income (% total income)	68.1	67.4
Operating expenses (% total income)	41.2	27.1

Source: Central Bank of Bahrain
**ROA = ratio of net income to assets*
***ROE = ratio of net income to tier 1 capital (for locally incorporated banks only*

[5] We define equity in ROE as net profit over Tier 1 Capital.

Liquidity position increased

Between September 2014 and March 2015, bank deposits decreased while non-bank deposits increased for retail banks. Bank deposits decreased to 21.8% in March 2015. Non-bank deposits increased at 78.2% over the same period. The overall loan-deposit ratio for the segment increased from 65.0% in September 2014 to 69.6% in March 2015. Liquid assets as a proportion of total assets remained nearly unchanged over the period of September 2014 to March 2015 at 26.7%, respectively. Similarly, liquid assets as a proportion of the short-term liabilities presented an increase from 37.4% to 40.9% over this period.

Table 3-7: Retail Banks' Liquidity Profile (%)

	Sept. 2014	March 2015
Liquid Asset Ratio	26.8	26.7
Loan-Deposit Ratio	65.0	69.6
Non-Bank Deposits as a % of total deposits	73.9	78.2

Source: Central Bank of Bahrain.

3.3 Conventional Wholesale Banks

increase in capital adequacy[6]

As at end-March 2015, the regulatory capital adequacy ratio for locally-incorporated wholesale banks was 21.5%, a slight increase from the 21.3% registered in September 2014. The core capital ratio (ratio of Tier 1 capital to risk-weighted assets) increased to 19.1% in March 2015 from the 18.4% registered in September 2014. On the other hand, the leverage ratio (ratio of assets over capital) showed an increase of 2.2% from the 6.2% registered in September 2014 to 8.4% in March 2015. The ratio of non-performing loans (NPLs) net of provisions to capital increased from 1.8% in September 2014 to 2.3% over the same period which is attributed to the increase in non-performing loans.

Table 3-8: Capital Provisions Ratios for Local Conventional Wholesale Banks

Indicator	Sept. 2014	March 2015
Capital Adequacy Ratio (%)	21.3	21.5
Tier 1 Capital Adequacy Ratio (%)	18.4	19.1
Leverage (assets/capital)(times)	6.2	8.4
NPLs net of provisions to capital (%)	1.8	2.3

Source: Central Bank of Bahrain

Increase in non-performing loans of wholesale banks

As at end-March 2015, loans classified as non-performing increased to 6.0%. The NPLs of *Locally-incorporated wholesale banks* increased to reach 4.0%. Similarly, *overseas wholesale* banks witnessed an increase in NPLs from 7.5% to 7.9% over the same period. Specific provisions as a proportion of NPLs witnessed a decrease from 72.6% in September 2014 to 70.5% in March 2015. The net NPLs increased from 1.7% in September 2014 to 1.9% in March 2015.

Table 3-9: NPL Figures for Conventional Wholesale Banks

Indicator	Sept. 2014	March 2015
NPL's (% Gross)	5.8	6.0
NPL's Local Banks	3.8	4.0
NPL's Overseas Banks	7.5	7.9
Specific provisions (% of NPLs) *	72.6	70.5
Net NPLs (% of net loans)	1.7	1.9

Source: Central Bank of Bahrain

** Specific provisions as a percentage of NPL's are calculated as specific provisions divided by gross impaired loans minus interest in suspense.*

[6] 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.

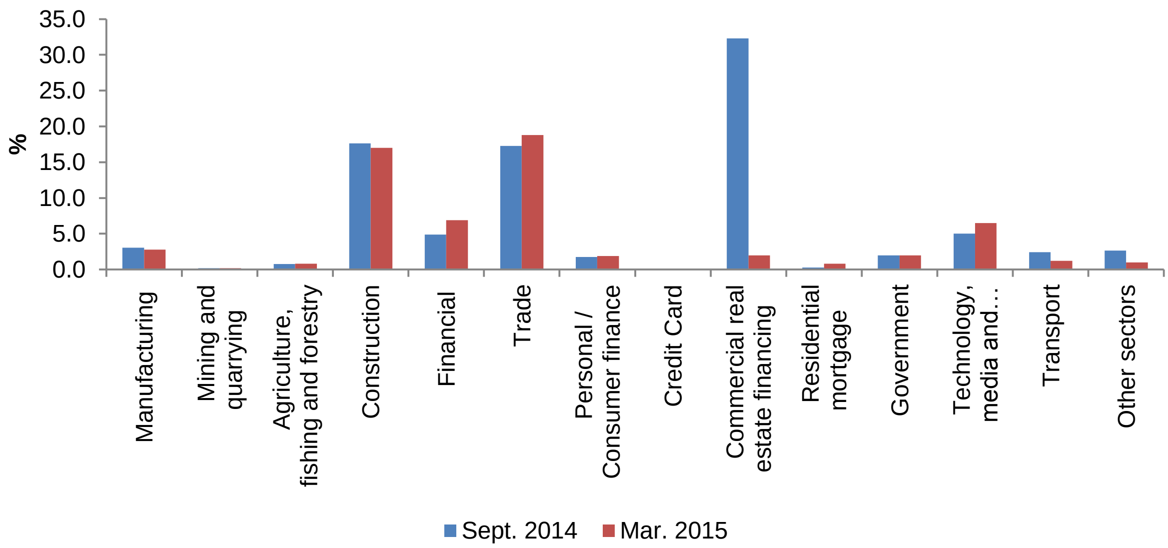
Available data on the sectoral breakdown of impaired loans shows that impairment in the "trade" was the highest between all sectors at 18.8% followed by the "Construction" sector with an impairment of 17.0%. The biggest increases were in the "trade" sector which increased by 2.5% followed by "financial" and "Technology, media and telecommunications" which increased both by 2.4%. The largest decrease in impairment were found in the "commercial real estate financing" sector which decreased by 22.3%.

Table 3-10: Conventional Wholesale Banks' Impaired Loan Ratios by Sector (% of gross loans to sector)

	Sept. 2014	March 2015	Change %
Manufacturing	3.1	2.8	(0.3)
Mining and quarrying	0.3	0.2	(0.1)
Agriculture, fishing and forestry	0.8	0.8	0.0
Construction	17.6	17.0	(0.6)
Financial	4.5	6.9	2.4
Trade	16.3	18.8	2.5
Personal / Consumer finance	1.8	1.9	0.1
Credit Card	0.0	0.0	0.0
Commercial real estate financing	24.3	2.0	(22.3)
Residential mortgage	0.3	0.8	0.5
Government	2.0	2.0	0.0
Technology, media and telecommunications	4.1	6.5	2.4
Transport	2.4	1.2	(1.2)
Other sectors	3.0	1.0	(2.0)

Source: Central Bank of Bahrain

Chart 3-4: Conventional Wholesale Banks' Impaired Loans by Sector (% of gross loans to sector)



Source: Central Bank of Bahrain

Loan portfolios remains concentrated despite decreases in some sectors

An examination of lending patterns as at end-March 2015 shows that for *locally-incorporated wholesale banks,* the top recipient of loans remained the "Manufacturing" sector, which accounted for 27.4% of total loans in March 2015 representing a decrease from the 28.4% in September 2014 (Table 3-10 and Chart 3-5).

Table 3-11: Distribution of Conventional Local Wholesale Banks' Lending (% total Loans)*

	Sept. 2014	March 2015	Change
Manufacturing	28.4	27.4	(1.0)
Mining and quarrying	3.2	3.0	(0.2)
Agriculture, fishing and forestry	2.3	2.0	(0.3)
Construction	8.2	7.5	(0.7)
Financial	22.6	21.6	(1.0)
Trade	10.9	11.1	0.2
Personal / Consumer finance	2.0	2.1	0.1
Credit Card	0.0	0.1	0.1
Commercial real estate financing	1.5	2.4	0.9
Residential mortgage	0.8	0.7	(0.1)
Government	0.9	1.5	0.6
Technology, media and telecommunications	2.1	2.1	0.0
Transport	7.0	7.7	0.7
Other sectors	10.1	10.8	0.7
Top two recipient sectors	**51.0**	**49.0**	**(2.0)**
Real Estate/ Construction Exposure**	**10.5**	**10.6**	**0.1**

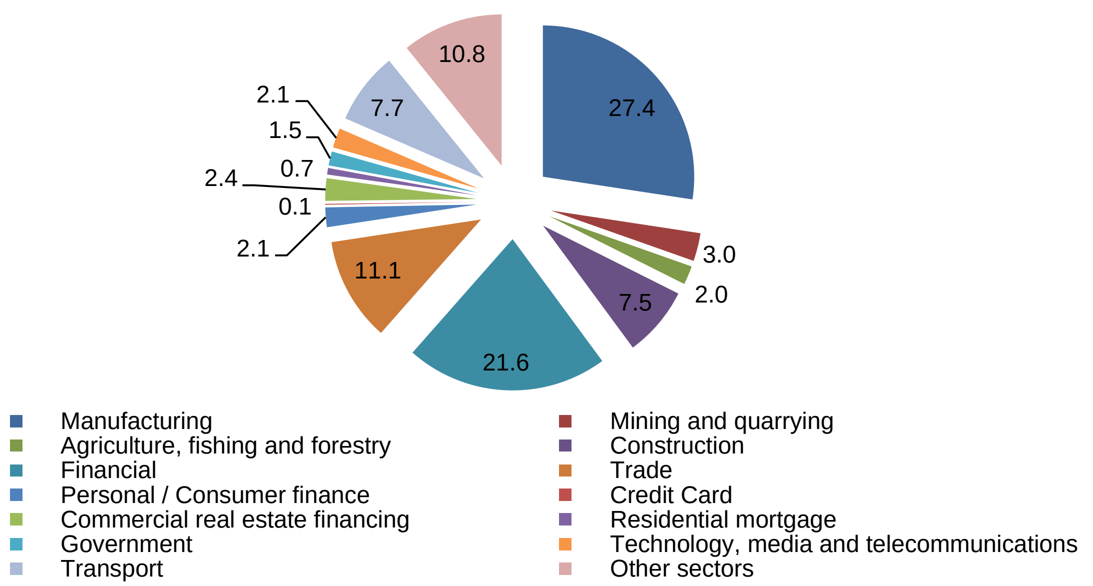
Source: Central Bank of Bahrain

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

*** Real Estate/ Construction exposure is the share of the Construction, Commercial real estate financing and Residential Mortgages sectors of total lending.*

Also, the top two sectors ("manufacturing" and "financial") accounted for 49.0% of total lending in March 2015 while real estate/ construction exposure increased to 10.6% from 10.5%.

Chart 3-5: Distribution of Conventional Local Wholesale Banks' Lending (% of total loans)



Source: Central Bank of Bahrain

In *overseas wholesale banks*, the top recipient of loans in March 2015 was the "financial" sector, with 24.5% of total loans down from the 38.8% in September 2014 (Table 3-11 and Chart 3-6). The top 2 sectors (financial and other) jointly represented 49.2% in March 2015. Real estate/construction exposure increased from 8.9% in September 2014 to 13.0% in March 2015.

Table 3-12: Distribution of Conventional Overseas Wholesale Banks' Lending (% total Loans)*

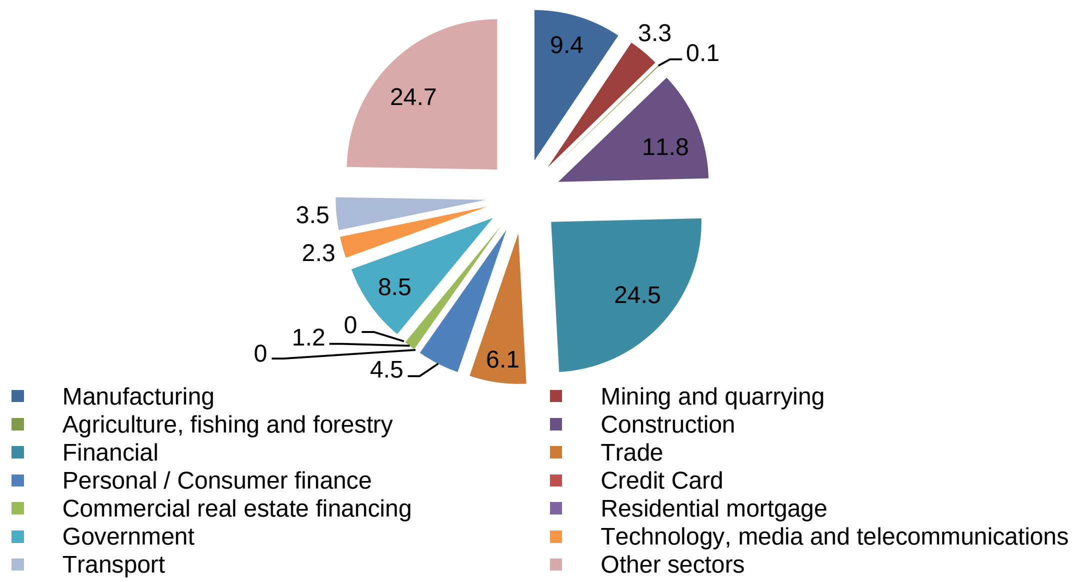
	Sept. 2014	March 2015	Change
Manufacturing	6.7	9.4	2.7
Mining and quarrying	1.0	3.3	2.3
Agriculture, fishing and forestry	0.1	0.1	0.0
Construction	7.7	11.8	4.1
Financial	38.8	24.5	(14.3)
Trade	7.4	6.1	(1.3)
Personal / Consumer finance	3.8	4.5	0.7
Credit Card	0.0	0.0	0.0
Commercial real estate financing	1.1	1.2	0.1
Residential mortgage	0.0	0.0	0.0
Government	7.7	8.5	0.8
Technology, media and telecommunications	2.5	2.3	(0.2)
Transport	4.2	3.5	(0.7)
Other sectors	19.1	24.7	5.6
Top two recipient sectors	**57.8**	**49.2**	**(8.6)**
Real Estate/ Construction Exposure**	**8.9**	**13.0**	**4.1**

Source: Central Bank of Bahrain

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

*** Real Estate/ Construction exposure is the share of the Construction, Commercial real estate financing and Residential Mortgages sectors of total lending.*

Chart 3-6: Distribution of Overseas Wholesale Banks' Lending (%)



Source: Central Bank of Bahrain

Decreased earnings for wholesale banks

ROA for the conventional wholesale banking sector was at 0.2% in March 2015, a decrease from the 0.5% in March 2014. The ROA for *local wholesale banks* decreased from 0.4% to 0.2% over the same period. ROA for overseas wholesale banks decreased from 0.6% to 0.1% over the same period.

ROE for *local wholesale banks* decreased from 2.5% to 1.6%. Net interest income as a proportion of gross income increased from 35.2% to 90.3% in March 2015. Operating expenses as a proportion of gross income showed an increase from 39.3% in March 2014 to 57.5% in March 2015.

Table 3-13: Profitability of Wholesale Banks (%)

	March 2014	March 2015
ROA *	0.5	0.2
ROA Locally Incorporated Banks	0.4	0.2
ROA Overseas Banks	0.6	0.1
ROE**	2.5	1.6
Net interest income (% total income)	35.2	90.3
Operating expenses (% total income)	39.3	57.5

Source: Central Bank of Bahrain
**ROA = ratio of net income to assets*
***ROE = ratio of net income to tier 1 capital (for locally incorporated banks only*

Liquidity position improves

As at end-March 2015, the overall loan-deposit ratio for conventional wholesale banks stood at 63.3%, a decrease from the 70.2% in September 2014. The loan deposit ratio for *local wholesale banks* decreased to 66.3% in March 2015 from the 69.0% in September 2014. Over the same period, the loan deposit ratio for *overseas wholesale* bank decreased from 71.2% to 60.5%.

Liquid assets for wholesale banks as a proportion of total assets increased to 24.7% in March 2015 from 19.9% in September 2014. *Locally incorporated wholesale banks* had a liquid asset ratio of 37.1% in March 2015 an increase from the 32.5% in September 2014. Overseas wholesale banks had a ratio of 12.3%, higher than the 7.6% registered in September 2014. Liquid assets as a proportion of short-term liabilities increased to 38.6% in March 2015 from 31.5% in September 2014. Lastly, the deposits from non-bank sources as a proportion of total deposits decreased to 45.7% from 47.2% while bank deposits increased from 47.1% to 54.3% over the same period.

Table 3-14: Wholesale Banks' Liquidity Profile (%)

	Sept. 2014	March 2015
Liquid Asset Ratio	19.9	24.7
Loan-Deposit Ratio	70.2	63.3
Non-Bank Deposits as a % of total deposits	47.2	45.7

Source: Central Bank of Bahrain.

3.4 Overall Assessment of the Conventional Banking Sector

The financial soundness indicators show that conventional retail banks witnessed a decrease in capital adequacy ratio while conventional wholesale sectors witnessed an increase in capital positions. Capital adequacy ratios for conventional retail banks decreased to 17.6% in March 2015. Capital adequacy ratio for conventional wholesale banks was 21.5%. Non-performing loans have shown a slight decrease between periods of September 2014 to March 2015 from 3.8% to 3.5%, for conventional retail banks. As for conventional wholesale banks, loans classified as non-performing were at 6.0% in March 2015 compared to 5.8% in September 2014. Loan concentration remains high for conventional retail and wholesale banks despite some decreases in some sectors.

As at end-March 2015, return-on-assets (ROA) increased for conventional retail banks and decreased for conventional wholesale banks to stand at 0.7% and 0.2% respectively. Return-on-equity (ROE) for *local retail banks banks* increased from 4.0% in March 2014 to 4.4% in March 2015. ROE for *local wholesale banks* decreased from 2.5% to 1.6% over the same period.

For conventional retail banks, liquid assets as a proportion of total assets remained unchanged over the period of September 2014 to March 2015 at 26.7%. Liquid assets for wholesale banks as a proportion of total assets increased to 24.7% in March 2015 from 19.9% in September 2014.

4. Islamic Banks

Chapter

4

Key Points

- Capital positions are stable for Islamic banks with slight increase for Islamic retail banks and a decrease for Islamic Wholesale banks.
- Decrease in non-performing facilities (NPFs) for Islamic retail and Islamic wholesale banks.
- Concentration of facilities for both Islamic retail banks and Islamic Wholesale Banks remains.
- Unchanged earnings for Islamic wholesale banks while it decreased for Islamic Wholesale banks.
- Liquidity positions remained almost the same for Islamic retail while it decreased for Islamic Wholesale banks.

4.1 Overview

This chapter analyzes the banking sector under the following categories: Islamic retail banks (section 4-2) and Islamic wholesale banks (section 4-3). Section 4.4 provides an overall assessment of the Islamic 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 2014 and compared with end-March 2015.

This chapter offers macroprudential analysis of the Islamic banking sector based on a set of selected Financial Soundess Indicators (FSIs).[7]

Annex1 presents selected *Financial Soundness Indicators* (FSIs) for the different banking segments. Annex 2 presents selected graphs showing the development of selected indicators over time.

[7] This chapter does not contain a section on stress testing. Stress Testing exercises are performed separately in an internal report to obtain information on the potential quantitative impact of hypothetical scenarios on selected Bahraini Systemically-Important Banks (SIB's).

NOTE: As part of CBB's implementation of Basel III, The CBB has made changes to its rulebook requiring all banks to report the capital ratios in compliance with Basel III effective January 2015. Therefore, the March 2015 capital ratios are Basel III compliant while previous quarters are Basel II compliant which may explain the changes in some FSI indicators. The existing minimum required target capital adequacy ratio of 12.5% remains in place but with adjustments to the definitions and contributions of the elements of capital.

4.2 Islamic Retail Banks

Increase in Capital Positions

The capital adequacy ratio of Islamic retail banks Increased from 15.4% in September 2014 to 16.1% in March 2015. Tier 1 capital increased slightly from 13.7% in September 2014 to 13.9% in March 2015.

Table 4-: Capital Provisions Ratios for Islamic Retail Banks

Indicator	Sep. 2014	Mar. 2015
Capital Adequacy Ratio (%)	15.4%	16.1%
Tier 1 Capital Adequacy Ratio (%)	13.7%	13.9%
Leverage (assets/capital)(times)	9.7	6.6
NPFs net of provisions to capital (%)	36.4%	19.7%

Source: Central Bank of Bahrain

Leverage (assets over capital) stood at 6.6 times. The ratio of non-performing facilities (NPFs) net of provisions to capital decreased from 36.4% to 19.7% for the same period.

Decrease in non-performing facilities and increase in provisioning

Non-performing facilities (NPFs) decreased to 11.0% in March 2015, compared to 36.4% in September 2014. Specific Provisoining increased from 38.3% in September 2014 to 42.3% in March 2015.

Table4-1: NPF Figures for Islamic Retail Banks

Indicator	Sep. 2014	Mar. 2015
NPFs (% Gross)	12.6	11.0
Specific Provisions (% of NPFs)	38.3	42.3

Source: Central Bank of Bahrain

A look at the non-performing facilities by sector indicates that the "construction" sector remains the sector with the highest rate with 21.5% in March 2015 followed by "trade" and "manufacturing" with 20.4% and 18.0% respectively. The biggest declines in NPF's by sector was in the "construction" Sector with a 7.2% decrease in NPFs from September 2014 to

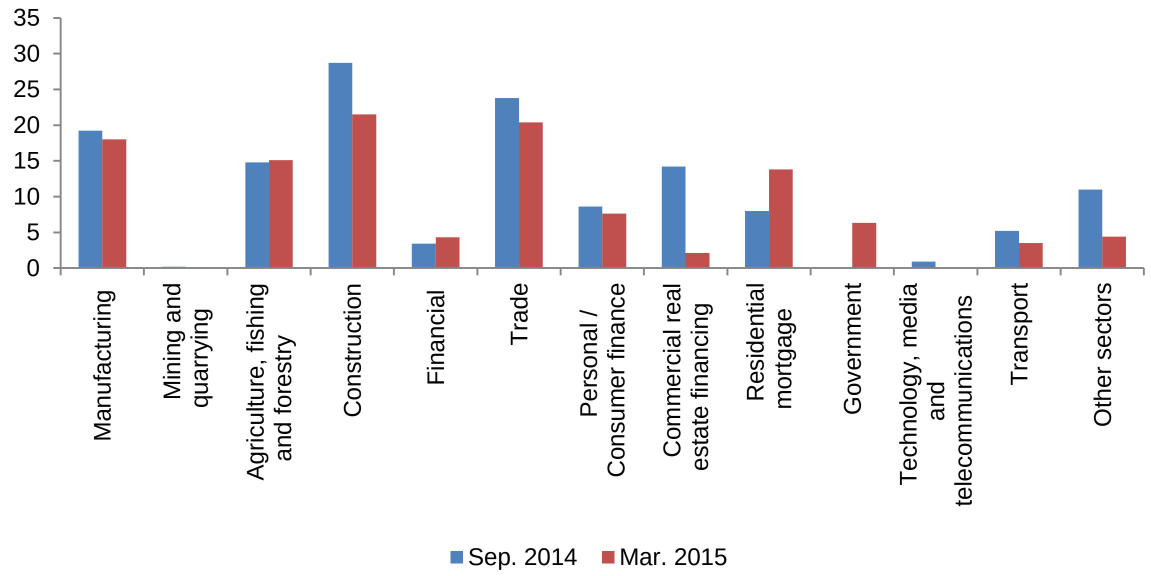
March 2015. The biggest increase in NPF's was the "technology,media and communication" sector with an increase of 2.6%.

Table 4-2: Islamic Retail Banks' NPF Ratios by Sector
(% of gross facilities per sector)

	Sep. 2014	Mar. 2015	Change
Manufacturing	19.2	18.0	(1.2)
Mining and quarrying	0.2	0.1	(0.1)
Agriculture, fishing and forestry	14.8	15.1	0.3
Construction	28.7	21.5	(7.2)
Financial	3.4	4.3	0.9
Trade	23.8	20.4	(3.4)
Personal / Consumer finance	8.6	7.6	(1.0)
Credit Card	-	2.1	2.1
Commercial real estate financing	14.2	13.8	(0.4)
Residential mortgage	8.0	6.3	(1.7)
Government	0.0	0.1	0.1
Technology, media and telecommunications	0.9	3.5	2.6
Transport	5.2	4.4	(0.8)
Other sectors	11.0	4.4	(6.6)

Source: Central Bank of Bahrain

Chart 4-1: Islamic Retail Bank's NPF's by Sector
(% of gross facilities per sector)



Source: Central Bank of Bahrain

No significant change in asset concentration (loan portfolio)

Asset concentration has improved slightly over the past six months as Islamic retail banks have begun to slowly diversify their asset concentration. At the end of March 2015, the top recipient of financing was "personal / consumer finance", surpassing "commercial real estate financing" at 19.9% up from 17.4% in September 2014. The top two recipients of financing ("personal / consumer finance" and "commercial real estate financing") accounted for 35.4% of total facilities extended compared to 34.3% for the top two sectors in March 2015. Moreover, the share of “Financial” declined from 12.2% in September 2014 to 9.8% in March 2015.

Table 4-3: Distribution of Islamic Retail Banks’ Lending by Economic Activity (% of total facilities)*

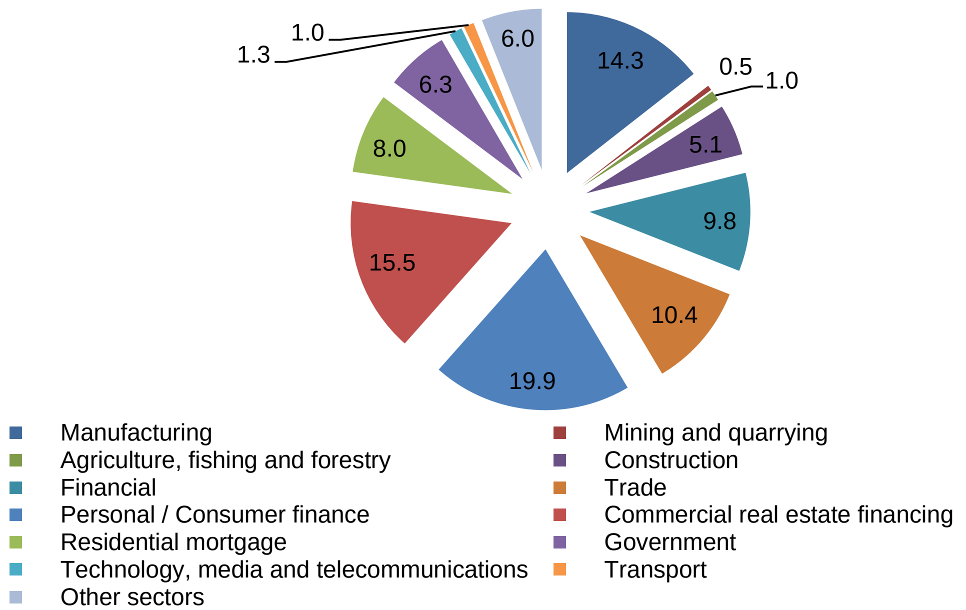
	Sep. 2014	Mar. 2015	Change
Manufacturing	14.6	14.3	(0.3)
Mining and quarrying	0.5	0.5	0.0
Agriculture, fishing and forestry	1.0	1.0	0.0
Construction	5.0	5.1	0.1
Financial	12.2	9.8	(2.4)
Trade	10.3	10.4	0.1
Personal / Consumer finance	17.4	19.9	2.5
Credit Card	0.0	0.7	0.7
Commercial real estate financing	16.9	15.5	(1.4)
Residential mortgage	7.1	8.0	0.9
Government	6.3	6.3	0.0
Technology, media and telecommunications	0.9	1.3	0.4
Transport	1.1	1.0	(0.1)
Other sectors	6.8	6.0	(0.8)
Top two recipient sectors	**34.3**	**35.4**	**1.1**
Real Estate/ Construction Exposure**	**29.0**	**28.6**	**(0.4)**

Source: Central Bank of Bahrain

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

*** Real Estate/ Construction exposure is calculated as the share of the Construction, Commercial real estate financing and Residential Mortgages sectors of total lending.*

Chart 4-2:Distribution of Islamic Retail Bank’s Lending by Economic Activity (% of total facilities)



Source: Central Bank of Bahrain

On the other hand, “Real Estate/ Construction” exposure decreased slightly from29.0 % in September 2014to 28.6% in March 2015.

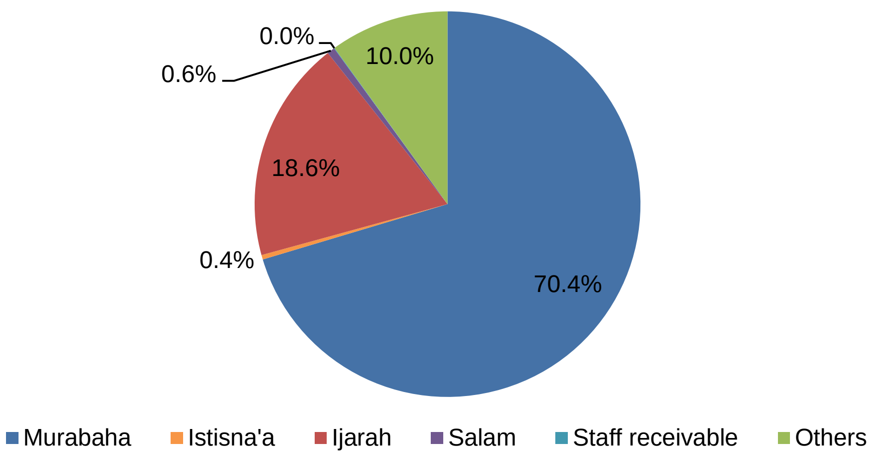
Lending distribution by Islamic instrument remained mostly stable over the past quarter. At the end of March 2015, the top recipient of finance was “Murabaha” at 70.4% down from 73.6% in September 2014. This was followed by “Ijarah” which increased from 17.7% to 18.6% in March 2015. The share of “Salam” increased from 0.3% in September 2014 to 0.6% in March 2015.

Table 4-4: Distribution of Islamic Retail Banks’ Lending by Islamic Instrument (% of total facilities)*

	Sep. 2014	Mar. 2015	Change
Murabaha	73.6	70.4	(3.2)
Istisna'a	0.2	0.4	0.2
Ijarah	17.7	18.6	0.9
Salam	0.3	0.6	0.3
Staff receivable	0.1	0.0	(0.1)
Others	8.3	10.0	1.7

Source: Central Bank of Bahrain
**Figures may not add to a hundred due to rounding*

Chart 4-3:Distribution of Islamic Retail Bank’s Lending by Islamic Instrument (% of total facilities)



Source: Central Bank of Bahrain

Stable earnings

The return on assets (ROA) for Islamic retail banks remained the same at 0.1% in March 2015 compared to March 2014. Return on equity (ROE) decreased from 1.2% to 1.0% for the same period.

Table 4-5: Profitability of Islamic Retail Banks (%)

	Mar. 2014	Mar. 2015
ROA*	0.1	0.1
ROE**	1.2	1.0
Operating expenses (% gross income)	77.2	72.8

Source: Central Bank of Bahrain
* ROA = ratio of net income to assets
**ROE = ratio of net income to tier 1 capital

Slight decrease in liquidity

The volume of liquid assets available to Islamic retail banks decreased slightly from 13.5% in September to 13.4% in March 2015. The ratio of total facilities to deposits decreased from 81.3% in September 2014 to 77.4% in March 2015.

Table 4-6: Liquidity Measures for Islamic Retail Banks

Indicator	Sept. 2014	Mar. 2015
Liquid Assets (% of total assets)	13.5	13.4
Facilities – deposits ratio (%)	81.3	77.4

Source: Central Bank of Bahrain

4.3 Islamic Wholesale Banks

decline in capital positions

As at end-March 2015, the CAR for Islamic wholesale banks decreases from 24.3% in September 2014 to 20.5% in March 2015. Tier1 capital similarly decreased from 22.8% to 20.2% over the same period. The ratio of NPFs net of provisions to capital also decreased from 3.5% to 3.0%.

Table 4-7: Capital Provisions Ratios for Islamic Wholesale Banks

Indicator	Sept. 2014	March 2015
Capital Adequacy Ratio (%)	24.3	20.5
Tier 1 Capital Adequacy Ratio (%)	22.8	20.2
Leverage (assets/capital)(times)	6.2	6.1
NPFs net of provisions to capital (%)	3.5	3.0

Source: Central Bank of Bahrain

Decrease in non-performing facilities (NPFs)

As at end-March 2015, NPFs for Islamic wholesale banks decreased to 4.7% from 5.0% in September 2014. Provisioning for NPF's Increased from 75.3% to 76.4% over the same period.

Table 4-8: NPF Figures for Islamic Wholesale Banks

Indicator	Sept. 2014	*March 2015*
NPFs (% Gross)	5.0	4.7
Specific Provisioning (% of NPFs)	75.3	76.4

Source: Central Bank of Bahrain

The sector with the highest impairment was the "Technology, media and telecommunications" sector with 55.2% in March 2015, up from the 52.0% in September 2014. This was followed by the "Agriculture, fishing and forestry" and "Construction" sectors.

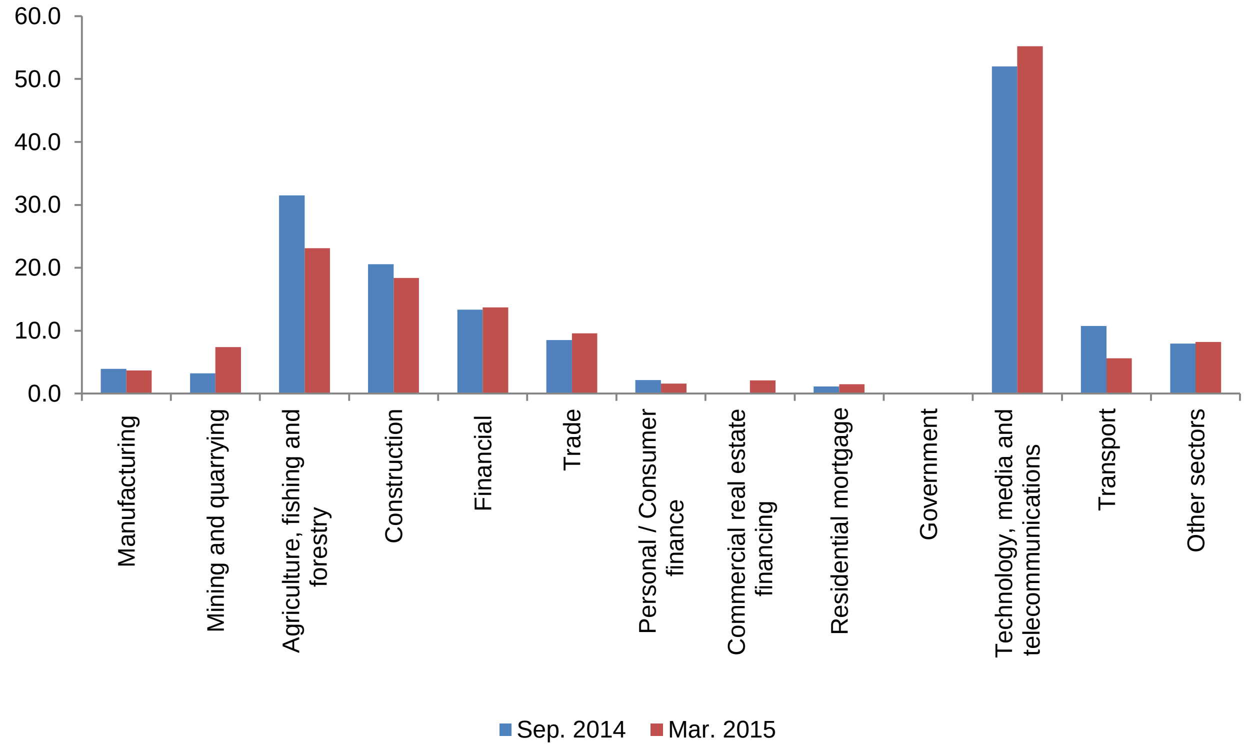
Available data on the sectoral breakdown of non-performing facilities shows that the biggest drop was in the "Agriculture, fishing and forestry" sector with a decrease of 8.4% from 31.5% in September 2014 to 23.1% in March 2015. The biggest increase was in the "Mining and quarrying" sector with an increase of 4.2%.

Table 4-9: Islamic Wholesale Banks' NPF Ratios by Sector (% of gross facilities per sector)

	Sept 2014	March 2015	Change
Manufacturing	3.9	3.7	(0.2)
Mining and quarrying	3.2	7.4	4.2
Agriculture, fishing and forestry	31.5	23.1	(8.4)
Construction	20.6	18.4	(2.2)
Financial	13.3	13.7	0.4
Trade	8.5	9.6	1.1
Personal / Consumer finance	2.2	1.6	(0.6)
Commercial real estate financing	3.8	2.1	(1.7)
Residential mortgage	1.2	1.5	0.3
Government	0.0	0.0	0.0
Technology, media and telecommunications	52.0	55.2	3.2
Transport	10.7	5.6	(5.1)
Other sectors	7.9	8.2	0.3

Source: Central Bank of Bahrain

Chart 4-4: Islamic Wholesale Bank's NPF's by Sector (% of gross facilities per sector)



Source: Central Bank of Bahrain

Asset concentration remains high in some sectors

At end-March 2015, the "manufacturing" sector remained the top recipient of financing from Islamic wholesale banks, at 25.6%, followed by "construction" at 16.9%.

Table 4-10: Distribution of Islamic Wholesale Banks' Lending by Economic Activity (% total facilities)*

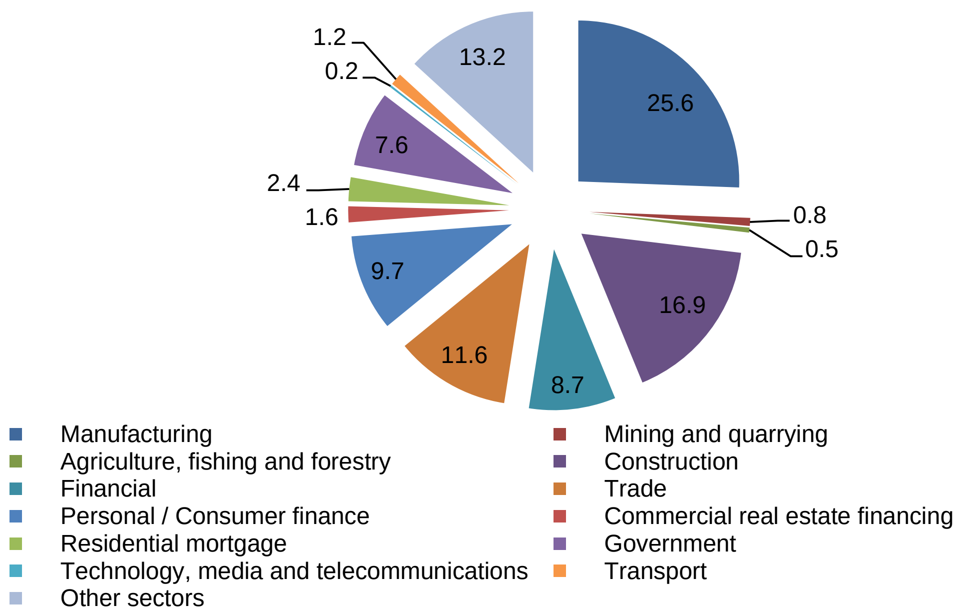
	Sept. 2014	March 2015	Change
Manufacturing	24.7	25.6	0.9
Mining and quarrying	0.9	0.8	(0.1)
Agriculture, fishing and forestry	0.4	0.5	0.1
Construction	16.3	16.9	0.6
Financial	9.4	8.7	(0.7)
Trade	12.5	11.6	(0.9)
Personal / Consumer finance	8.9	9.7	0.8
Commercial real estate financing	1.6	1.6	0.0
Residential mortgage	2.5	2.4	(0.1)
Government	6.2	7.6	1.4
Technology, media and telecommunications	0.2	0.2	0.0
Transport	1.2	1.2	0.0
Other sectors	15.2	13.2	(2.0)
Top two recipient sectors	**41.0**	**42.5**	**1.5**
Real Estate/ Construction Exposure**	**20.4**	**20.9**	**0.5**

Source: Central Bank of Bahrain

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

*** Real Estate/ Construction exposure is calculated as the share of the Construction, Commercial real estate financing and Residential Mortgages sectors of total lending.*

Chart 4-5: Distribution of Islamic Wholesale Banks's Lending (% of total facilities)



Source: Central Bank of Bahrain

The top two recipient sectors in March 2015 ("Manufacturing" and "Construction") jointly represented 42.5% of total financing, up from 41.0% in September 2014. Real estate/ construction exposure increased from 20.4% in September 2014 to 20.9% in March 2015.

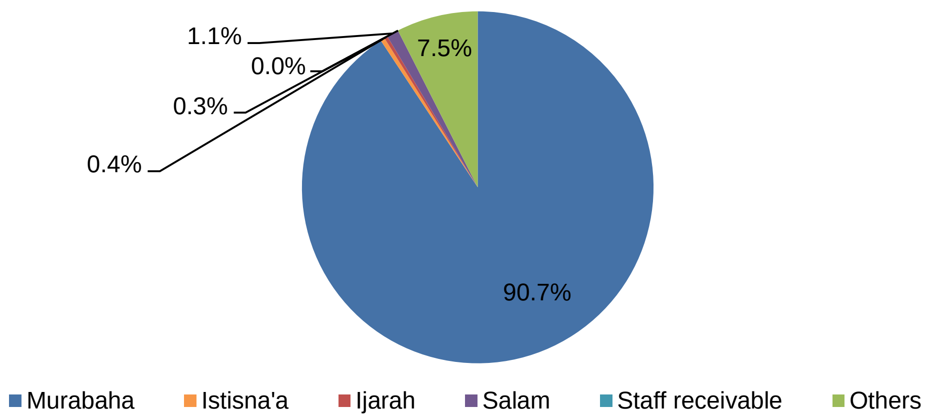
Lending distribution by Islamic instrument shows that at the end of March 2015, the top recipient of finance was "Murabaha" at 90.7% up from 90.7% in September 2014.

Table 4-11: Distribution of Islamic Wholesale Banks' Lending by Islamic Instrument (% of total facilities)*

	Sep. 2014	March2015	Change
Murabaha	90.6	90.7	0.1
Istisna'a	0.3	0.4	0.1
Ijarah	0.3	0.3	0.0
Salam	1.0	1.1	0.1
Staff receivable	0.0	0.0	0.0
Others	7.8	7.5	(0.3)

Source: Central Bank of Bahrain
**Figures may not add to a hundred due to rounding*

Chart 4-6: Distribution of Islamic Wholesale Bank's Lending by Islamic Instrument (% of total facilities)



Source: Central Bank of Bahrain

Decrease in earnings

The earnings performance of Islamic wholesale banks declined over the period from March 2014 to March 2015. Return on assets (ROA) remained unchanged at 0.2 % in March 2015 and the Return on equity (ROE) decreased from 1.3% to 1.0% for the same period. It should be noted however that operating expenses (as % of gross income) increased from 59.8% in March 2014 to 61.5% in March 2015.

Table 4-12: Profitability of Islamic Wholesale Banks (%)

	March 2014	March 2015
ROA*	0.2	0.2
ROE**	1.3	1.0
Operating expenses (% gross income)	59.8	61.5

Source: Central Bank of Bahrain
* ROA = ratio of net income to assets
**ROE = ratio of net income to tier 1 capital

Liquidity position declined

As at end- March 2015, liquid assets of Islamic wholesale banks represented 19.5% of total assets, 3.3% lower than the 22.8% registered in September 2014. On the on the other hand, the facilities deposit ratio decreased from 64.7% to 63.2% March 2015.

Table 4-13: Liquidity Measures for Islamic Wholesale Banks

Indicator	Sept. 2014	March. 2015
Liquid assets (% of total)	22.8%	19.5
Facilities-deposit ratio	64.7%	63.2

Source: Central Bank of Bahrain

4.4 Overall Assessment of the Islamic Banking Sector

The financial soundness indicators show that Islamic retail banks 'capital positions increased during the period between September 2014 and March 2015 reaching 16.1% while wholesale banks decreased reaching 20.5% for the same period.

Non-performing facilities decreased for Islamic retail and Islamic wholesale to reach 11.0% and 4.7% respectively. Facilities concentration has decreased in some sectors in retail Islamic banks and wholesale Islamic banks.

The earnings were stable for Islamic retail banks and Islamic wholesale banks with no significant change.

Islamic retail banks experienced a minor change in its liquidity position as the liquid asset ratio decreased slightly while the facilities to deposit ratio had a bigger drop. Islamic wholesale's liquidity positions showed a decrease in liquid assets and facilities to deposit ratio.

Part III:

Developments in the Equity Market and Payment Systems

5. Performance of Equity Market

Chapter
5

Key Points

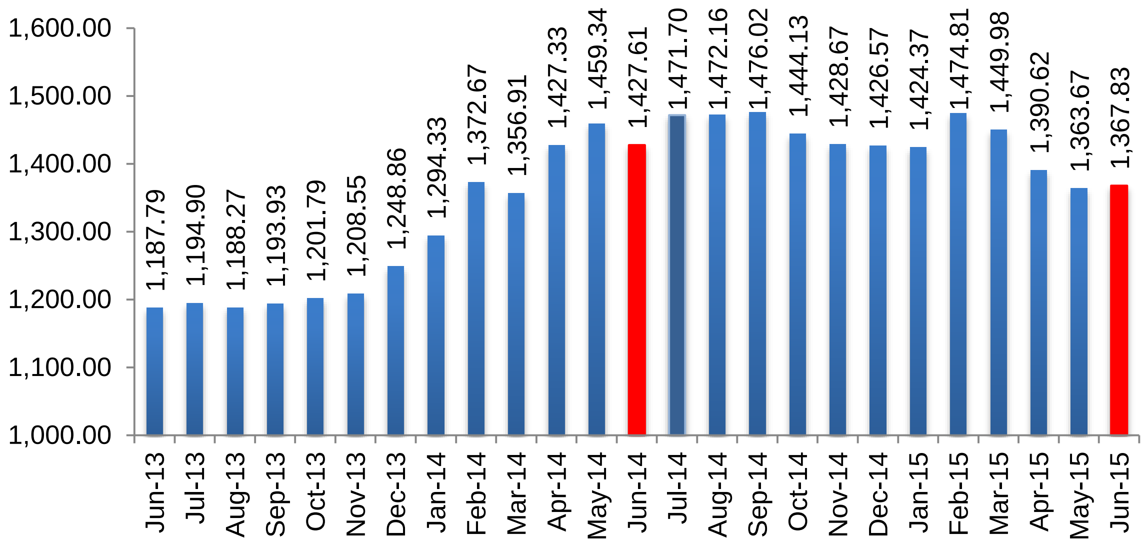
- Decrease in the Bahrain All Share index
- Year-on-year decline in market capitalization
- Year-on-year decline in price-earnings ratio
- GCC indices decline amid decreasing oil price

5.1 Bahrain Market Trends

Decrease in market index

A look at year-on-year data shows that the Bahrain All Share Index decreased by 59.78 points (4.1%) between June 2014 and June 2015 (Chart 5-1). The index experienced steady increases from November 2013 to February 2014. However, the index experienced a slight dip in May 2014. The Bahrain all share index stabilized in the lower bounds of around 1400 points by December 2014 after reaching its peak in September 2014 at 1476.02 points.

Chart 5-1: Recent Trends in the Bahrain All-Share Index, June 2013-June 2015

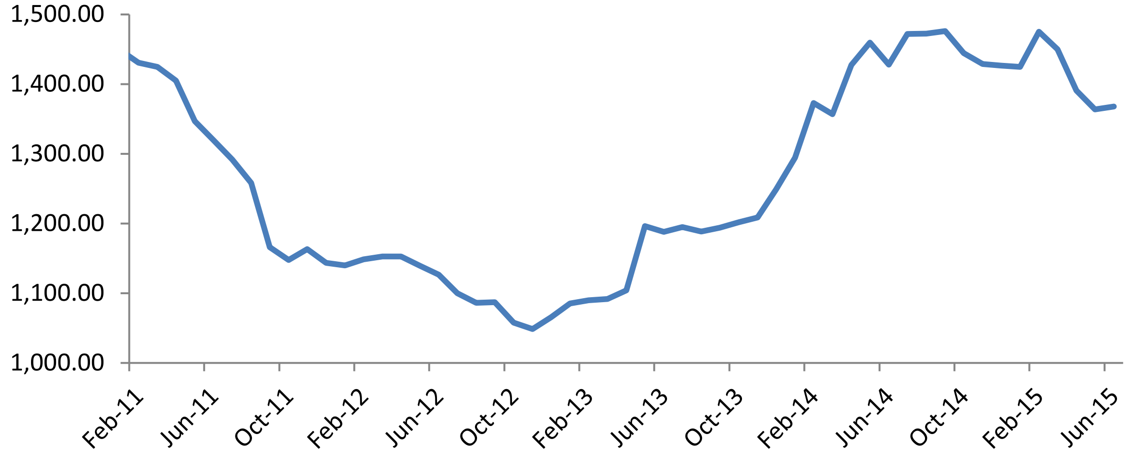


Source of Data: Bahrain Bourse

The index in January 2015 was around 1424.37 points before experiencing a rapid gain in February, ending at 1474.81 points. However, it gradually decreased thereafter until it reached 1367.83 points as of the end of June.

Looking at the overall performance of the Bahrain All Share index since June 2013 (Chart 5-2), the index has performed positively in the last two years. Markedly, the Bahrain All Share Index has experienced a stable increase in the period between December 2013 and December 2014, reflecting growing confidence in the Bahraini stock market. However, the index experienced a slight decline in the past six months period from January 2015 when it was around 1424.37 points to 1367.83 points as of the end of June 2015.

Chart 5-2: Bahrain All-Share Index Feb 2011-June 2015



Source of Data: Bahrain Bourse

Decline in market capitalization

As at end-June 2015, market capitalization of the Bahrain Bourse stood at BD 8.0 billion (Table 5-1). This level of market capitalization is 3.2% lower than the level as at end-December 2014 and 0.7% lower *year-on-year*.

Table 5-1: Market Capitalization on the Bahrain Bourse

(BD)

Sector	June 2014	Dec. 2014	June 2015	Dec 2014-June 2015 (% Change)	June 2014-June 2015 (% Change)
Commercial banks	3,825,790,134	3,793,805,442	3,664,820,365	-3.4%	-4.2%
Investment	2,159,672,680	2,295,082,815	2,121,193,355	-7.6%	-1.8%
Insurance	174,549,943	163,878,591	161,883,489	-1.2%	-7.3%
Services	1,099,045,952	1,125,569,854	1,156,482,718	2.7%	5.2%
Industrial	647,368,316	751,120,639	730,756,917	-2.7%	12.9%
Hotel and Tourism	207,494,503	197,610,963	223,467,892	13.1%	7.7%
Total	8,113,921,529	8,327,068,303	8,058,604,736	-3.2%	-0.7%

Source: Bahrain Bourse

A breakdown of market capitalization by sector indicates that "Industrial" recorded the highest *year-on-year* increase in market capitalization (12.9%) followed by "Hotel and Tourism" (7.7%) and "Services" (5.2%). The rest of the sectors witnessed a year on year decrease in market capitalization.

Decrease in price-earnings ratios

As June 2015, the price-earnings ratio (P-E ratio) for the stock market stood at 9.83, a decrease from the 10.29 attained last year in June 2014 and the 10.41 in December 2014. Commercial banks is the only sector that experienced year on year increase in price earnings ratio, while the rest of the sectors experienced varying degrees of declines in the PE ratio.

Table 5-2: Price-Earnings Multiples

Sector	June 2014	Dec. 2014	June 2015
Commercial banks	10.79	10.63	11.11
Investment	9.15	9.47	8.24
Insurance	10.13	9.50	9.65
Services	13	12.87	11.52
Industrial	7.95	9.22	7.43
Hotel and Tourism	12.88	12.26	11.84
Total Market	10.29	10.41	9.83

Source: Bahrain Bourse

The bulk of the value of shares traded in June 2015 was the "Services" sector whose traded shares (by value) represented 45.9% of total shares traded up from 6.5% in June 2014. The "Commercial banks" sector represented 45.1% of the total value of shares traded in June 2015 down from 76.2% in June 2014 (Table 5-3).

Table 5-3: Value of Shares Traded by Sector (% shares of total value traded)*

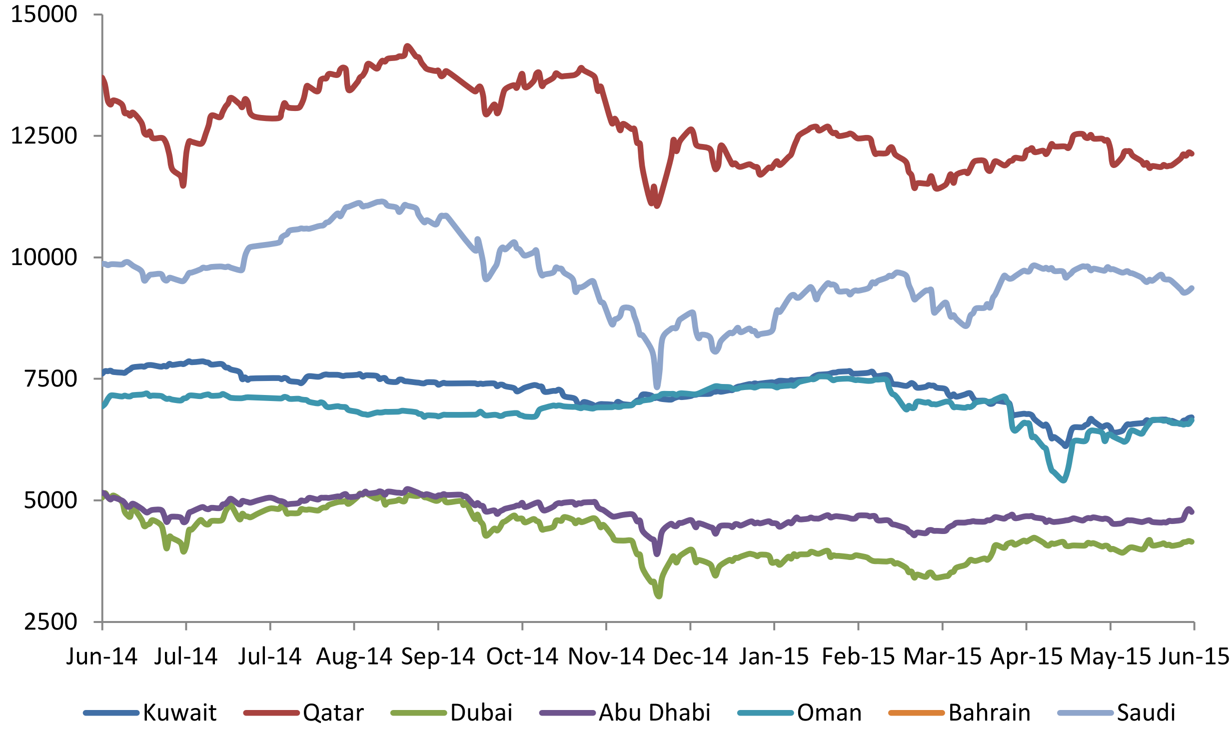
Sector	June 2014	Dec. 2014	June 2015
Commercial banks	76.2	42.0	45.1
Investment	10.2	0.0	1.3
Insurance	0.3	0.0	0.8
Services	6.5	47.7	45.9
Industrial	1.7	6.0	6.6
Hotel and Tourism	4.9	2.4	0.3

**Figures may not add to a hundred due to rounding*
Source: Bahrain Bourse

5.2 GCC Market Trends

The performance of the GCC Markets in the first two quarters of 2015 was mixed. Saudi Tadawul index was the biggest gainer among the GCC markets, increasing by 11.4% from December 2014. The Muscat Security Market Index increased by 6.3% over the last six months while the UAE equity markets experienced similar increases where the Dubai Financial Market Index and Abu Dhabi Index increased by 6.8% and 3.9% respectively. On the other hand, Bahrain, Qatar, and Kuwait Indices experienced slight declines from the levels attained in December 2014.

Chart 5-3: GCC Indices June 2014 – June 2015



Sources: Bloomberg

However, the GCC indices have not yet fully recovered from the levels attained in June 2014 as a result of their exposure to the oil price declines. All GCC indices experienced varying degrees of declines in comparison to the level attained in June 2014, with Dubai being the most affected (its index decreased year on year by 18.0%) and Bahrain being the least affected (its index decreased year on year by 4.1%). Saudi's Tadawul index, the biggest equity market in the GCC, experienced a decrease of 5% compared to June 2014. Its index ended at 9,367.2 points in June 2015 compared to 9,864.6 points in June 2014.

Table 5-4: Stock Market Indices in GCC counties

Index	Jun-14	Dec-2014	June 2015	Dec 2014- June 2015 (%)	June 2014- June 2015 (%)
Bahrain All Share Index	1,427.6	1,403.2	1,368.4	(2.5)	(4.1)
Tadawul All Share Index	9,864.6	8,410.9	9,367.2	11.4%	(5.0)
Kuwait Market Index	7,321.1	6,562.7	6,211.7	(5.3)	(15.2)
Qatar Exchange Index	13,696.9	12,339.8	12,133.2	(1.7)	(11.4)
Dubai Financial Market Index	5,056.3	3,882.9	4,146.7	6.8	(18.0)
Abu Dhabi Index	5,157.6	4,582.9	4,760.7	3.9	(7.7)
Muscat Securities Market Index 30	6,890.7	6,059.1	6,441.9	6.3	(6.5)

Sources: Bahrain Bourse, Saudi Stock Exchange (Tadawul), Kuwait Stock Exchange, Qatar Exchange, Dubai Financial Market, Abu Dhabi Securities Exchange, and Muscat Securities Market.

5.3 Overall assessment of the equity market

The Bahrain All Sahre Index recorded 1,368.4 points in June 2015, a level that is 2.5% less than the level attained six months ago, and 4.1% less than the level attained a year ago. The decline can be explained by the less than favourable conditions in the international oil market. Bahrain market capitalization decreased by 3.2% over the last six months and by 0.7% from June 2014. The decline, however, seems to be temporary. As the oil price and business sentiment start to recover, the Bahraini stock market index will gradually recover and improve.

In the GCC equity markets, however, the indices have been temporarily decreasing given the declining oil price. Markets in the GCC are very sensitive to oil price fluctuations. The oil price has reached a five-year low in December 2014, hovering around $65 per barrel. The overall market conditions should improve over the medium term, however, propped up by increased government spending on various infrastructure projects.

6. Payments and Settlements Systems

Chapter

6

Key Points

- The various components of Bahrain's payments and settlement framework continue to function efficiently.
- Retail payments include cheques, credit transfers, and debit and credit card transactions.
- Year-on-year decrease in the volume and increase in value of cheques processed through the ACS.
- Year-on-year rise in value and the number of ATM withdrawals.
- The availability of cash has increased over the past decade due to growing number of ATMs.
- Year-on-year increase in volume and decrease in value of transfers through the RTGS.

6.1 Overview

Payments 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.

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 Scriptless Securities Settlement System (SSSS); and v) the clearing, settlement and depository system for the Bahrain Bourse. 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. The launch of the ACS was a milestone to the Bahraini financial sector which raised efficiency and customer services. This section describes recent trends in the retail and wholesale payments system.

6.2 Retail Payments

In the Kingdom of Bahrain, households can carry out their cash and non-cash transactions with a wide range of instruments of payment. Cash payment instruments are basically based on paper money and coins. It is the most popular instrument in Bahrain and it is based on face-to-face or hand-on-hand operation. Non-cash payment instruments include: cheques, credit transfer, debit transfer and debit and credit cards. In this section we show the evolution of retail payment transactions based on paper money and e-payment channels.

6.2.1 Cheques and paper based instruments

Cheques are seen as the most popular instrument in use among non-banks in all types of payments. With the increasing usage of electronic means of payments, in particular debit cards and credit cards, the use of cheques in the Kingdom of Bahrain decreased drastically. Cheques are still used for retail and large-value payments in virtually all the national payments systems in the Kingdom and remain the principal instrument for large-value payments.

In 2013, the CBB has decided to improve the use of cheques in order to reduce their related risks. Therefore, it launched a new cheque clearing system based on the electronic transmission of images and payment information. The new procedure replaced the common paper-based procedure on May 2012. The Bahrain Cheque Truncation System (BCTS) was commenced in cooperation with the BENEFIT Company (BENEFIT) which also operates Bahrain's ATM service and point-of-sale systems. The Automated cheque clearing system (ACS) replaced the old paper based cheque clearing system in Bahrain. The main feature of the ACS is that it speeds up the clearing process and customers could process cheques on the same day.

Year on year decrease in average daily volume and increase in value of cheques through ACS

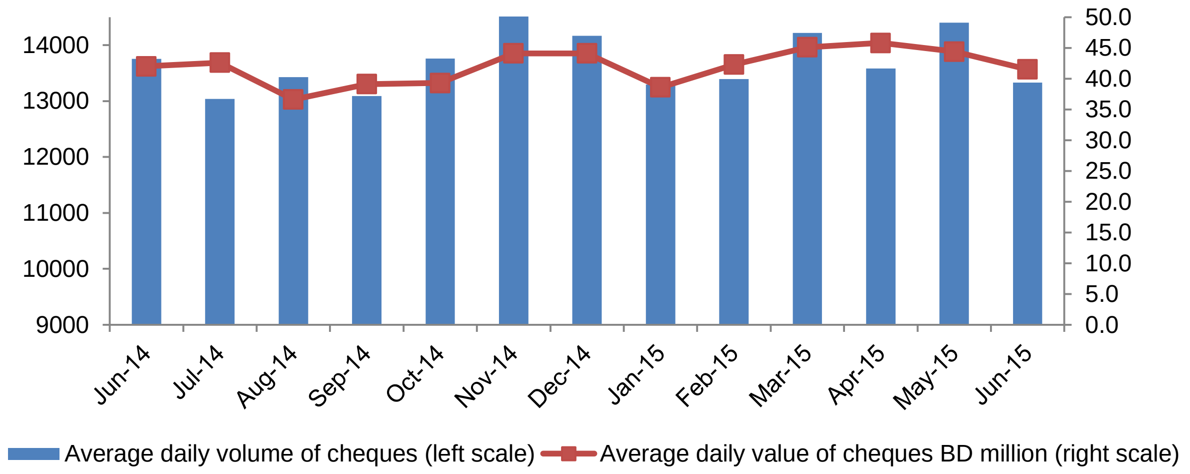
In the period between December 2014 and June 2015, the average daily volume of cheques processed through the Automated Cheque Clearing System (ACS) decreased by 6.1% from 14,168 to 13,332 (year-on-year decrease of 3.1%) (Chart 6-1). The average daily value of cheques decreased by 5.9% from BD 44.1 million in December 2014 to BD 41.5 million in June 2015 (year-on-year decrease of 0.9%).

The average daily volume kept fluctuating from December 2014 until June 2015; however the biggest increase was by 6.1% in March 2015. The average daily volume reached its peak in May 2015 at 14,401 average daily transactions. The average daily volume had a drop in June 2015 by 7.4%.

The average daily value of cheques was mostly growing between December 2014 and June 2015. The highest value of cheques cleared was seen in April 2015 by BD 45.8 million whereas the lowest value of cleared cheques occurred in January 2015 by BD 38.6million. It has to be noted that cheques are now cleared in the Bahrain Cheque Truncation System

(BCTS), which went live on 13th May, 2012 and there is no cap on the value of cheques cleared in the BCTS.

Chart 6-1: ACS System- Average Daily Volume and Value of Payments Processed, June 2014-2015



Source: Central Bank of Bahrain

6.2.2 E-Payment systems

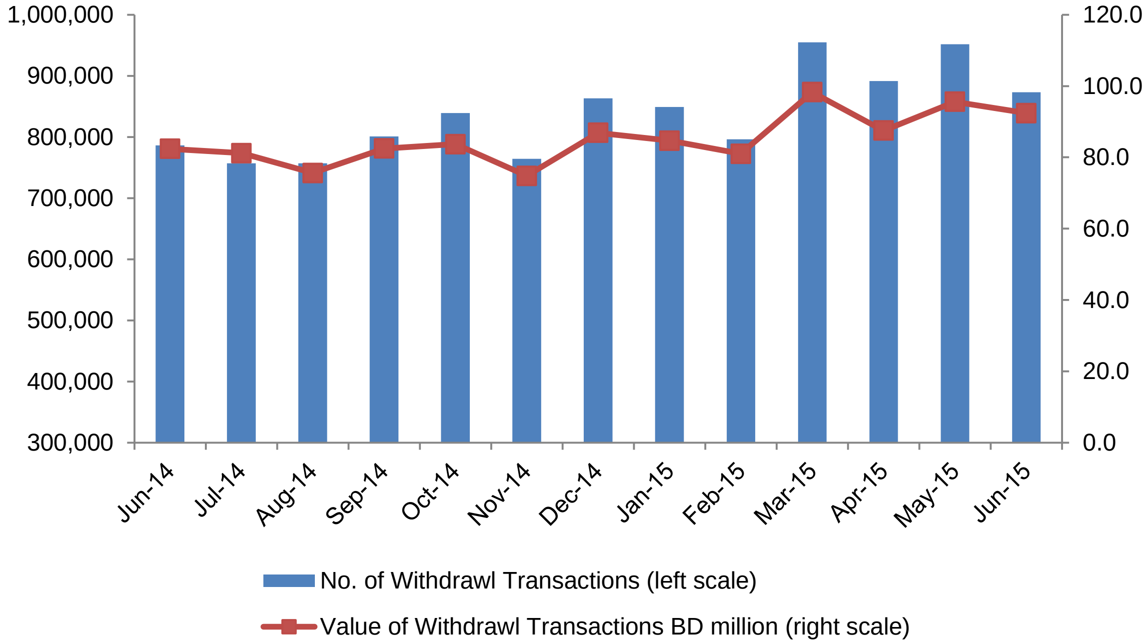
ATM clearing is based on a Deferred Net Settlement (DNS) system. The Benefit Company in Bahrain receives and processes all the ATM transactions. The GCC net, a leased line network across the GCC countries, provides for the communication backbone for the transmission of all the ATM transactions and settlement related electronic messages (source: Benefit website).

Year on year growth in number and value of ATM withdrawals

Between December 2014 and June 2015, the number of withdrawal transactions processed through the ATM Clearing System increased by 1.1% from 863,244 to 873,164 (year-on-year growth was 11.0%)(Chart 6-2). Similarly, in value terms, total withdrawals processed increased by 6.3% from BD 86.9 million to 92.4 million (year-on-year growth was 12.1%).

There have been fluctuations in both the value and volume of transactions between December 2014 and June 2015. March 2015 witnessed the highest number of ATM withdrawals with an increase of 19.9% from the previous month whereas the biggest decrease in the number of withdrawals took place in the month of June 2015 by almost 8.2%. The highest value of withdrawals was witnessed in March 2015 by BD 98.3 million and the lowest value of withdrawals in February 2015 by BD 81.0 million.

Chart 6-2: Number and Value of ATM Transactions, June 2014- June 2015



Source: The Benefit Company

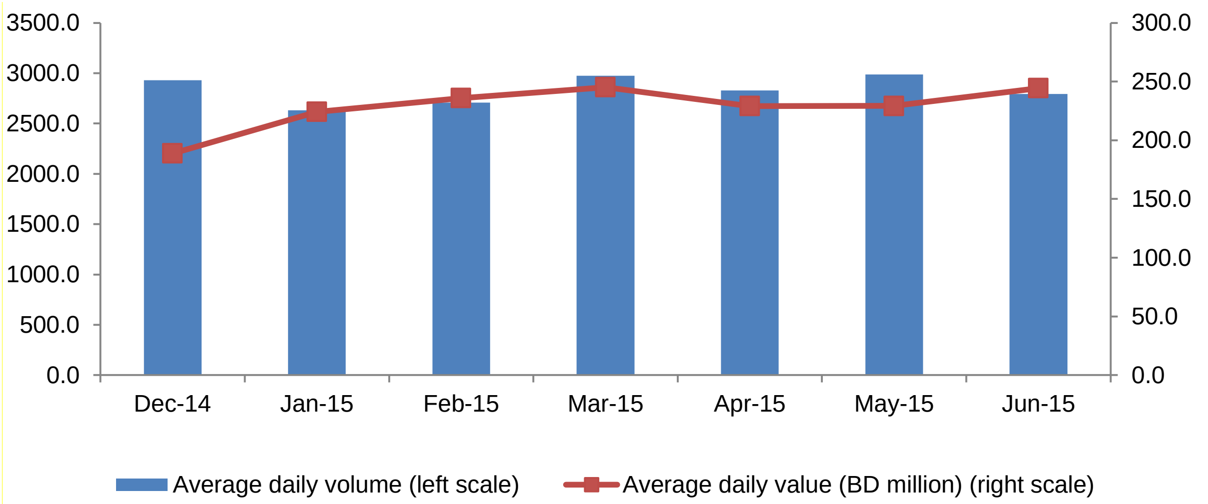
With the widespread use of internet and mobile services in Bahrain, another payment solution was introduced by banks. Nowadays, Bahraini household started paying their bill online (e-bill) with both internet and mobile bill. Moreover, the government of Bahrain encouraged the use of internet ICT tools in all the government services. It launched the e-government portal which includes the most important services. In addition to the development of e-banking and internet banking, a number of banks in Bahrain offer mobile banking services to their customers. The purpose is to receive regular information on their balances accounts and their current transactions.

6.3 Wholesale Payments

Year on Year Increase in volume and decrease in value of payments through RTGS

In Bahrain, wholesale transaction are made though the Real Time Gross Settlement (RTGS), which hinges on (real-time) which settles fund transfers, on solo basis when an order arises (without netting). The major difference is that it takes orders on spot rather than later. 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. The volume and value of payments passing through the RTGS system between June 2014 and June 2015 is seen in Chart 6-4 below.

Chart 6-3: RTGS System- Average Daily Volume and Value of Payments Processed, June 2014 – June 2015



Source: Central Bank of Bahrain

Between December 2014 and June 2015, the *average daily volume of transfers* decreased by 4.6% from 2929.7 to 2793.0 (21.7% year-on-year increase). In value terms, the *average daily value of transfers* witnessed a 29.4% increase from BD 188.9 million in December 2014 to BD 244.4 million in June 2015 (18.9% year-on-year increase).

Annex:

Financial Soundness Indicators
Selected Graphs

Annex 1: Financial Soundness Indicators

Annex1 Table 1:
Selected Financial Soundness Indicators—Conventional Retail Banks

(End of period)

	Mar-14	Sep-14	Mar-15
Capital Adequacy			
Total capital adequacy ratio (%) *	18.3	18.6	17.6
Tier 1 capital adequacy ratio (%) *	15.7	15.0	15.6
Leverage (assets/capital)(times)*	8.6	8.3	8.0
Non-performing loans net provisions to capital ratio (%)*	8.9	8.9	7.5
Asset Quality			
Non-performing loans (% of gross loans)	3.8	3.8	3.5
Specific provisions (% of NPLs)	55.2	53.9	55.6
Net non-performing loans (% of net loans)	1.7	1.8	1.6
Loan concentration (share of top-2 sectors) (%)	29.4	30.8	30.3
Real Estate/ Construction exposure (%) **	28.6	29.9	29.1
Earnings			
ROA retail banks (%)	0.4	1.2	0.7
ROA Local Retail banks (%)	0.4	1.1	0.5
ROA Overseas Retail banks (%)	0.6	1.4	1.3
ROE Local Retail banks (%)***	4.0	11.3	4.4
Net interest income (% of gross income)	68.1	71.4	67.4
Net fees & commissions (% of gross income)	15.3	15.7	17.8
Operating expenses (% of gross income)	41.2	43.1	27.1
Liquidity			
Liquid assets (% of total assets)	24.3	16.8	26.6
Liquid assets (% of short-term liabilities)	33.5	37.4	40.9
Loan-deposit ratio (%)	64.2	65.0	69.6
Deposits from non-bank sources (% of total deposits)	73.9	73.9	78.2

** Locally-incorporated banks only*
*** Real Estate/ Construction exposure is calculated as the share of the Construction, Commercial real estate financing and Residential Mortgages sectors of total lending.*
**** ROE is defined as net profit over Tier 1 Capital.*
Source: Central Bank of Bahrain

Annex1 Table 2:
Selected Financial Soundness Indicators—Conventional Wholesale Banks

(End of period)

	Mar-14	Sep-14	Mar-15
Capital Adequacy			
Total capital adequacy ratio (%) *	21.6	21.3	21.5
Tier 1 capital adequacy ratio (%) *	18.7	18.4	19.1
Leverage (assets/capital)(times)*	6.0	6.2	8.4
Non-performing loans net provisions to capital ratio (%)*	2.3	1.8	2.3
Asset Quality			
Non-performing loans (% of gross loans)	6.8	5.8	6.0
Specific provisions (% of NPLs)	66.1	72.6	70.5
Net non-performing loans (% of net loans)	2.4	1.7	1.9
Loan concentration (share of top-2 sectors) (%)	47.7	47.9	41.3
Real Estate/ Construction exposure (%) **	8.8	9.6	11.8
Earnings			
ROA retail banks (%)	0.5	0.7	0.2
ROA Local Wholesale banks (%)	0.4	0.6	0.2
ROA Overseas Wholesale banks (%)	0.6	0.8	0.1
ROE Local Wholesale banks (%)***	2.5	4.4	1.6
Net interest income (% of gross income)	35.2	58.3	90.3
Net fees & commissions (% of gross income)	37.3	26.0	31.3
Operating expenses (% of gross income)	39.3	49.5	57.5
Liquidity			
Liquid assets (% of total assets)	19.4	19.9	24.7
Liquid assets (% of short-term liabilities)	29.7	31.5	38.6
Loan-deposit ratio (%)	63.7	70.2	63.3
Deposits from non-bank sources (% of total deposits)	45.0	47.2	45.7

** Locally-incorporated banks only*
***Real Estate/ Construction exposure is calculated as the share of the Construction, Commercial real estate financing and Residential Mortgages sectors of total lending.*
**** ROE is defined as net profit over Tier 1 Capital.*
Source: Central Bank of Bahrain

Annex1 Table 3:
Selected Financial Soundness Indicators—Islamic Retail Banks

(End of period)

	Mar-14	Sep-14	Mar-15
Capital Adequacy			
Total capital adequacy ratio (%) *	17.6	15.4	16.1
Tier 1 capital adequacy ratio (%) *	15.0	13.7	13.9
Leverage (assets/capital)(times)*	8.1	9.7	6.6
Non-performing facilities net provisions to capital ratio (%)*	28.6	36.4	19.7
Asset Quality			
Non-performing facilities(% of gross facilities)	12.3	12.6	11.0
Specific provisions (% of NPFs)	42.7	38.3	42.3
Net non-performing facilities (% of net facilities)	7.0	7.4	6.0
Facilities concentration (share of top-2 sectors) (%)	33.7	34.3	35.4
Real Estate/ Construction exposure (%) **	28.5	29.0	28.6
Earnings			
ROA (%)	0.1	0.4	0.1
ROE (%)***	1.2	3.9	1.0
Net income from own funds, current accounts and other banking activities (% of operating income)	75.5	73.0	69.7
Net income from jointly financed accounts and Mudarib fees (% of operating income)	16.9	18.6	20.4
Operating expenses (% of gross income)	77.2	78.7	72.8
Liquidity			
Liquid assets (% of total assets)	14.1	13.5	13.4
Facilities-deposit ratio (%)	79.2	81.3	77.4
Current accounts from non-banks (% of non-capital liabilities, excl. URIA)	24.5	24.8	24.9

** Locally-incorporated banks only*
***Real Estate/ Construction exposure is calculated as the share of the Construction, Commercial real estate financing and Residential Mortgages sectors of total financing.*
**** ROE is defined as net profit over Tier 1 Capital.*
Source: Central Bank of Bahrain

Annex1 Table 4:
Selected Financial Soundness Indicators—Islamic Wholesale Banks

(End of period)

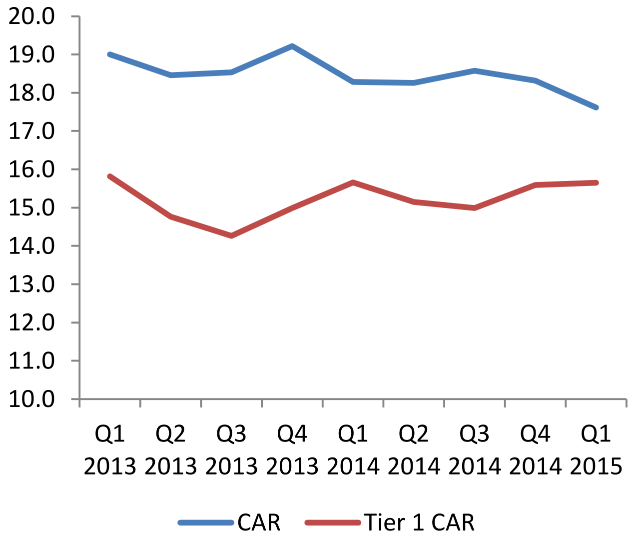
	Mar-14	Sep-14	Mar-15
Capital Adequacy			
Total capital adequacy ratio (%) *	24.7	24.3	20.5
Tier 1 capital adequacy ratio (%) *	23.7	22.8	20.2
Leverage (assets/capital)(times)*	6.2	6.2	6.1
Non-performing facilities net provisions to capital ratio (%)*	3.6	3.5	3.0
Asset Quality			
Non-performing facilities(% of gross facilities)	5.1	5.0	4.7
Specific provisions (% of NPFs)	75.4	75.3	76.4
Net non-performing facilities (% of net facilities)	1.3	1.2	1.1
Facilities concentration (share of top-2 sectors) (%)	35.8	41.0	42.5
Real Estate/ Construction exposure (%) **	19.3	20.4	20.9
Earnings			
ROA (%)	0.2	0.5	0.2
ROE (%)***	1.3	3.5	1.0
Net income from own funds, current accounts and other banking activities (% of operating income)	66.4	63.6	61.9
Net income from jointly financed accounts and Mudarib fees (% of operating income)	32.2	34.8	37.8
Operating expenses (% of gross income)	59.8	59.6	61.5
Liquidity			
Liquid assets (% of total assets)	22.4	22.8	19.5
Facilities-deposit ratio (%)	67.2	64.7	63.2
Current accounts from non-banks (% of non-capital liabilities, excl. URIA)	42.1	43.2	40.1

** Locally-incorporated banks only*
***Real Estate/ Construction exposure is calculated as the share of the Construction, Commercial real estate financing and Residential Mortgages sectors of total financing.*
**** ROE is defined as net profit over Tier 1 Capital.*
Source: Central Bank of Bahrain.

Annex 2: Selected Graphs

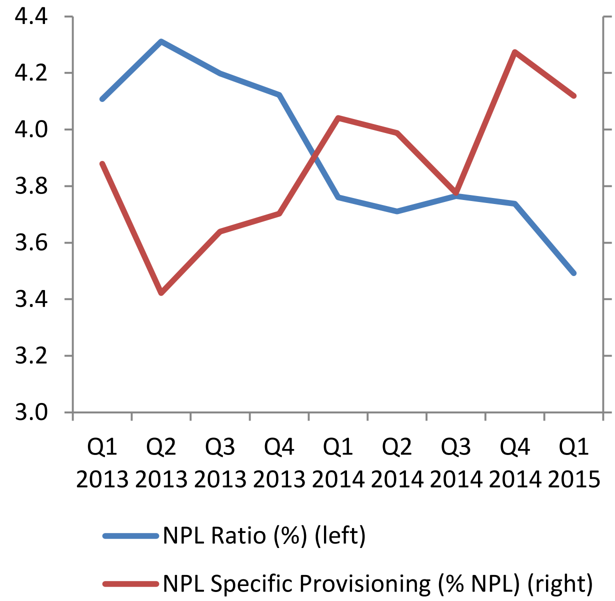
A. Conventional Retail

Annex 2 Graph 1: CAR



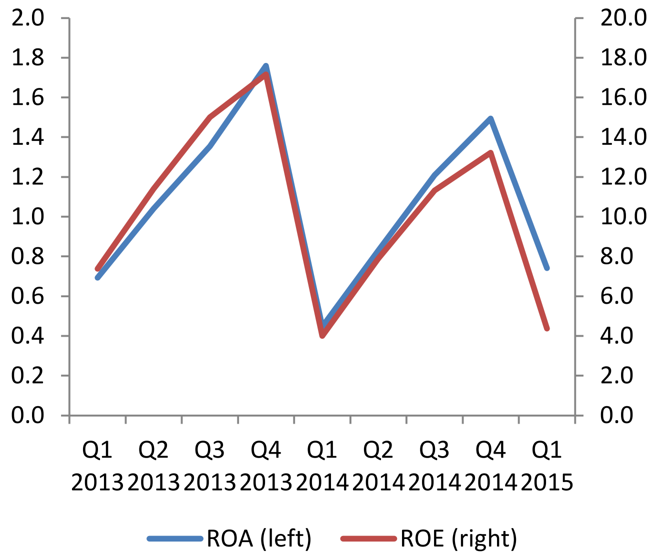
Source: Central Bank of Bahrain

Annex 2 Graph 2: NPL and Provisioning

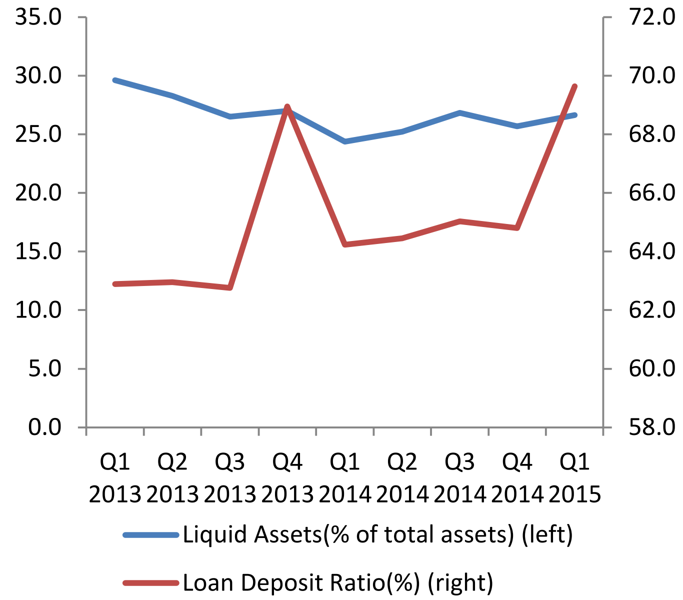


Source: Central Bank of Bahrain

Annex 2 Graph 3: Profitability



Annex 2 Graph 4: Liquidity

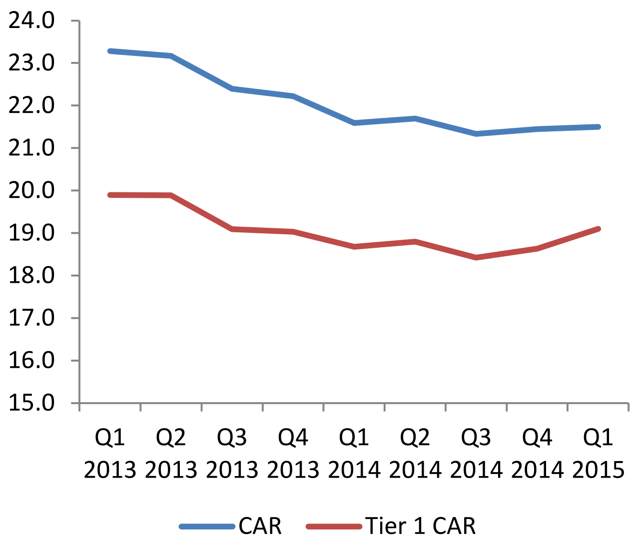


Source: Central Bank of Bahrain

Source: Central Bank of Bahrain

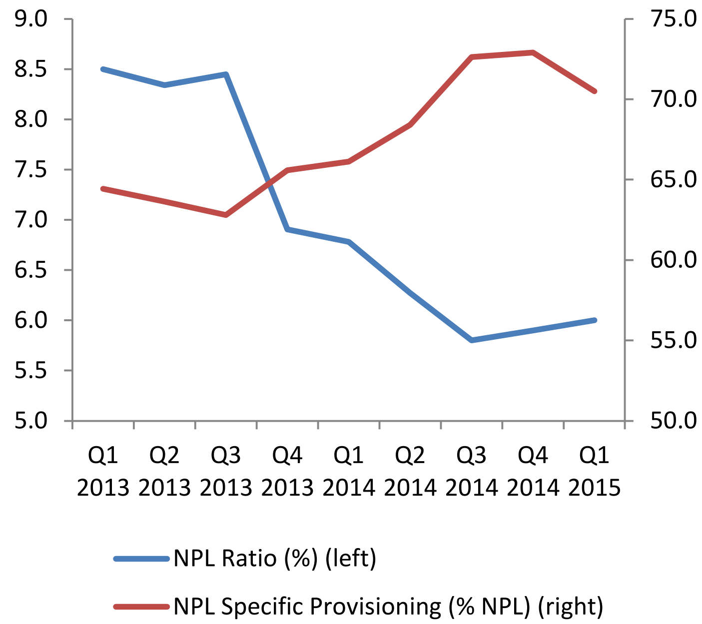
B. Conventional Wholesale

Annex 2 Graph 5: CAR



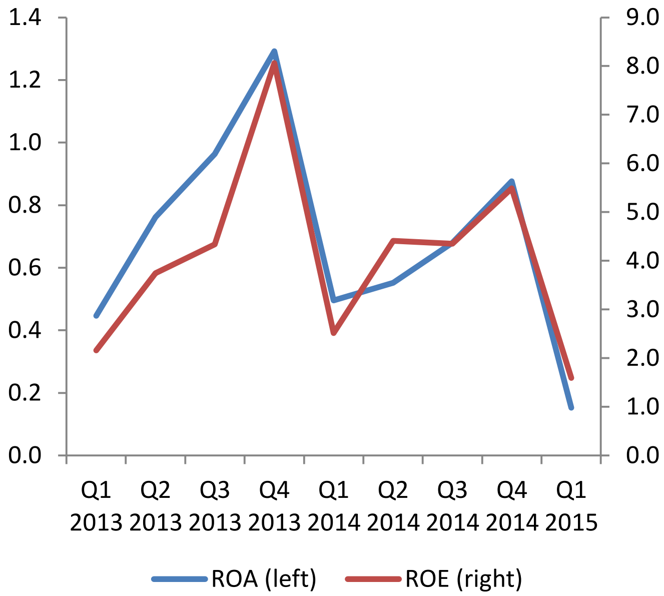
Source: Central Bank of Bahrain

Annex 2 Graph 6: NPL and Provisioning



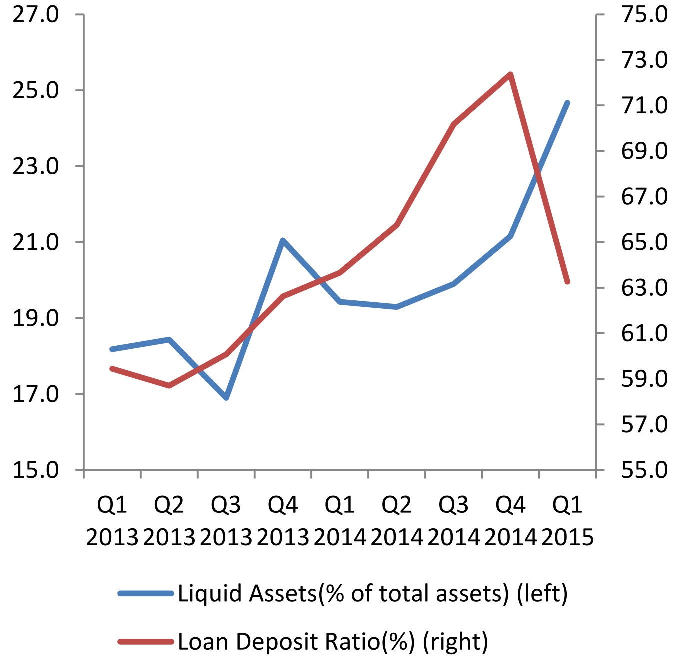
Source: Central Bank of Bahrain

Annex 2 Graph 7: Profitability



Source: Central Bank of Bahrain

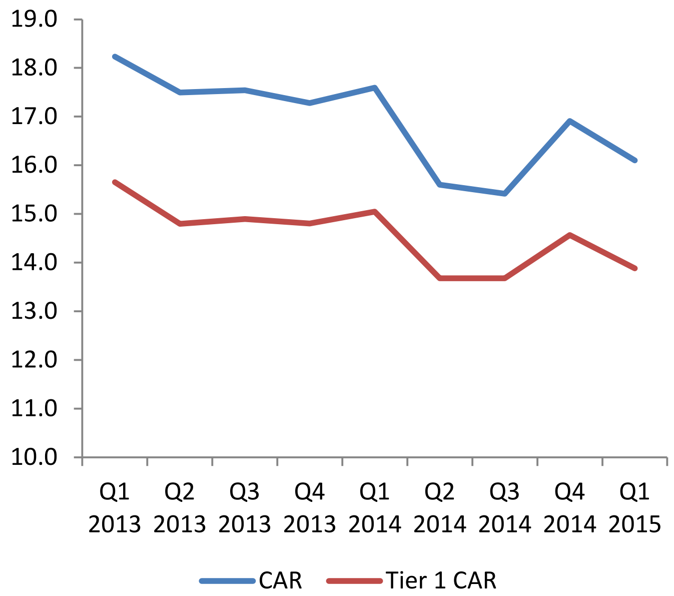
Annex 2 Graph 8: Liquidity



Source: Central Bank of Bahrain

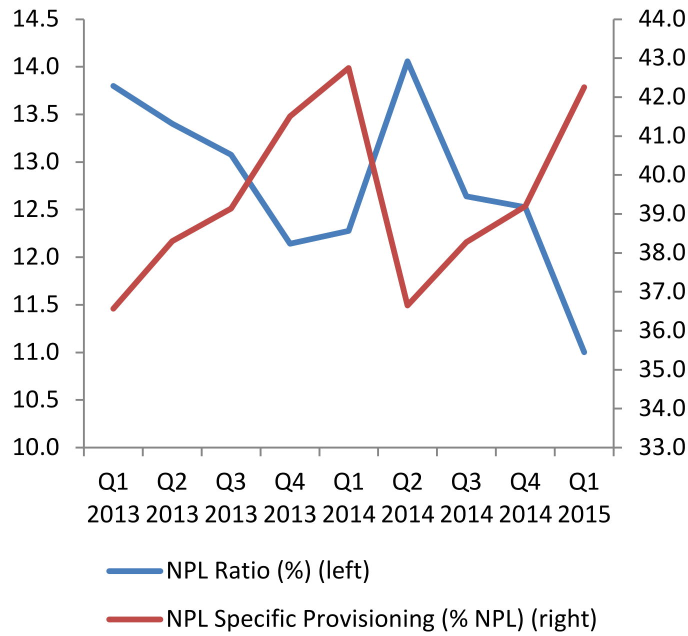
C. Islamic Retail

Annex 2 Graph 9: CAR



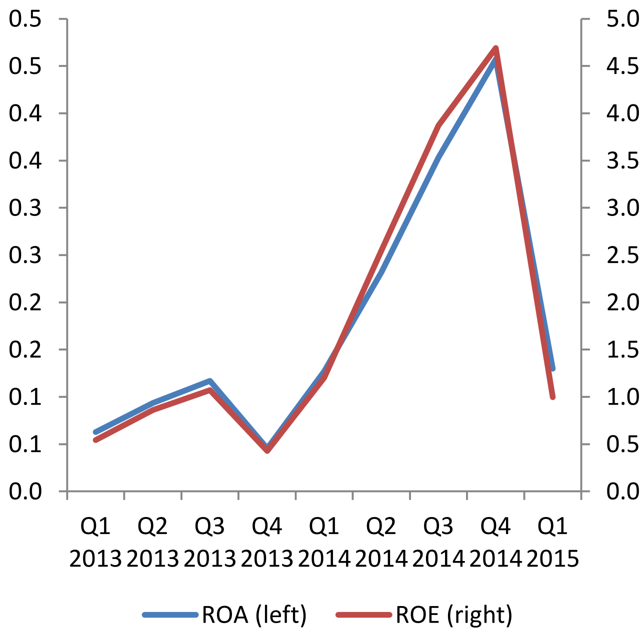
Source: Central Bank of Bahrain

Annex 2 Graph 10: NPL and Provisioning



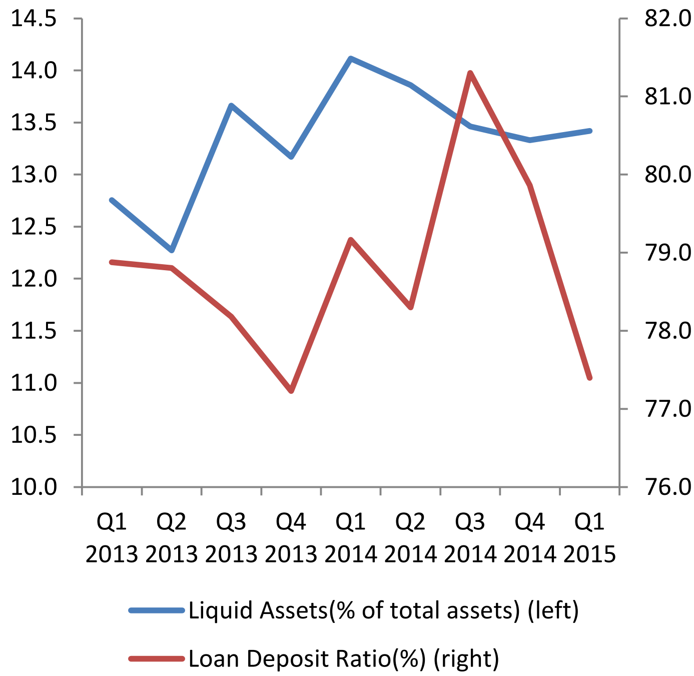
Source: Central Bank of Bahrain

Annex 2 Graph 11: Profitability



Source: Central Bank of Bahrain

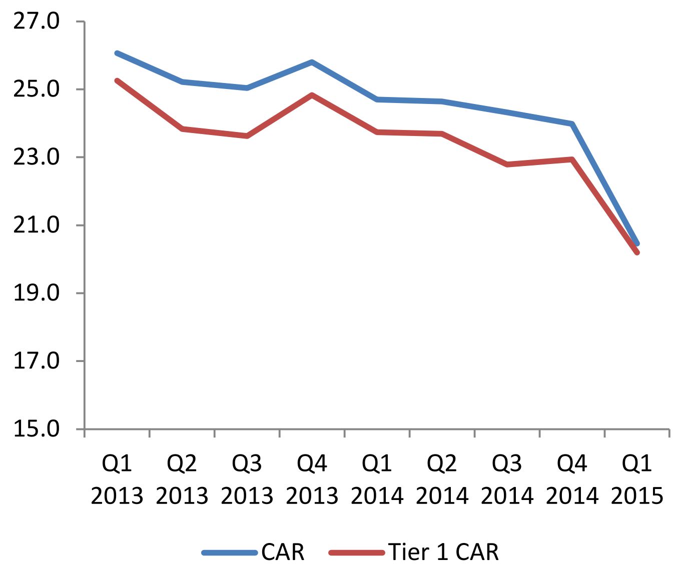
Annex 2 Graph 12: Liquidity



Source: Central Bank of Bahrain

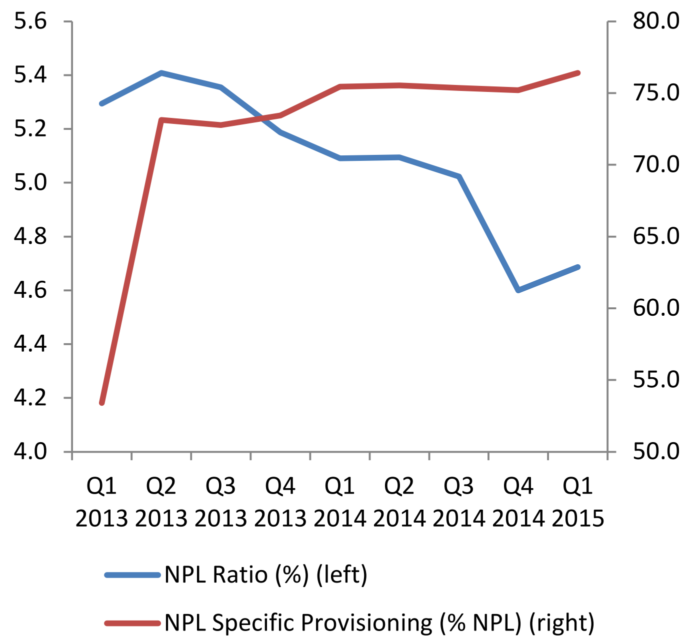
D. Islamic Wholesale

Annex 2 Graph 13: CAR



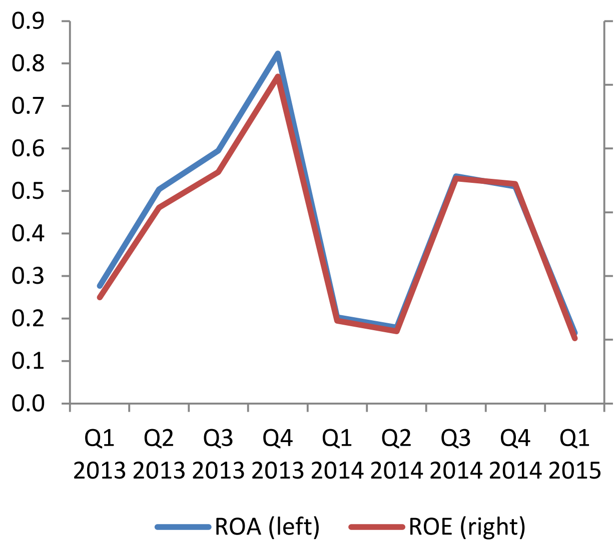
Source: Central Bank of Bahrain

Annex 2 Graph 14: NPL and Provisioning



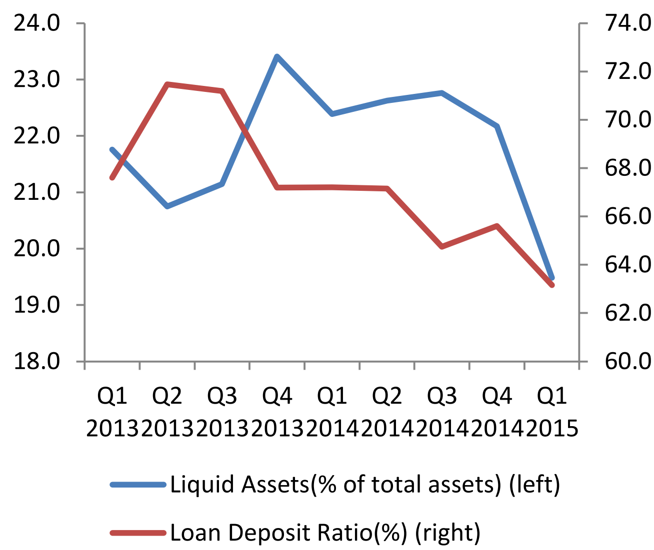
Source: Central Bank of Bahrain

Annex 2 Graph 15: Profitability



Source: Central Bank of Bahrain

Annex 2 Graph 16: Liquidity



Source: Central Bank of Bahrain