Financial Stability Directorate

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Central Bank of Bahrain

Financial Stability Report

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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

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

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

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

The *Financial Stability Report* (FSR) is one of the key components of CBB's financial sector surveillance framework. Produced semi-annually by the Financial Stability Directorate (FSD), its principal purpose is macro-prudential surveillance, assessing the safety and soundness of the financial system as a whole (intermediaries, markets and payments/settlement systems). The ultimate objective of such macro-prudential analysis is to identify potential risks to financial stability and mitigate them before they crystallize into systemic financial turbulence.

This 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 and domestic macro-financial developments.
    - Chapter 2 examines the financial position of households and business enterprises as well as trends in the construction and real estate sector.
- 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 t 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 2013 and end-March 2014.

Executive Summary

Global Macro Financial Environment Overview

The global economy has shown signs of improvement and recovery supported by governments and central banks throughout the implementations of fiscal adjustments and monetary accommodations, also called quantitative easing programs (QE). Major central banks continue supporting the banking sector through monetary policy accommodation and unconventional measures.

Global economic activity improved slightly but it remains subdued and growth remains uneven across countries and regions as well. Major European countries have experienced a positive growth. Non-European countries had their economic conditions improved slightly while emerging economies have experienced a fairly broad-based slowdown. Regarding the GCC region, solid economic growth was experienced (5.2%) in 2014, due to high oil and energy prices which in turn boosted the regional economy and reduced the weight of debts.

Despite the modest performance of peripheral countries, the euro (EUR) remains remarkably a strong currency and it recently showed high resilience, the British pound (GBP) gradually appreciated against the US dollar, Japanese yen (JPY) depreciated slightly against the US dollar.

Bahrain’s financial sector was resilient in the face of the different financial turbulences it had encountered in the past five years. Despite the various types of crises, the banking sector in Bahrain remains resilient and stable and Bahrain emerged during the past recent years to become a hub of finance and insurance industry, especially Islamic finance and Takaful sector.

The Non-Financial Sector Overview

Outstanding personal loans, used as a proxy for household borrowing, shows that the household debt burden remained stable with a slight increase between the period September 2013 to March 2014. Personal loans remained steady at around 24.5% of GDP.

Between September 2013 and March 2013, Business loans and advances decreased until December 2013, and then increased steadily to March 2014. Outstanding business loans averaged of 40.4% of GDP decreasing from 40.9% in September 2013 to 40.5% in March 2013.

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 slightly decreased to 18.3% in March 2014. Capital adequacy ratio for locally-incorporated wholesale banks was 21.6%. Loan delinquencies have shown decreases for conventional retail and wholesale banks reaching 3.8% and 6.8% respectively. Loan concentration remains for conventional retail and wholesale banks despite some decrease in some sectors.

As at end-March 2014, return-on-assets (ROA) decreased to 0.4 from 0.7% in March 2013. Return-on-equity (ROE) for *locally-incorporated retail banks* decreased from 7.4% in March 2013 to 4.0 % in March 2014. ROA for the conventional wholesale banking sector was at 0.5% in March 2014, a decrease from the 0.4% in March 2013. ROE for *local wholesale banks* increased from 2.2% to 2.5%. For conventional retail banks liquid assets as proportion of total assets decreased to 24.3% while it increased to 19.4% for conventional wholesale banks.

Islamic Banks

The financial soundness indicators show that capital positions increased for Islamic retail banks and declined slightly for Islamic wholesale banks. The capital adequacy ratio of Islamic retail banks increased to 17.7% in March 2014 from 17.5% in September 2013. As at end-March 2014, the CAR for Islamic wholesale banks declined to 24.6% against 25.0% in September 2013.

Non-performing facilities (NPFs) for Islamic retail banks dropped to 12.6% in March 2014 and 5.1% for Islamic wholesale banks. Facilities concentration has decreased for retail Islamic banks and wholesale Islamic banks. The earnings picture looks better for Islamic retail banks with ROA remaining unchanged and an increase in ROE. Moreover, Islamic retail banks experienced a strengthened liquidity position as the liquid asset ratio increased to reach 14.3% and 22.6% for Islamic retail and wholesale banks respectively. The facilities to deposit ratio increased slightly for Islamic retail banks and decreased for Islamic wholesale banks.

Performance of Equity Markets

A look at *year-on-year* data shows that the Bahrain All Share Index increased by 239.8 points (20%) between June 2013 and June 2014. The Bahrain All Share Index has experienced a stable increase in the period between June 2013 and June 2014, reflecting growing confidence in the Bahraini stock market.

Market capitalization of the Bahrain Bourse stood at BD 8.1 billion. This level of market capitalization is 16.5% higher than the level as at end-December 2013 and 23.9% higher *year-on-year*. As June 2014, the price-earnings ratio (P-E ratio) for the stock market stood at 10.29, an increase from the 9.38 attained last year in June 2013 and the 10.07 in December 2013.

The bulk of the value of shares traded in June 2014 was the “Commercial Banks” sector whose traded shares (by value) represented 76.2% of total shares traded up from 68.5% in December 2013.

The GCC Markets performed very well in the first quarter of 2014, supported by steady production over the GCC countries and high oil prices. Accommodative monetary policy in the GCC countries given its peg to the US dollar and expansionary fiscal policy that materialized through major investment projects (especially in the non-oil sector) reinforced investors' sentiments and business confidence.

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.

The average daily volume of cheques processed through the Automated Cheque Clearing System (ACS) decreased by 3.7% (year-on year increase of 3.5%). The average daily value of cheques increased by 4.7% over same period (year-on-year increase of 9.9%).

Between December 2013 and June 2014, the number of withdrawal transactions processed through the ATM Clearing System increased by 13.4% (year-on-year growth was 19.8%). In value terms, total withdrawals processed increased by 18.7% (year-on-year growth was 23.4% growth).

The *average daily volume of transfers* increased by 0.1% over the same period (14.6% year-on-year increase). The *average daily value of transfers* witnessed a 12.8% decrease between December 2013 and June 2014 (2.8% year-on-year increase).

Part I:

Recent Developments in the International Financial Markets

1. Financial Stability Overview

Chapter

1

Key Points

- The global macro-financial environment has witnessed a new strengthening trend and the global economic and financial conditions have improved.
- Financial stability has improved in the advanced economies and deteriorated somewhat in emerging market economies.
- The future adjustment in monetary policies by major developed countries, particularly QE, remains an important risk factor for global growth and financial stability.
- The Bahraini financial sector is performing effectively with no major financial stability concerns.

1.1 Overview

Since our previous financial stability report, the global economy has shown signs of improvement and recovery. This performance was supported by governments and central banks throughout the implementations of fiscal adjustments and monetary accommodations, also called quantitative easing programs (QE). However, high accommodative monetary policy is often associated with some sophisticated risks, since rising yields may generate severe volatility in financial markets, increase uncertainty and hamper the sustainability of economic development. Therefore, global financial stability remains vulnerable and fragile.

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, the economic activity has faced some serious challenges in the beginning of the year caused by harsh weather conditions over the winter which hampered GDP growth in the first quarter of the current year. In the beginning of spring 2014, retail sector recorded a strong demand as consumer confidence improved remarkably. Furthermore, the US real estate market has recently shown signs of recovery in both volume and price and the US economy has witnessed an upsurge in home sales and non-residential investments. Regarding the monetary policy, the Federal Reserve has already announced in multiple occasions (meetings) 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.

- In euro area, the economic conditions have continued to improve progressively thanks to the implementation of various structural reforms and the continued support by the ECB. In the past recent months, the demand for euro area assets has increased remarkably and the euro (EUR) remains remarkably strong. According to the ECB, three major factors could explain the recent strong demand. First, investor confidence to date has been supported by further progress on European safety nets, ratings upgrades, improving fiscal prospects and lower political uncertainty. (ECB June 2014). Despite the encouraging signs of recovery, risks to the euro area remain. Precisely, the Euro area is currently facing a risk of deflation. In fact, during the past few months, inflation in Euro area fell below 1% and it even reached 0.5% in March 2014. Worst, some countries like Spain has experienced a negative inflation rate (CPI was -0.2% y/y). This rate is far from the initial inflation rate target fixed by the ECB in 1998. That could impede the economic growth. To curb the risk of deflation, Mario Draghi, President of the ECB has announced a new series of monetary accommodations including: a cut of the deposit facility rate from 0.00% to negative (-0.10%), in order to increase the demand for high-quality assets notably government securities purchased by money market funds. The ECB also announced targeted credit easing measures to support business lending.

- Emerging market economies have experienced some financial stress and significant tensions at the beginning of the year which were caused by the announcement of the Fed's tapering policy. Following the announcement, sudden huge movements of capital flows left EMEs, notably south and East Asia economies, to advanced economies as investors were looking for high yields. As a result, EMEs have witnessed a sharp depreciation of currencies. For example during the third quarter of 2013, major currencies of majors emerging economies depreciated: the Indonesian rupiah by 5.7%, the Philippine peso by 6.5%, the Indian rupee fell by 11%, the Thai Baht by 6% and the

Malaysian ringgit by 8.8%. Furthermore, equity prices declined and exchange rates went down and bond yields rose in late January 2014 amid renewed capital outflows. The cost of US tapering could worsen and could deteriorate the economic conditions in EMEs by for example increasing the external financing costs. Fortunately, thanks to the effectiveness of macroeconomic policy decisions and effective regulations and banking supervision, the real impact was short and the market tensions were limited.

- The MENA region, as an important bloc of the world economy, has recorded a positive sign of recovery and the global economic and financial conditions remain favorable. However, given the economic and political turmoil in MENA region, notably in Iraq and Syria, the stability of the MENA region remains uncertain and subject to serious threats. Therefore, the regional macroeconomic stability is still facing several challenges. Hence, many countries need to re-establish macroeconomic and political stability over the short term.

- GCC countries are a central bloc of MENA region; they have recorded strong economic performances boosted by large infrastructure projects. 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.

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

1.2 Global Macro-financial Environment

Since our previous report, the global macro-financial environment has witnessed a new strengthening trend and the global economic and financial conditions have improved. Major central banks continue supporting the banking sector through monetary policy accommodation and unconventional measures such as quantitative easing programs. More recently, the European Central Bank announced that the monetary policy stance will continue to be accommodative and will thereby continue to support the ongoing economic recovery in the euro area.

Financial market's sentiment remained positive, 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 control despite the volatility of end-October 2013 due to the US Government blackout and debt ceiling negotiations.

1.3 Recent Trends in the Global Economy

A- GDP Growth

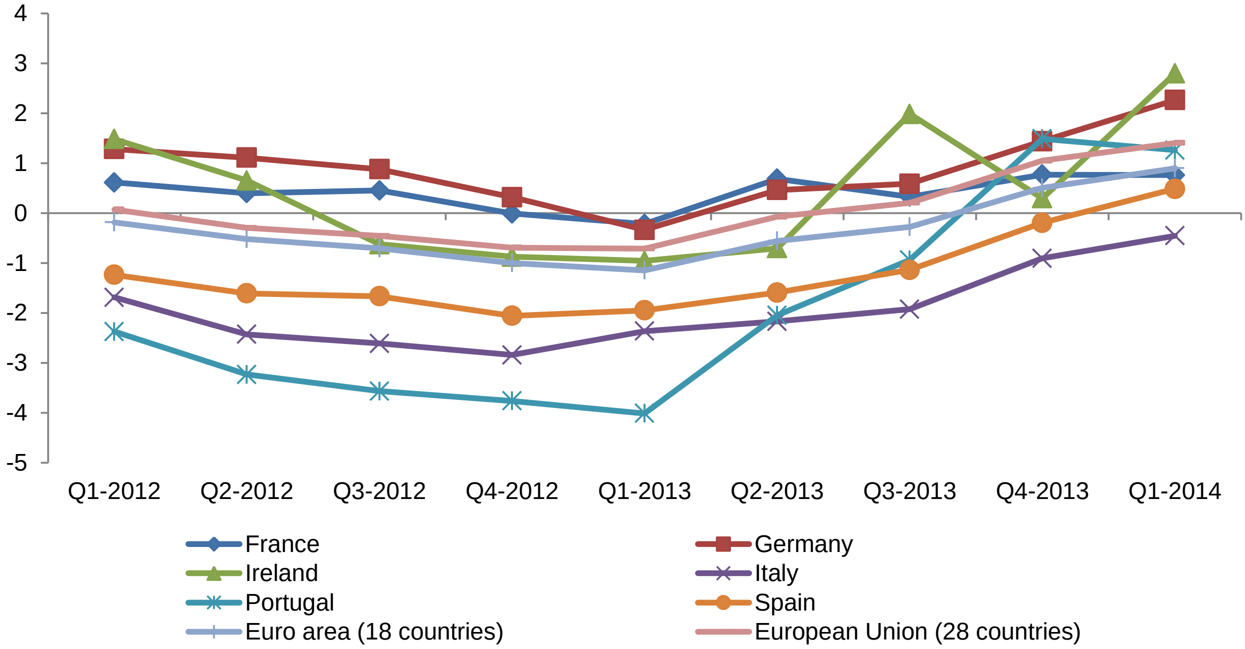
Since our December's report, global economic activity improved slightly but it remains subdued and growth remains uneven across countries and regions as well.

The recent OECD's data shows that since the fourth quarters of 2013, the Euro Area (18 countries) has been experiencing a positive growth. In the first quarter of 2014, Euro Area (18 countries) has achieved a growth of 0.9%. Similarly, the Eurozone (28 countries) has recorded a positive growth rate since the third quarter of 2013. In the first quarter of 2014, Euro Area (28 countries) real GDP growth was 1.4%. The risks surrounding the economic outlook for the Euro Area are evaluated to be on the downside. To boost further the Eurozone economic recovery, the European central bank has announced in June 2014 a variety of new easing actions for the euro area including: forward guidance which states 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, Ireland has achieved the best performance in the first quarter of 2014 with a growth rate of 2.8% followed by Germany, the largest economy in the Eurozone. After a contraction in the first quarter of 2013, the German economy continues growing and it achieved a growth rate of 2.3% in the first quarter of 2014.

Major important European countries have experienced a positive growth rate of their economy in the recent period. In Spain, positive growth trend was restored as the economy achieved 0.5% rate of growth in the first quarter of 2014. However in Italy, GDP growth continues to be negative for the eleventh consecutive quarter but with the pace of contraction slowing down continuously.

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



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

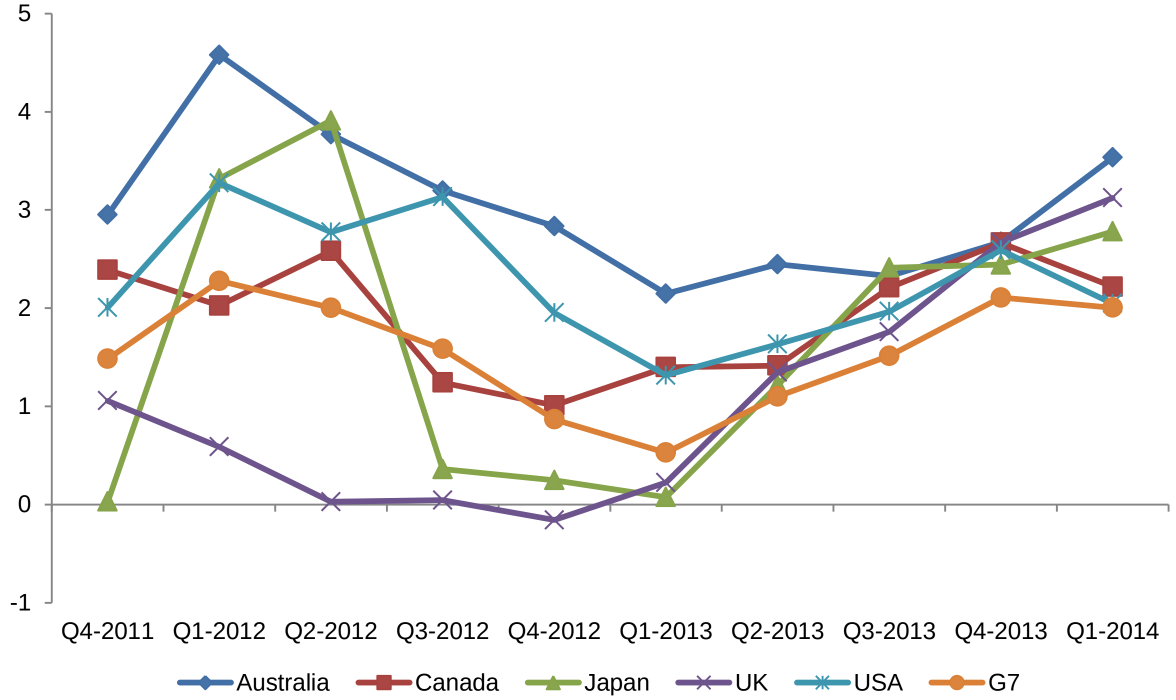
Regarding non-European countries (Chart 1-2), the economic conditions improved slightly, especially in Australia which recorded a positive GDP growth of 3.53% in the first quarter of 2014 and economic activity has remained robust.

In the UK, GDP grew by 3.1% in the same period, supported by Bank of England's quantitative easing program. Recently, the Monetary Policy Committee (MPC) indicated that the economic conditions improved and the Bank Rate was likely to rise progressively to a level below its pre-crisis average.

For Japan, the economy grew by 1.5 per cent in 2013, and recently showed a positive sign of fast recovery as GDP grew by 2.8% in the first quarter of 2014. The expansionary fiscal and monetary policies introduced in 2013 were the main drivers for growth. In 2014, the government has launched further measures to speed up the recovery. The government first increased the sales tax in April 2014, and then injected more expenditure through a complementary budget. The central bank (Bank of Japan, BoJ) would further increase its effort to reinforce its determination to end deflation and offset the adverse effects of a planned tax hike at the turn of the fiscal year.

According to the IMF economic outlook, GDP is expected to grow by 2.8 and 3.0% in 2014 and 2015, respectively. The rebound will be 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 2014 and into 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 trading partners is expected to remain relatively weak.

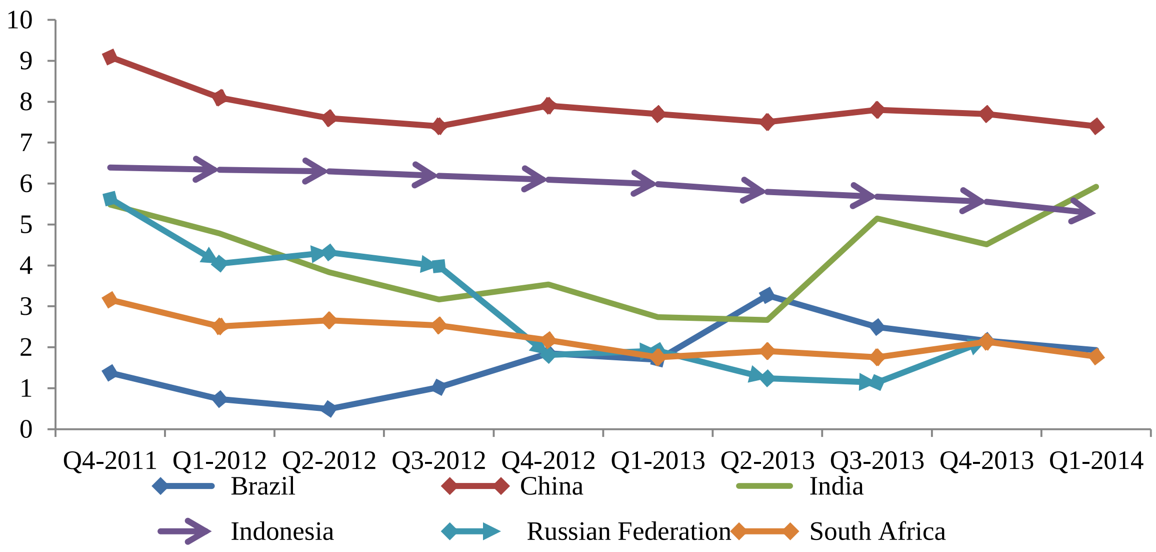
Chart 1-2: Real GDP Growth in Advanced Economies (Quaterly%)*



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

In the beginning of 2014, India experienced a positive growth rate of 5.9% while GDP growth rates of the other countries slowed down.

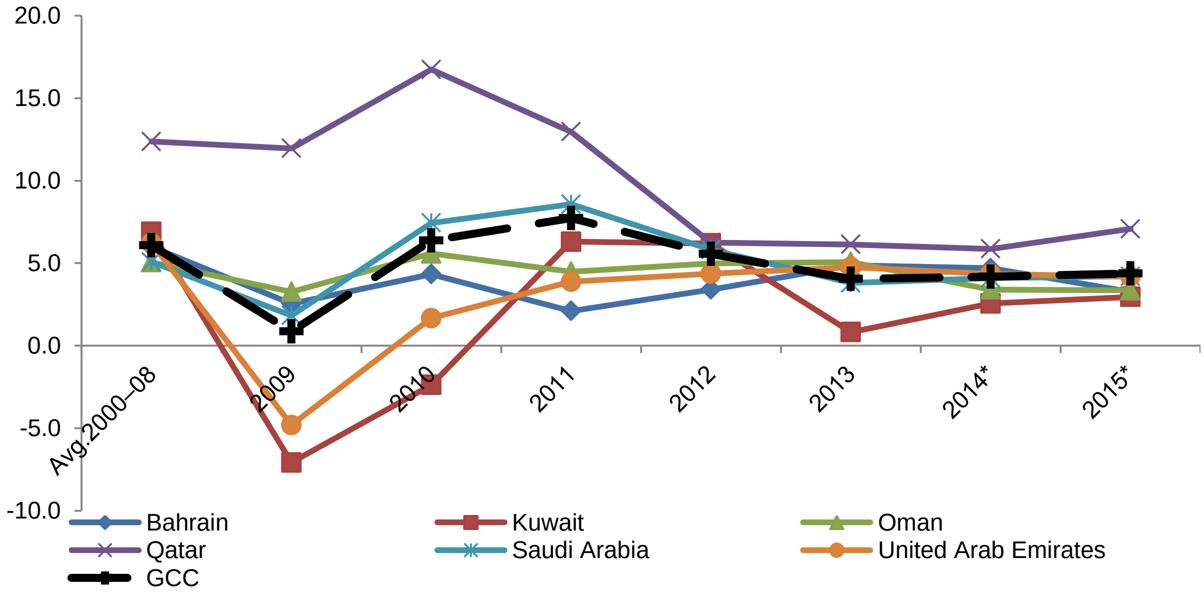
Chart 1-3: Quaterly Real GDP Growth in BRICS (Quaterly%)*



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

Regarding the GCC region, solid economic growth was experienced (5.2%) in 2014, thanks to high oil and energy prices which in turn boosted the regional economy and reduced the weight of debts. The IMF forcasts that GCC economic performance will continue to improve further in 2014 and 2015 with a growth rate of 4.2% and 4.4% respectively (chart 1-4). The member states of the Gulf Cooperation Council (GCC) have been on a stable growth path, despite the trouble in the MENA region and the global uncertainty.

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



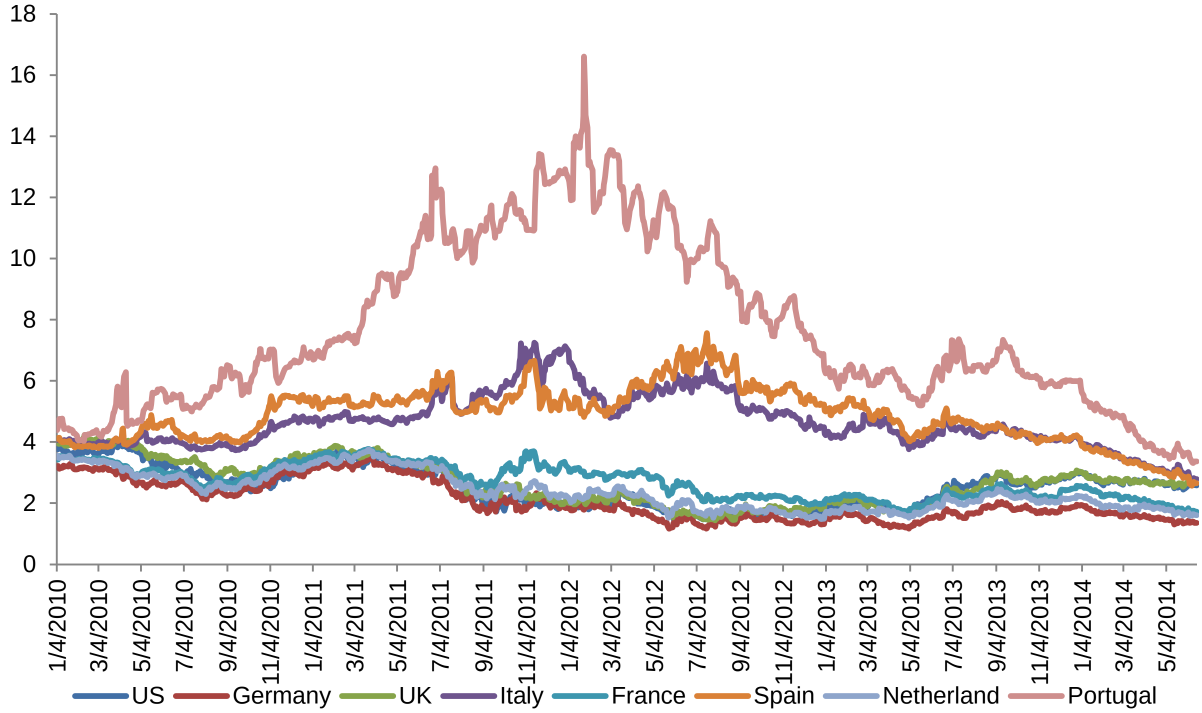
**Denotes forecast.*
Source: IMF MENAP Regional Economic Outlook, April 2014.

B- Financial Markets

Chart 1-5 highlights the change in Yields on 10 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.

In the beginning of 2014, Yields remained low relative to historical norms. 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 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

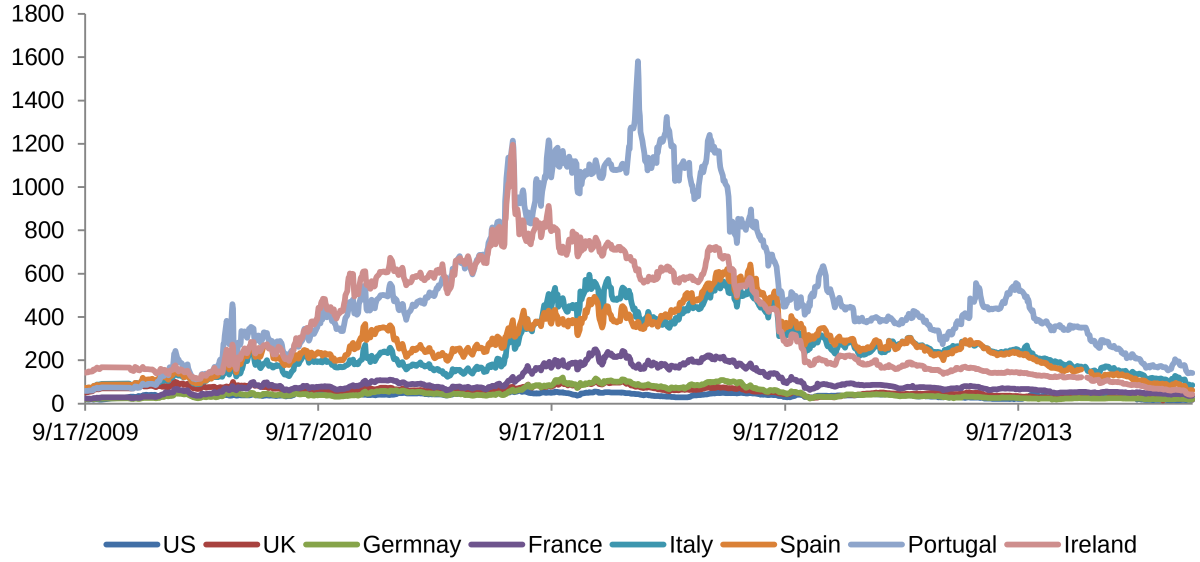
CDS spreads are a fundamental metric of default risk. Broadly, a higher spread on the CDS implies a greater risk of default for the reference entity. Chart 1-6 provides information as to how financial markets perceive the risk of default on corporate and sovereign debt. It illustrates spreads on five-year 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 of defaulting on their debt. The policy measures launched by the European Central Bank have reduced 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.

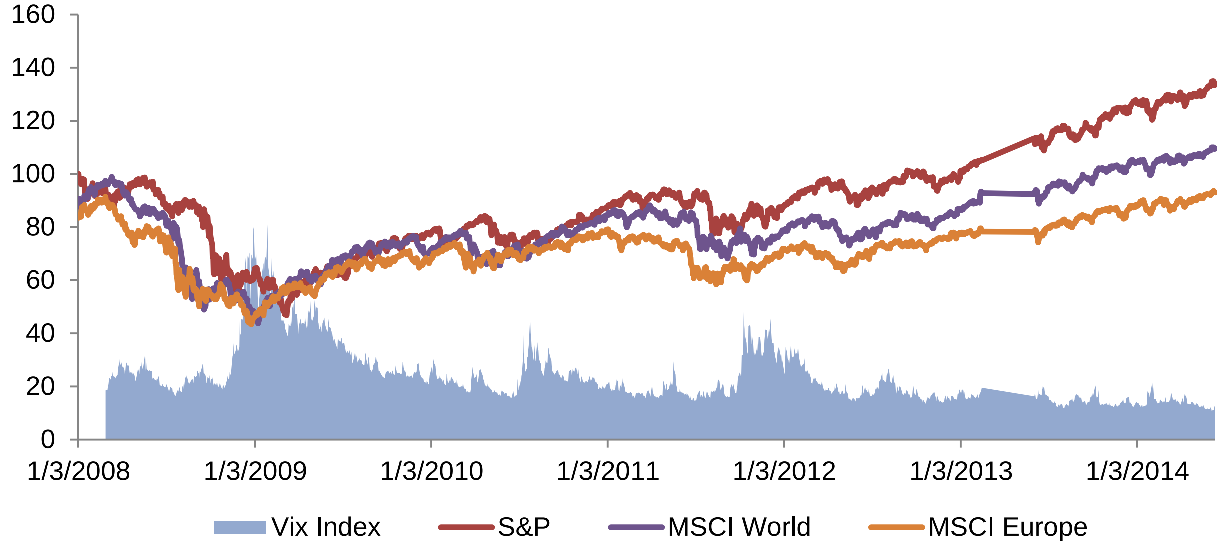
Chart 1-6: Five Year Spreads on Credit Default Swaps



Source: Bloomberg

Regarding global equity markets, chart 1-7 shows that following a period of hesitation and 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 which had an immediate impact on equity markets.

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



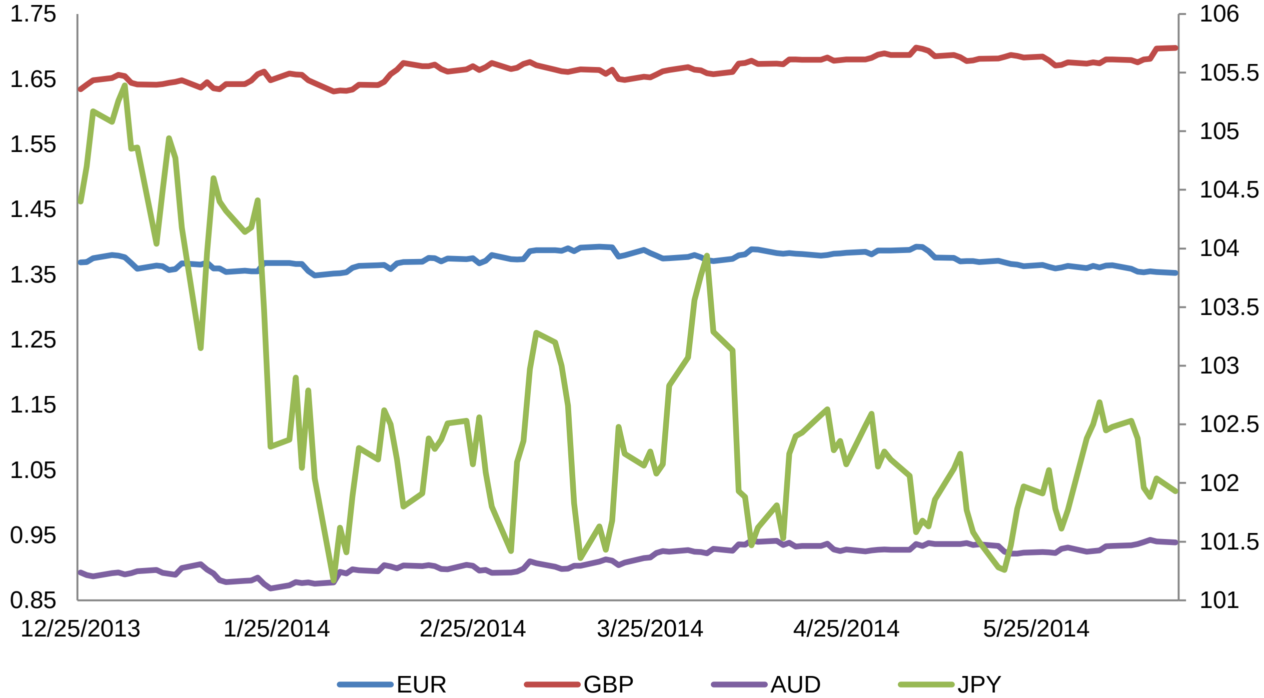
Source: Bloomberg

C- Volatility of the major currencies

Despite the modest performance of peripheral countries, the euro (EUR) remains remarkably a strong currency and it recently showed high resilience to geo-political concerns in Russia-Ukraine, as it was exchange at 1.392 marks against the dollar in March 2014. Following the recent announcement of European Central Bank President Draghi which aims at devaluating the Euro, the single currency remains stable and it has been exchanged at the level of USD 1.36 in all June 2014 (chart 1.8). The European currency appears defiant of the unfavorable growth and interest rate differentials as compared with the US outlook. The resilience of the Euro could be explained by the fact that manufacturing and services output in the Euro area expanded at a faster pace the past months than economists' forecasts.

Since our previous report, the British pound (GBP) gradually appreciated against the US dollar and it is traded to year high in June 2014, supported by a relatively strong fundamental backdrop, the outlook for Bank of England policy and supportive capital inflows. For the Bank of England, at current levels (1GBP=1.69 USD), the GBP is priced to perfection.

Chart *1-8: Various Currencies Against US dollar*



Source: Bloomberg

The introduction of new quantitative ease measures in Japan during 2013 has triggered a significant depreciation of the yen vis-à-vis all major currencies. In

January 2014, Japanese yen (JPY) depreciated slightly against the US dollar and then it has maintained a stable trading range over the past four months, even following the new fiscal and monetary measures implemented by the Bank of Japan in April 2014. Finally, Australian dollar appreciated slightly during the past six months, it was traded at USD 0.89 in January 2014, and it is at USD 0.93 in June 2014.

D- The Eurozone and the Global financial stability

Recent data reveals that the euro area financial markets have improved remarkably during the past few months. The Euro area favorable global condition, notably ratings upgrades, improving fiscal projections and lower political uncertainty, has regained investors' confidence.

The recent Euro area economic and financial performance was supported by thoughtful efforts for boosting economic recovery, progress with structural reforms in fragile euro area economies, and continuous assistance by the European Central Bank. As a result, the euro area has experienced a prolonged period of capital inflows from emerging markets, in particular those with weaker essential fundamentals

In the first two quarter of 2014, the Euro area has witnessed a strong demand for euro area assets and some of the bond and equity market improved considerably. One of the reason explaining the high demand is the rebalancing of portfolios from emerging to advanced economies amid the deterioration of economic and financial conditions in these economies.

Despite the recent courageous signs of recovery and further positive developments over the past six months in the Euro area, fiscal and banking sector problems in the region remain a serious threat to global financial stability. In fact, the credit conditions in the euro area remain relatively difficult, in line with the soft economic situation. According to the recent ECB's lending survey, the demand for business loans continued to fall over the six months to December 2013 and banks continued to tighten lending standards. Accordingly, credit growth continued to decline over the year to December, driven by falls in business sector credit. Furthermore, the political tension in the region, combined with the sluggish growth profile, strong currencies and weaker commodity prices, has led to extremely low rates of inflation, to the point of triggering concerns about the risk of deflation. To curtail these risks, the European central bank has announced a series of measures to fight the euro zone's deflation and speed up the economic recovery and ensure the soundness of the banking and financial sector. In early June 2014, the ECB has announced to cut the rate on its deposit facility for banks from 0 percent to minus 0.10 percent. It also announced to cut its main interest rate to from 0.25 percent to 0.15 percent, and cut the rate on its marginal lending facility by 35 basis points to 0.4 percent from 0.75 percent.

However, three weeks later, the Euro remains strong against the US dollar and no sign of market dynamism has been seen yet.

Another factor that threaten the global recovery in the Euro area and hence the financial sector, is the persistence of high levels of unemployment. In fact, the situation in Euro Area has degenerated in 2013 as unemployment rate amplified to reach 12.05% higher than the 11.39% recorded in 2012. In the last quarter of 2013 Euro Area unemployment hit 12%. According to Eurostat Euro-indicators 2013, the euro area (EA17) seasonally-adjusted unemployment rate was 12.2% in September 2013 while it was 11% for The EU28. In both zones, rates have risen compared with September 2012, when they were 11.6% and 10.6% respectively.

With regards to youth unemployment rate, it was 23.5% in the EU28 and 24.1% in the euro area in September 2013, compared with 23.1% and 23.6% respectively in September 2012 (Eurostat, September 2013). In September 2013, the lowest rates were observed in Germany (7.7%) and Austria (8.7%), and the highest in Greece (57.3% in July 2013), Spain (56.5%) and Croatia (52.8% in the third quarter of 2013). The IMF predicts that in 2014 unemployment rates for Euro Area will have almost similar level of 2013.

To conclude, certain risks to the euro area persist. Banking systems continue to face financial stress and the regional economy continues facing various challenges especially: high unemployment persists; strong European currency (EUR) that could weaken competitiveness and price declines in some countries that could increase the real burden of debt service. All these problems associated with the global uncertainty may make European banks 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 level continues 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.

1.4 Recent deveopment in the Bahraini financial sector

The aim of this section 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 remaining resilient or not since our last evaluation.

1.4.1 Assessing the resilience of the Bahraini financial sector

Bahrain's financial sector was resilient in the face of the different financial turbulences it had encountered in the past five years. The first major crisis was the financial crisis of 2008 which led to a global liquidity squeeze. The CBB provided retail banks a daily FX-swap facility in October 2008 allowing them to obtain dinars in return for dollars and allowed them to borrow overnight funds using government short- and long-term *Ijara* sukuk denominated in dollars as collateral. To support further the banking sector and boost the lending activities, the CBB has decided to lower the reserve requirement to 5% from 7% in March 2009.

Other turmoil included the debt crisis in Europe that has threatened the global financial stability and the crisis associated with the current political instability in the MENA region notably in Syria and Iraq.

Despite the various types of crises, the banking sector in Bahrain remains resilient and stable and Bahrain emerged during the past recent years to become a hub of finance and insurance industry, especially Islamic finance and Takaful sector.

Evolution of the financial system

Over the past decades, 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.

In May 2014, the banking sector in Bahrain was made up of 115 banking financial institutions, categorized as follows:

- 104 banks:
  - 22 conventional retail banks, 7 of them are incorporated in Bahrain and the other are braches of foreign banks;
  - 58 conventional wholesale banks, 17 of them are incorporated in Bahrain;
  - 24 Islamic banks, 6 of them locally incorporated retail Islamic banks and 18 wholesale Islamic banks.

- 11 Representative offices: 1 Islamic, 10 conventional,

There are also 290 non-banking financial institutions operating in Bahrain, categorized as follows:

- 52 Investment business forms
- 140 Insurance Companies
- 70 specialized licenses, which include 5 for Insurance and 8 for Investment Business firms
- 28 Capital Markets

It is worth recalling that the insurance industry has progressed effectively during the past few years, which has grown into a regional hub. Insurance contribution increased remarkably 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.

The boom in Islamic banking and Islamic financial services make Bahrain a very attractive destination for Islamic finance. In this sense it is worth recalling that Bahrain worked efficiently since the seventies to achieve what the country has today. 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).

The size of the banking sector

Bahrain's banking sector was very large as it 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 drastically 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 3.6 in the fourth quarter of 2013 and to 3.5 times of GDP in Q1/2014. Further, Table 1 shows that the size of the retail banking sector diminished slightly during the same period and it recorded an increase in the first quarter of 2014 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 represents around 17% of GDP in Q1/2014. Retail banks in Bahrain remain the main engine for the financial sector growth in the Kingdom.

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

	2007	2008	2009	2010	2011	2012	2013/ Q4	2014/ Q1

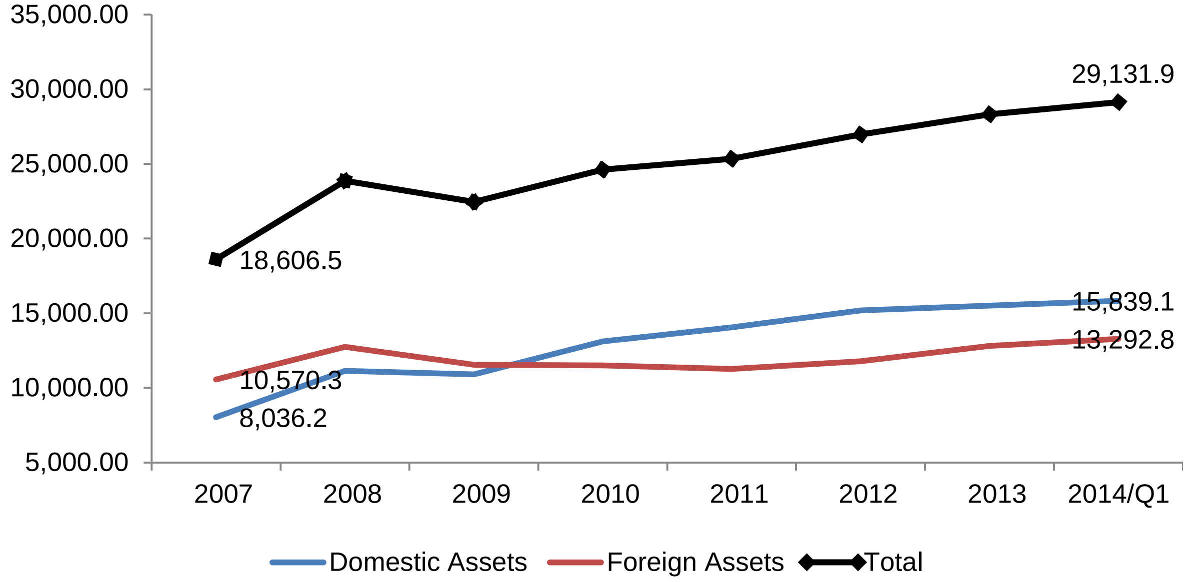
Size of the Banking sector (times GDP)	13.4	11.5	11.5	11.5	6.8	6.9	5.9	5.9
Consolidated B.S. Retail (USD billion)	49.5	63.5	59.8	65.4	67.3	71.7	75.3	77.5
As times of GDP	2.7	2.9	3.1	3.4	2.3	2.5	2.3	2.4
Consolidated B.S. Wholesale (USD billion)	196.3	188.9	162.5	157.7	129.0	127.0	116.7	115.2
As times of GDP	10.7	8.6	8.4	8.1	4.5	4.4	3.6	3.5

Souce: CBB Statistical Bulletin

Market Capacity

Bahrain's financial sector has faced a number of shocks over the past seven years from the sub-prime crisis to the European debt crisis and lastly the social unrest. 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 29.1 billion in the first quarter of 2014 (see Chart 1-9).

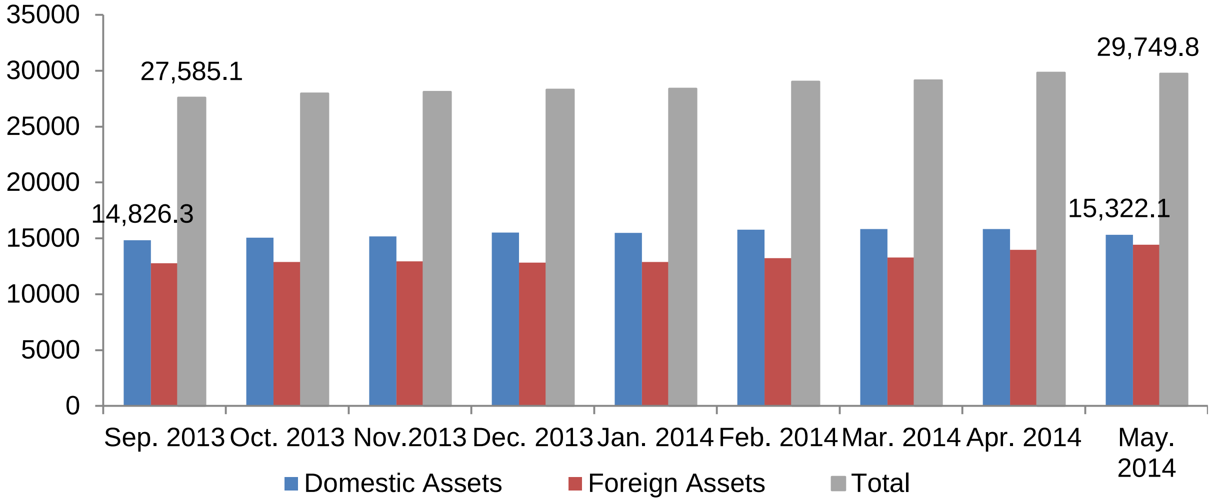
Chart 1-9: Retail Banks' Assets (BD million)



Source: Central Bank of Bahrain

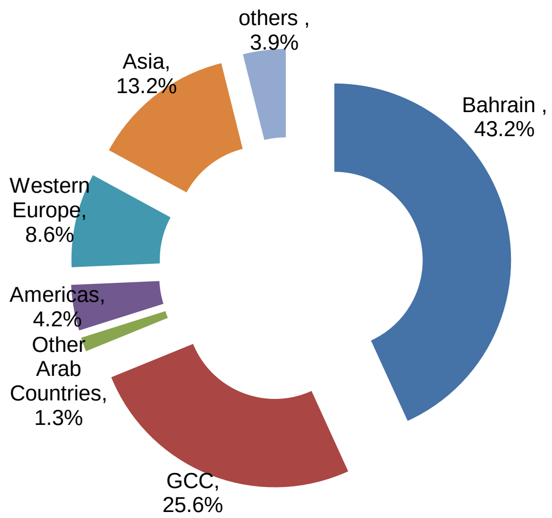
It is worth mentioning that despite the global uncertainty and the trouble in MENA region (notably civil war in Syria and political instability in Iraq), retail banking total assets continued growing since December 2012 moving from BD 26.9 billion to BD 27.5 billion as of end-September 2013 to reach 29.8 in May 2014 (see Chart1-10). This increase in retail banking assets was driven by domestic assets which contributed to 51.1% of total assets at May 2014, up from 46.2% at end-September 2013.

Chart1-10: Cathegorization of Retail Banks' Assets (BD million)



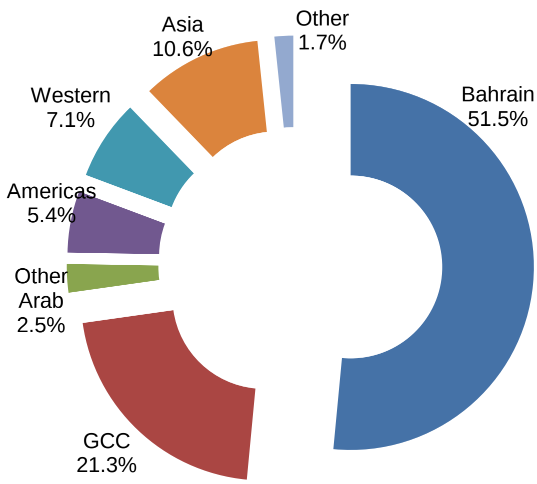
Source: Central Bank of Bahrain

Chart 1-11: Retail Banks' Assets (%) by Geographical Classification (2007)



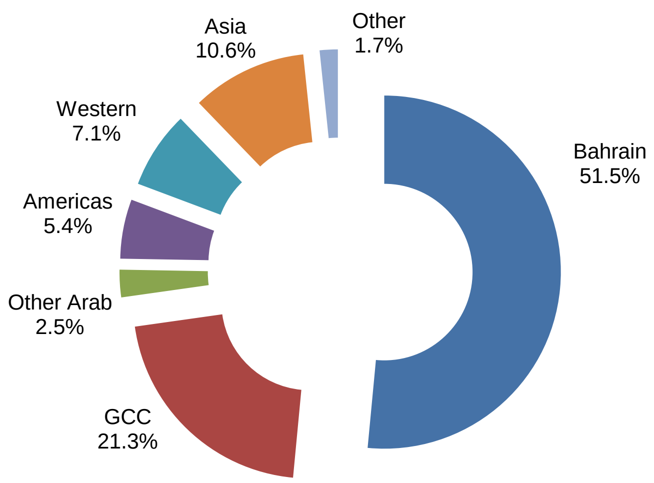
** For conventional and Islamic retail banks*
Source: Central Bank of Bahrain

Chart 1-12: Retail Banks' Assets (%) by Geographical Classification (2013)



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

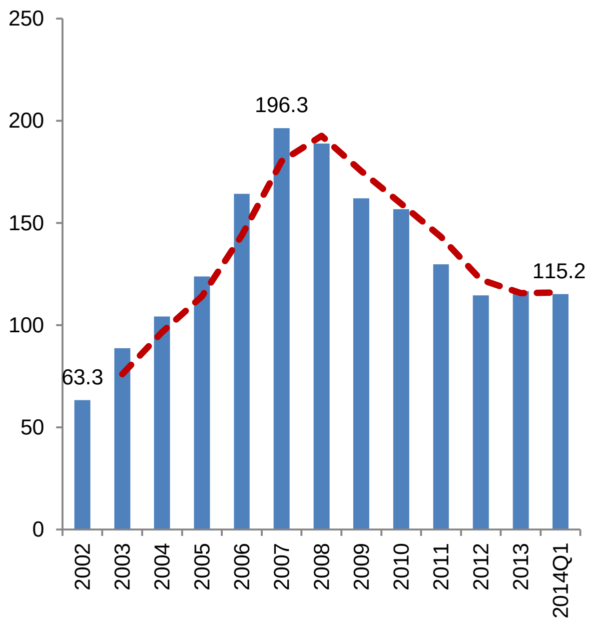
Chart 1-13: Retail Banks' Assets (%) by Geographical Classification (May 2014)



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

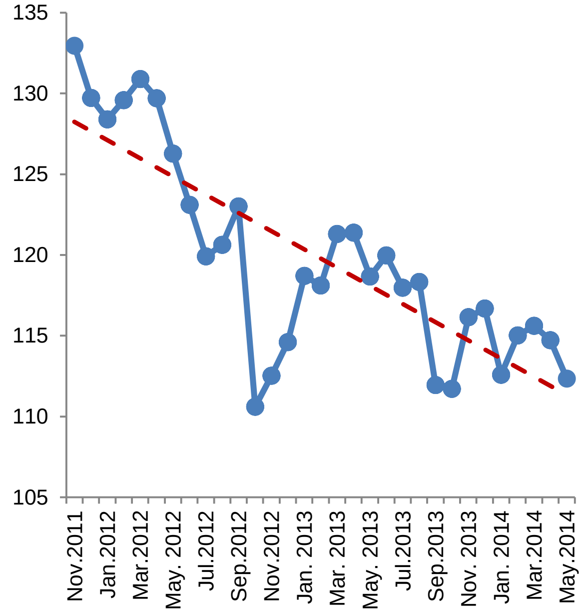
In contrast to the retail banking sector, the wholesale banking sector has witnessed a drop in its total assets from USD 196.3 billion in 2007 to USD 114.6 billion in 2012; hence a decrease of 41.6 %. However, the volume of total assets in the whole sale banking sector improved slightly during the past few month and it reached USD 115.2 million as of end May 2014. (See Charts 1-14 and 1-15).

Chart 1-14: Wholsale Banks' Assets (USD Billion)



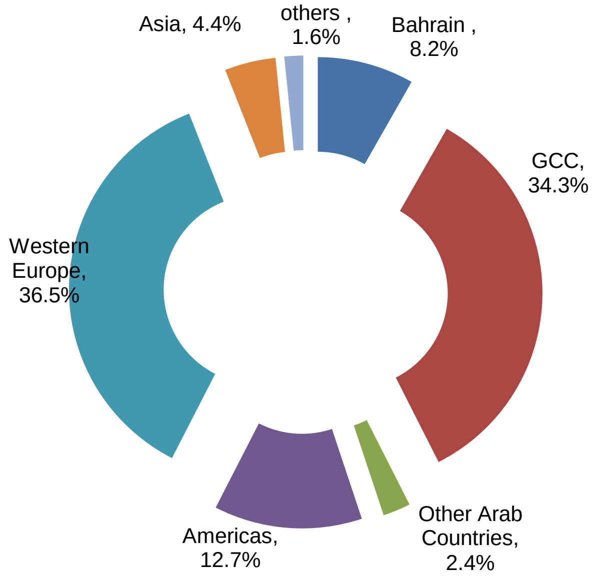
---. *Mouving average trendline*
** For conventional and Islamic wholesale banks*
Source: Central Bank of Bahrain

Chart 1-15: Wholsale Banks' Assets (USD Billion)



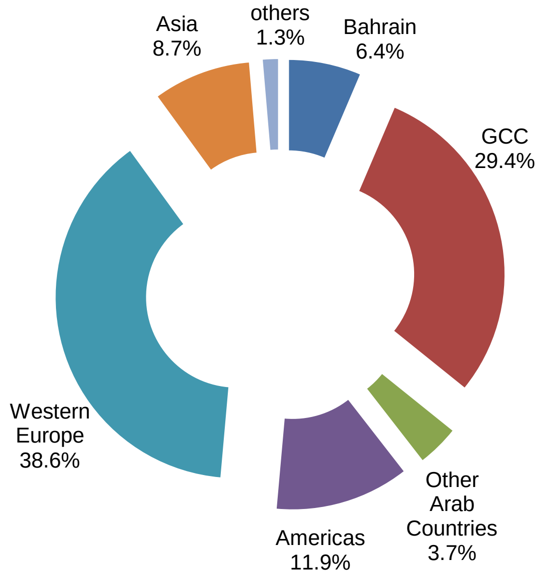
--- *Linear Trendline*
** For conventional and Islamic wholesale banks*
Source: Central Bank of Bahrain

Chart 1-16: Wholesale Banks Assets by: Geographical Classification (2007) *



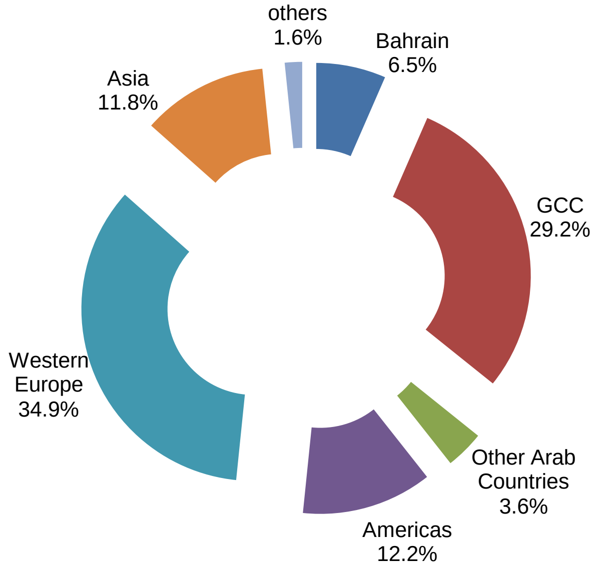
** For conventional and Islamic retail banks*
Source: Central Bank of Bahrain

Chart 1-17: Wholesale Banks Assets by: Geographical Classification (2013) *



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

Chart 1-18*: Wholesale Banks Assets by: Geographical Classification (May 2014) *

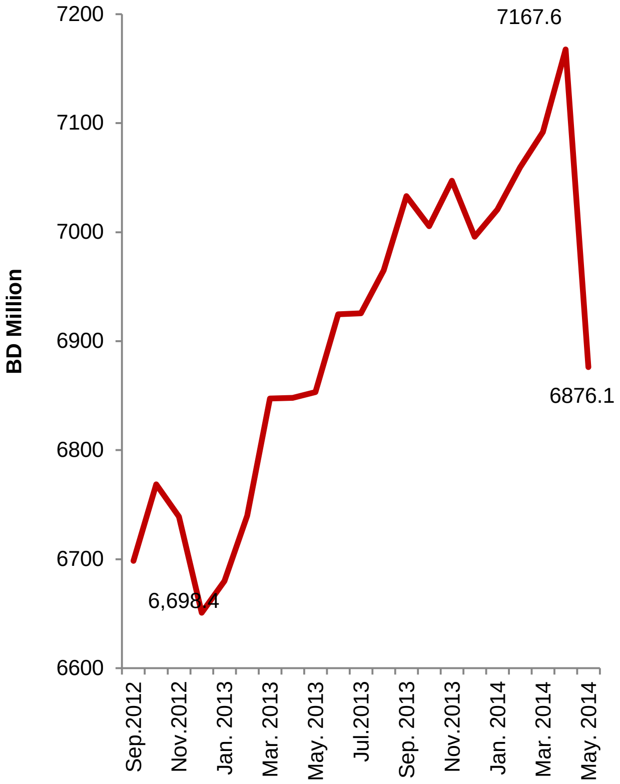


** For conventional and Islamic retail banks*
Source: Central Bank of Bahrain

A- Credit Conditions

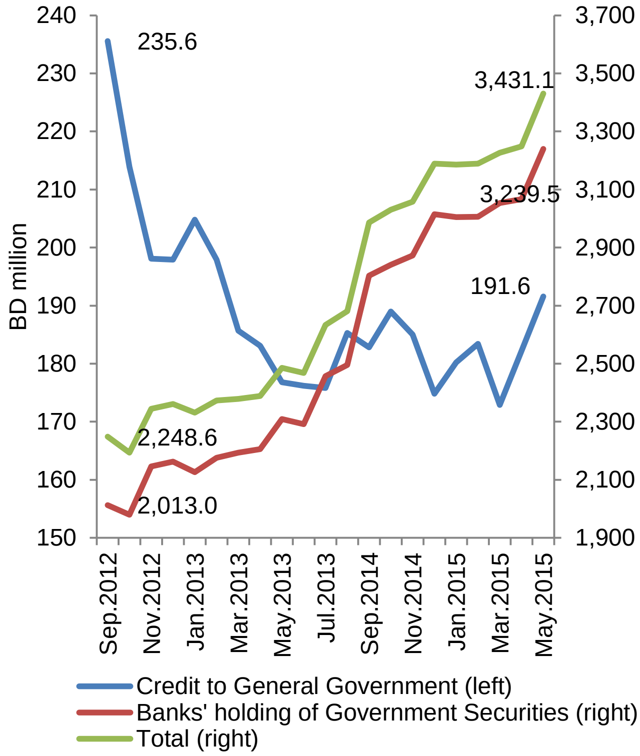
Credit conditions have also improved during the recent period. After a drop in December 2012, credit to the private sector continue to grow and reached BD 7167.6 million at the end of April 2014, this level is higher than all previous years, including 2008 (chart 1-19). The recent higher growth in credit was driven by the revival of projects, which were frozen during the past five years. The high credit growth reveals the recovery of the economic activities and the restoration of confidence in the kingdom of Bahrain. Banks' lending to the government decreased during the past few months, moving from BD 235.6 million in September 2012 to BD 191.6 million at end-May 2014 (chart 1-20). While lending to government decreased, there is a noticeable shift to government securities where banks' holding of government securities increased significantly from BD 2,013.0 million in September 2012 to BD 3,239.5 million in May 2015 and hence increasing total credit to government.

Chart 1-19: Credit to Private Sector (BD Million)



Source: Central Bank of Bahrain

Chart 1-20: Credit to Government (BD Million)

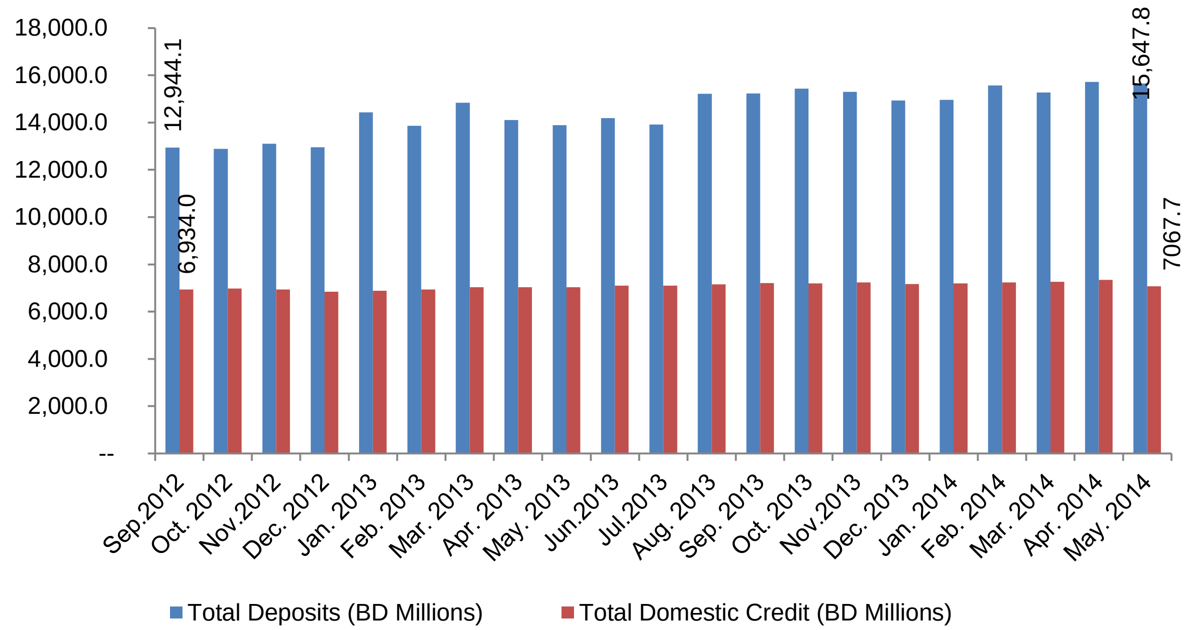


Source: Central Bank of Bahrain

Regarding total deposits, they reached BD15,647.8 million in May 2014, 87% of them are total local deposit. Interestingly, this was followed by an increase in total domestic credits which moved from BD 6,934.0 million in September 2012 to BD

7,067.7 million at end-May2013 (chart 1-21). Despite the high availability of liquidity (the total deposits represent 126.9% of GDP in May 2014) total domestic credit remains moderate in Bahrain; it represents only 57.3 % of GDP as of end-May 2014.

Chart 1-21: Total Deposits and total Domestic Credit (BD Million)

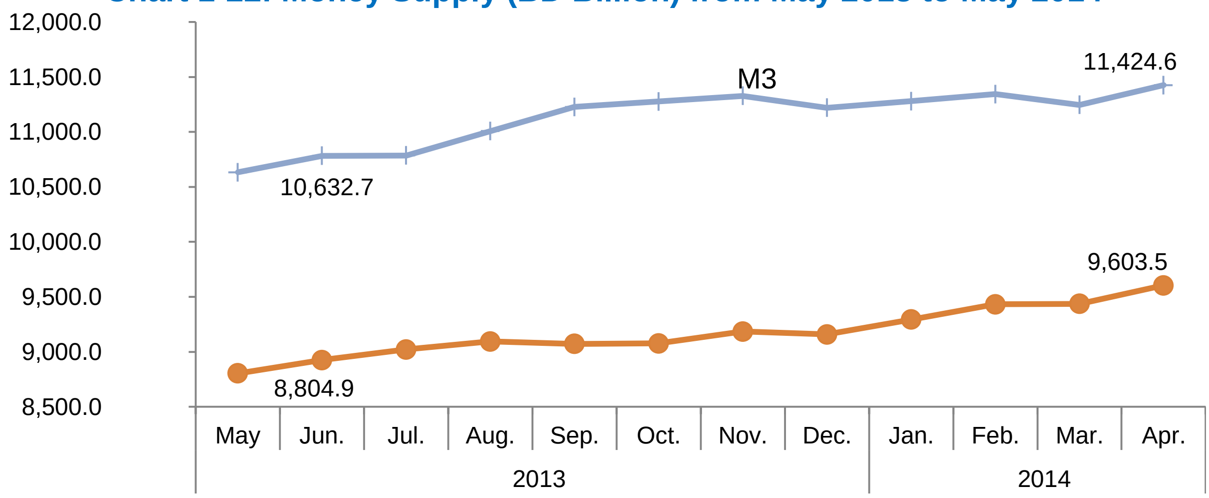


Source: Central Bank of Bahrain

B- Money Supply

Money supply has continued to grow since the second quarter of 2013. M2 stood at BD 9603.5million in end-April 2014, 9% higher than its value of May 2013. M3 was BD 11424.6 million in April 2014, 7% higher than in May2013 (Chart 1-22).

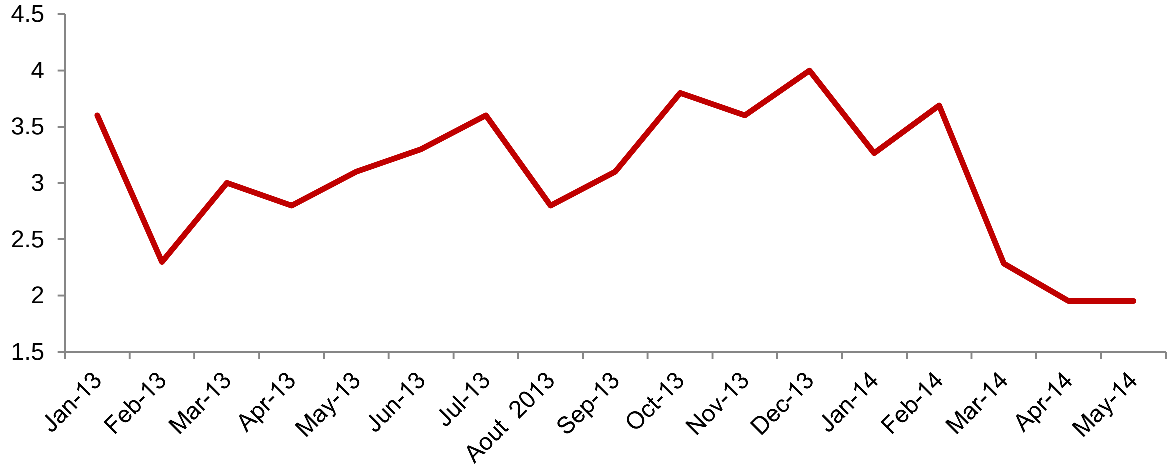
Chart 1-22: Money Supply (BD Billion) from May 2013 to May 2014



Source: Central Bank of Bahrain

Broadly, inflation in Bahrain during 2013 was moderate with an average rate of 3%. However, the inflation rate in consumer prices decreased drastically during the period from December 2013 to May 2014 moving from 4% to 2% respectively. According to CIO, the CPI increased however by 1.9% in May 2014, compared to its level in the same period of the previous year and the CPI moved from 117.8 points in May 2013 to 120.1 points in May 2014. The main upward contribution during May 2014 compared with May 2013 came from increase in prices of the following groups; “Education” group by 5%, “Recreation and Culture” by 4.1% and “Miscellaneous Goods and Services” group by 2.8%.

Chart 1-23: Monthly Inflation in 2013-2014 (CPI%*)



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

1.4.2 Is the Bahraini Banking system resilient?

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 in end-2013 and the beginning of 2014. Bank loans continue their recovery and credit growth is expected to grow further in the coming year. Overall funding conditions have improved and demand for loans has accelerated in Bahrain. This would boost further non-hydrocarbon sector and would accelerate the recovery from the multiple crises that has witnessed Bahrain is during the past few years.

It should be noted that the retail banking sector in Bahrain has more of an effect on the real economy than the wholesale banking sector. Therefore, it is expected that there will not be any negative effects of the region current instability (Iraq and Syria) or the Russia-Ukraine political tension on Bahrain’s wholesale sector and no major impact on Bahrain’s economy. This show that Bahrain financial sector remains sound, and well placed to support expansion in the economy.

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 both banks. The outlook for financial stability in Bahrain is strongly positive, given the healthy balance sheets of financial institutions in an environment of favourable domestic, regional and global macroeconomic trends. Bahrain's vulnerability to capital outflows is also low because current inflows are dominated by direct investment, which are less prone to reversals. All these positive changes will be ever more beneficial for financial stability and will further strengthen the position of Bahrain as a financial center

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

2. Non-Financial (Household and Business) Sector Overview

Chapter

2

Key Points

- Household debt ratio increased
- Business debt ratio fluctuated
- Construction permits decreased and commercial licenses increased

2.1 Overview

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.

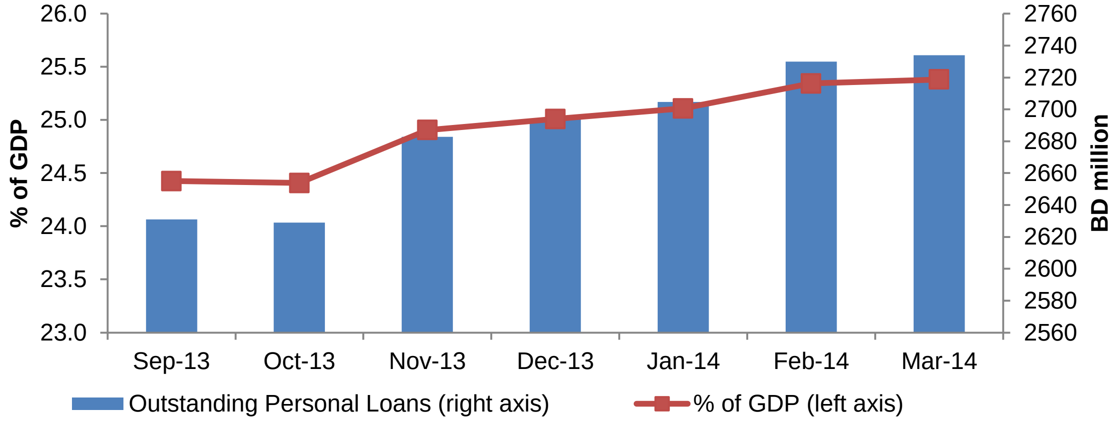
The construction and real estate sector receives special attention because this sector is usually highly sensitive to developments in macroeconomic conditions and financial institutions in Bahrain have direct and indirect exposures to the sector.

2.2 The Bahraini Households Sector

Household Debt Ratio Stable

Outstanding personal loans, used as a proxy for household borrowing, for the period shows that the household debt burden remained stable with a slight increase between the period September 2013 to March 2014 (Chart 2-1).

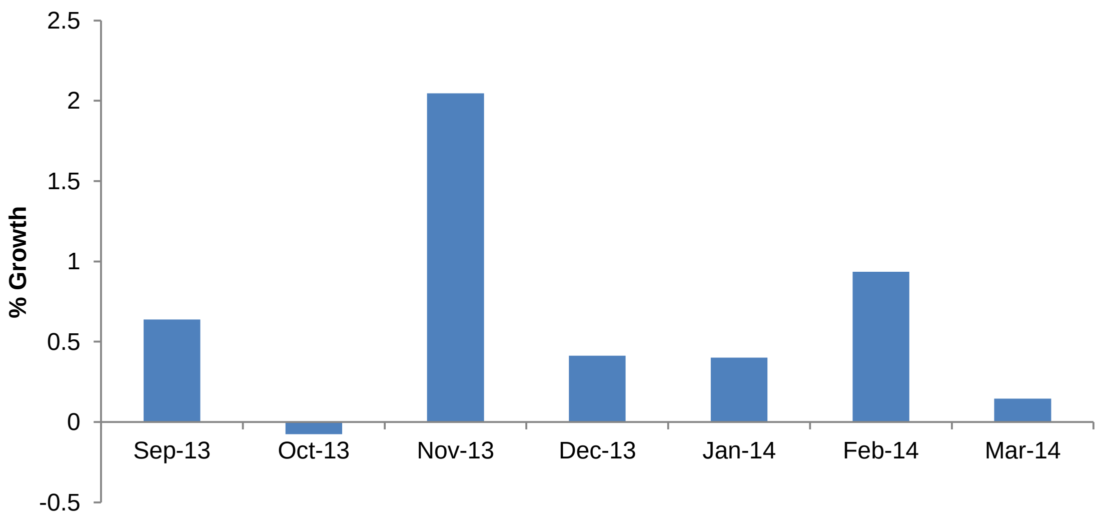
Chart 2-1: Personal Loans and Advances (Volume and % of GDP)



**Using 2012 GDP, provisional data*
Source: Central Bank of Bahrain

Personal loans remained steady at around 24.5% of GDP from September 2013 to to 25.4% in March 2014 due to a fairly constant amount of outstanding personal loans throughout the six month period. Outstanding Personal loans between Septmber 2013 and March 2013 grew by 3.9% over the same period. The biggest increase was in November 2013 by 2.0%.

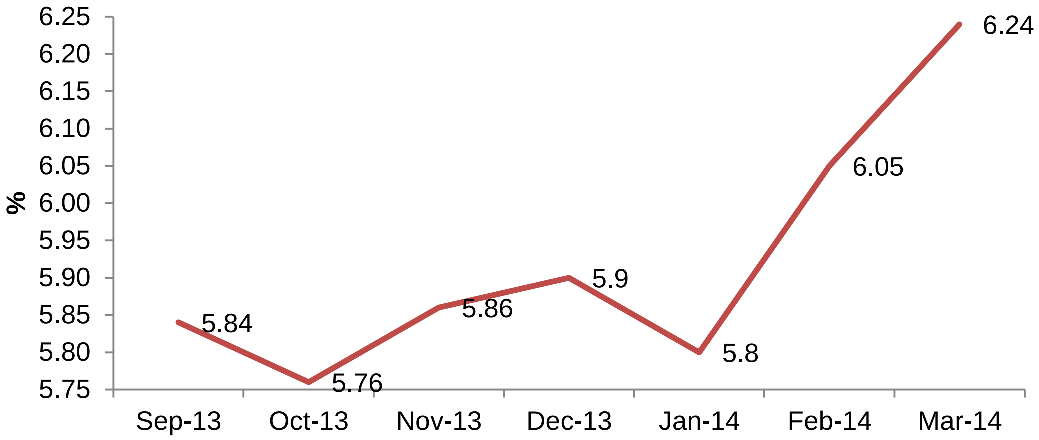
Chart 2-2: Growth Rate of Total Personal Loans and Advances (%)



Source: Central Bank of Bahrain

Interest rate on personal loans reached its peak at 6.24% in March 2014 (Chart 2-3). Interest rates on secured and unsecured loans were constant throughout this period.

Chart 2-3: Retail Banks- Average Interest Rates on Personal Loans (%)



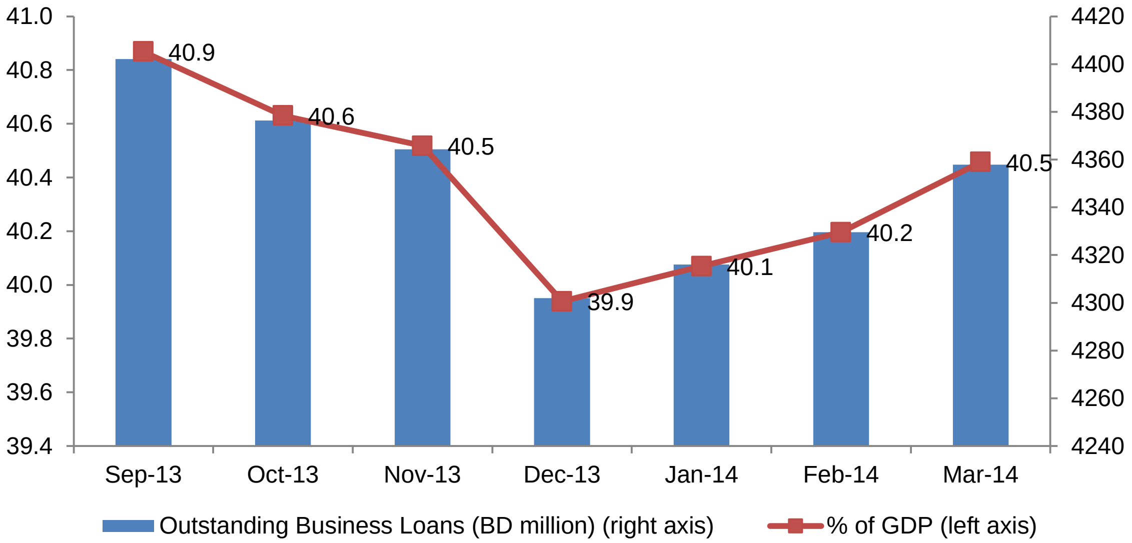
Source: Central Bank of Bahrain

2.3 The Bahraini Corporate Sector

Business Debt Ratio is Stable

Between September 2013 and March 2013, Business loans and advances decreased until December 2013, and then increased steadily to March 2014 (Chart 2-4). Outstanding business loans averaged of 40.4% of GDP decreasing from 40.9% in September 2013 to 40.5% in March 2013.

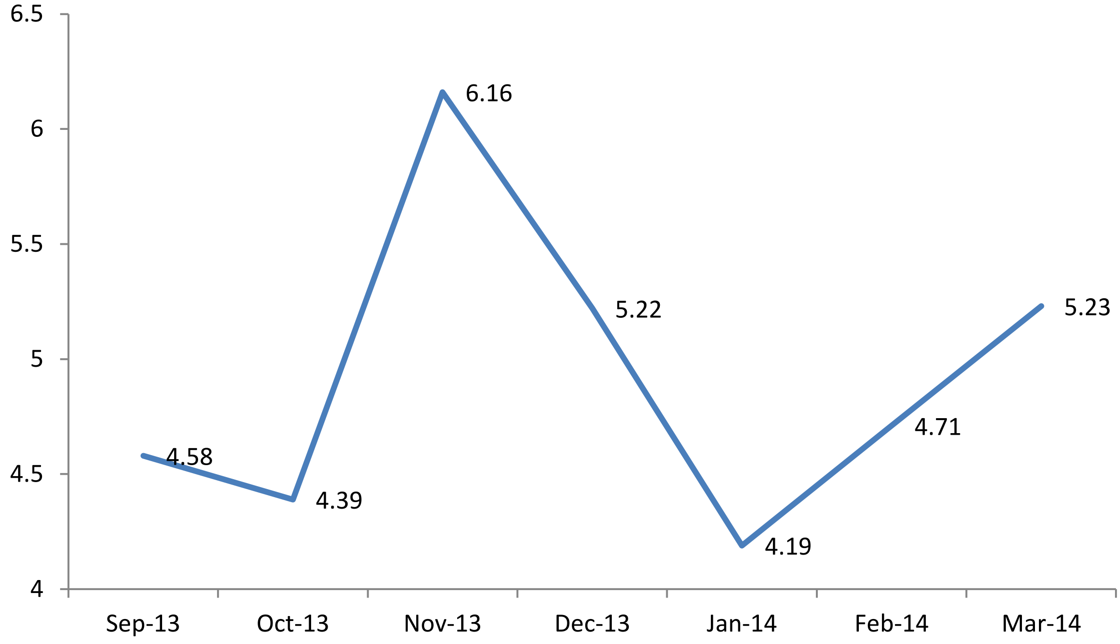
Chart 2-4: Business Loans and Advances (Volume and % of GDP)



Source: Central Bank of Bahrain

Average interest rates on business loans fluctuated throughout the six months. It was at its highest in November 2013 at 6.16% (Chart 2-5), and then reaching its lowest rate in January 2014. Interest rates on non-bank financial loans on transportation & communication loans remained steady during this period.

Chart 2-5: Retail Banks- Average Interest Rates on Business Loans (%)



Source: Central Bank of Bahrain

2.4 Construction and Real Estate

Construction Permits and Commercial Licenses Drop

Commercial licenses issued for construction increased steadily throughout the first three quarters of 2013 and then showed a decrease in the fourth quarter, while real estate sector has seen a rise in Q4 to 406 licenses, up from 364 licenses in Q3. In Q4 2013, a total of 625 new commercial licenses were issued for construction and real estate, rentals, and associated activities, an increase from 610 in Q3 2013 (Table 2-1).

Table 2-1: Commercial Licenses Issued for Construction and Real Estate

	2013:Q1	2013:Q2	2013:Q3	2013:Q4
Construction	221	237	246	**219**
Real Estate, Rentals and Associated Activities	445	375	364	**406**
Total	**666**	**612**	**610**	**625**

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 until Q4 2013 far, ending with 607 permits in the three types of permits, demolition and new construction, new construction and reclamation.

Table 2-2: Selected Construction Permits by Type

	2013:Q1	2013:Q2	2013:Q3	2013:Q4
Demolition and New Construction	17	12	14	8
New Construction	549	574	577	563
Reclamation	2	1	1	36
Total	**568**	**587**	**592**	**607**

Sources: Ministry of Municipality Affairs and Agriculture

2.5 Overall Assessment of the Non-Financial Sector

Available data shows that debt ratio for households sector has increased during the period from September 2013 to March 2014. Interest rates for personal loans increased steadily from 5.84% to 6.24%. The debt ratio for the business sector fluctuated as interest rates hit its peak in November 2013 and then declined.

For the *construction and real estate sector*, there has been an increase in commercial licenses issued in the fourth of 2013, whilst construction permits decreased during this period.

Part II:

Performance of the Banking Sector

3. Conventional Banks

Chapter

3

Key Points

- A slight decrease in capital positions of conventional retail and conventional wholesale banks.
- Decrease in Non-performing loans (NPLs) for conventional retail banks and conventional wholesale banks.
- Loan portfolios in conventional retail and wholesale banks remain concentrated despite the decrease in some sectors.
- Fall in earnings for conventional retail banks and increased for conventional wholesale banks.
- Slight decreases in liquidity for 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-Sept 2013 and compared with end-March 2013.

This chapter offers macroprudential analysis of the conventional banking sector based on a set of selected Financial Soundess Indicators (FSIs). The Annex presents selected FSIs for conventional retail and conventional wholesale banks.

3.2 Conventional Retail Banks

Slight decrease in capital adequacy [1]

Capital adequacy ratios for conventional retail banks slightly decreased from 18.5% in September 2013 to 18.3% in March 2014. The core capital ratio (ratio of Tier 1 capital to risk-weighted assets) showed an increase from 14.3% in September 2013 to 15.7% in March 2014. The leverage ratio (ratio of assets over capital) also showed a slight increase of 0.3% from 8.3% in September 2013 to 8.6% in March 2014. The ratio of non-performing loans (NPLs) net of provisions to capital decreased from 9.2% in September 2013 to 8.9% in March 2014. This increase indicates that the capacity of local retail banks' capital to withstand NPL related losses has increased over this period due to a decrease in non-performing amounts.

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

Indicator	Sept. 2013	Mar. 2014
Capital Adequacy Ratio	18.5	18.3
Tier 1 Capital Adequacy Ratio	14.3	15.7
Leverage (assets/capital)(times)	8.3	8.6
NPFs net of provisions to capital	9.2	8.9

Source: Central Bank of Bahrain

Decrease in non-performing loans

Loan delinquencies have shown a decrease between the periods of September 2013 to March 2014 from 4.2% to 3.8%, respectively. The specific provisions as a proportion of NPLs showed an increase to 55.2% in March 2014 from 53.2% in September 2013. The net NPLs of net loans decreased from 2.1% in September 2013 to 1.7% in March 2014. For *local retail banks*, the NPLs decreased to 4.7% in March 2014. For *overseas retail banks*, the NPLs decreased to 1.7% in March 2014.

Table 3-2: NPL Figures for Conventional Retail Banks

Indicator	Sept. 2013	Mar. 2014
NPL's (% Gross)	4.2	3.8
NPL's Local Banks (% Gross)	4.9	4.7
NPL's Overseas Banks (% Gross)	2.4	1.7
Specific provisions (% of NPLs) *	53.2	55.2
Net NPL's (% of net loans)	2.1	1.7

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.*

Available data on the sectoral breakdown of impaired loans [2] shows most sectors experiencing a decrease in impairment, while some experience an increase and

[1] 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.
[2] 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.

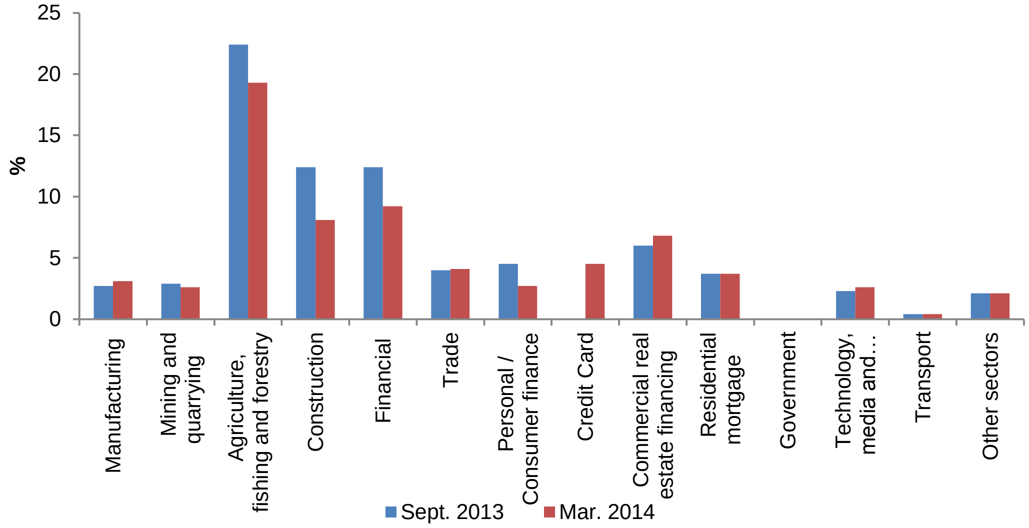
others remaining unchanged (Table 3-3 and Chart 3-1). The highest decrease was in "construction" by 4.3% followed by "financial" by 3.2%. The "residential mortgage", "government" and "transport" sectors remained unchanged between the period of September 2013 and March 2014.

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

	Sept. 2013	Mar. 2014	Change %
Manufacturing	2.7	3.1	0.4
Mining and quarrying	2.9	2.6	(0.3)
Agriculture, fishing and forestry	22.4	19.3	(3.1)
Construction	12.4	8.1	(4.3)
Financial	12.4	9.2	(3.2)
Trade	3.9	4.1	(0.2)
Personal / Consumer finance	4.5	2.7	(1.8)
Credit Card	-	4.5	4.5
Commercial real estate financing	6.0	6.5	(0.5)
Residential mortgage	3.7	3.7	0.0
Government	0.0	0.0	0.0
Technology, media and telecommunications	2.3	2.6	0.3
Transport	0.4	0.4	0.0
Other sectors	2.1	2.1	0.0

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

Loan portfolios remain concentrated

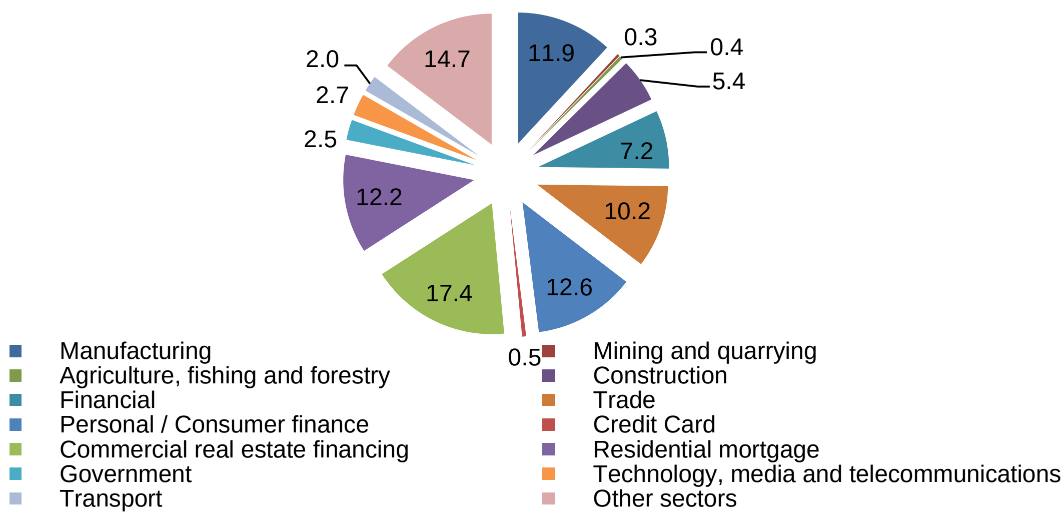
The loan portfolio of *locally incorporated retail banks* remains concentrated with the top recipient of loans being the "commercial real estate financing" sector and accounted for 17.4% of total loans in March 2014, an increase from the 16.8% in September 2013. The "personal/consumer finance" was the second recipients of loans at 12.6%, an increase from 12.3% over the same period. The top two recipient sectors "commercial real estate financing" and "other sectors"[3] jointly represented 32.1% of loans in September 2013, a decrease from the 32.9% in September 2013. Exposure to real estate/ construction was 35.0% of total lending in March 2014, an increase from the 33.9% in March 2013.

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

	March 2013	Sept. 2013	March 2014
Manufacturing	12.1	11.8	11.9
Mining and quarrying	0.2	0.3	0.3
Agriculture, fishing and forestry	0.3	0.3	0.4
Construction	6.4	5.8	5.4
Financial	8.8	7.6	7.2
Trade	9.3	9.9	10.2
Personal / Consumer finance	12.1	12.3	12.6
Credit Card	-	-	0.5
Commercial real estate financing	16.5	16.8	17.4
Residential mortgage	10.4	11.3	12.2
Government	3.2	3.0	2.5
Technology, media and telecommunications	2.6	2.7	2.7
Transport	2.5	2.1	2.0
Other sectors	15.6	16.1	14.7
Top two recipient sectors	**32.1**	**32.9**	**32.1**
Real Estate/ Construction Exposure**	**33.2**	**33.9**	**35.0**

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



Source: Central Bank of Bahrain

The numbers as of end-March 2014 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

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

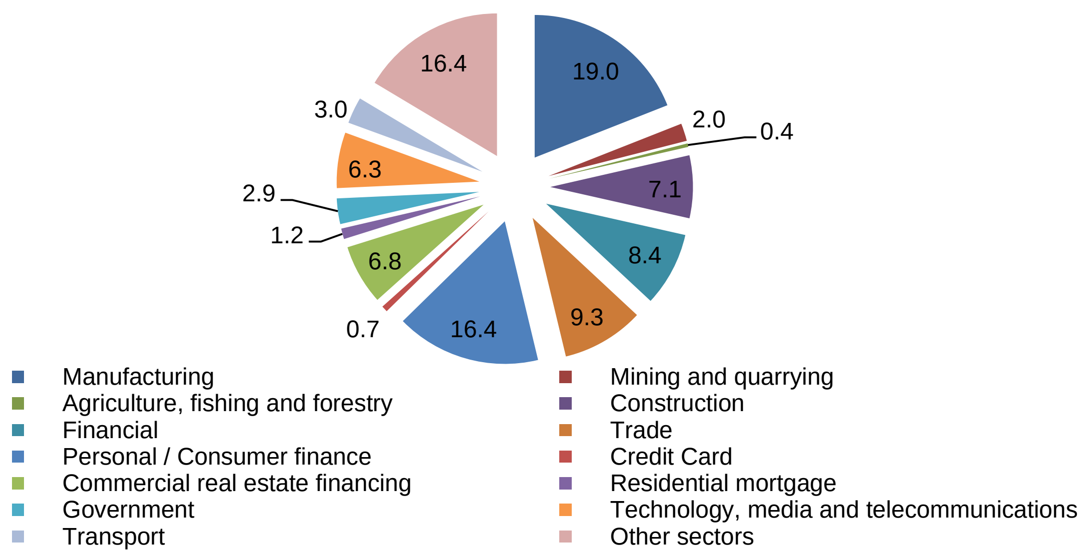
"manufacturing" sector with 19.0% of total loans in March 2014, a slight decrease from the 21.3% in September 2013.

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

	Mar. 2013	Sept. 2013	Mar. 2014
Manufacturing	21.8	21.3	19.0
Mining and quarrying	2.4	2.1	2.0
Agriculture, fishing and forestry	0.5	0.4	0.4
Construction	8.1	7.4	7.1
Financial	8.7	7.0	8.4
Trade	10.5	13.2	9.3
Personal / Consumer finance	13.6	14.0	16.4
Credit Card	-	-	0.7
Commercial real estate financing	6.1	5.4	6.8
Residential mortgage	1.5	1.3	1.2
Government	2.3	2.2	2.9
Technology, media and telecommunications	4.5	4.7	6.3
Transport	4.3	4.2	3.0
Other sectors	15.6	16.6	16.4
Top two recipient sectors	**37.5**	**37.9**	**35.4**
Real Estate/ Construction Exposure**	**15.7**	**14.2**	**15.1**

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



Source: Central Bank of Bahrain

The top two recipients of loans ("manufacturing" and "other sectors") jointly accounted for 35.4% of total loans, a decrease from the 37.9% in September 2013. Exposure to real estate/ construction was 15.1% of total lending in March 2014, an increase from 14.1% in September 2013.

Box 1: Small and Medium Enterprise (SME) Financing

Small and Medium Enterprises (SME's) have played a key role in the development of some economies around the world. Governments recognize the importance of SMEs to spur economic growth and have established specialized bodies and developed regulations and programs to support and nourish them.

Countries have been concentrating their efforts in developing the SME sector and Bahrain is no exception to this where both the Government of Bahrain along with other entities and the Central Bank of Bahrain have been trying to develop the growth of SME's in the Kingdom.

According to the Ministry of Inustry and Commerce in Bahrain, an SME is defined as a company that fits into the following categories:

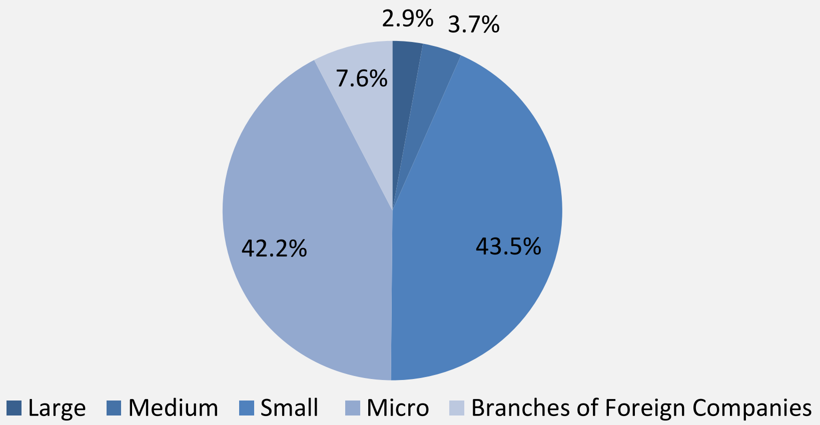
Box Table 1- Definition of SME's in Bahrain

Category	Number of Employees	Capital Investment (BD) Manufacturing Section	Annual Turnover (BD) (All Sectors)
Micro	Up to 10	Up to 20,000	Up to 100,000
Small	11-50 (up to 100 for construction sector)	20,001-500,000	100,001 - 1 Million
Medium	51-250 (up to 400 for construction sector)	500,001 - 3 Million	1,000,001 - 5 Million

1. Threshold limits of both employment and capital investment/turnover will have to be complied with.
2. For SME's in manufacturing sector (including process industries), capital investment will be the defining criterion. For all other sectors, turnover based definition will be used.
3. Capital investment does not include cost of land and building and will be calculated at the original value of purchase.
4. Turnover figures need to be substantiated by a copy of audited balance sheet. (For micro businesses, only bank statements should be sufficient. For Small Businesses, in the absence of audited financials, software based compiled financials and bank statements will be sufficient.)

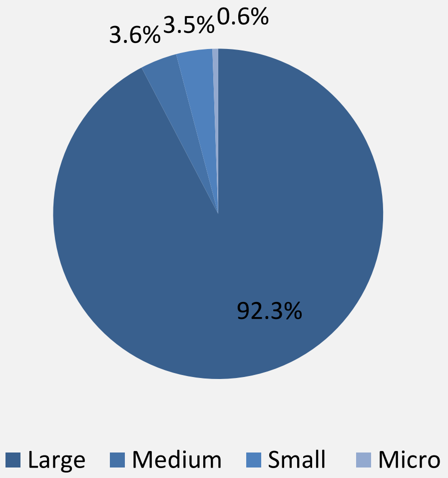
SME's contribute to sustainable growth of a country and in some cases form a fundamental part of the economy compromising a large percentage of total establishments by contributing to a large number of employment and gross domestic product. According to 2012 data, SME's represented 89.4% of all companies in Bahrain (42.2% micro, 43.5% medium, and 3.7% small). In terms of captial, SME's only represented 7.7% of total capital for all companies in Bahrain even though they represented the biggest share when it comes to number of companies.

Annex Graph 1- Distribution of Number of Companies in Bahrain by Type (2012)



Source: Ministry of Industry and Commerce Annual Report 2012

Annex Graph 2- Distribution of Capital in Companies in Bahrain by Type (2012)



Source: Ministry of Industry and Commerce Annual Report 2012

According to a study performed in 2011 by the World bank and the Union of Arab banks titled" The Status of Bank Lending to SMEs in the Middle East and North Africa Region", the average share of SME lending in MENA was low and less than 8% of total lending. The average share of SME lending in the GCC was only 2% and 13% for non-GCC. The low share of SME lending across all GCC countries was due to the structure of oil-based economies. The study emphasises how governments play a critical role in promoting an enabling environment in which private banks can fulfill their SME finance targets prudently and responsibly.

There is a strong positive correlation between the gross domestic product (GDP) per capita and the SME sector contribution to employment. In economies like Bahrain where there are higher levels of education, low inflation rates and higher levels of financial development, there is a huge opportunity where supporting SMEs can lead to a spur in GDP.

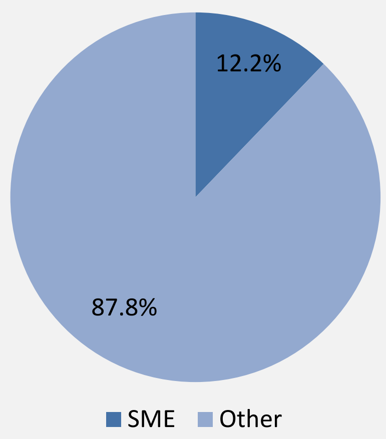
The importance of the SME sector in Bahrain is underlined by its contribution to private-sector employment. SME in Bahrain account for nearly 73 per cent of all private sector jobs and contributes to around 28% of of total GDP.

Therefore The CBB is highly aware of the needs of small to medium-sized companies for dependable and affordable finance to facilitate economic growth in the private sector. Based on a survey performed by the Financial Stability Directorate in March 2014, 12.2% of the total business by retail banks to the private sector, were provided to SME's. The amount of funding provided to SME's by conventional retail banks and Islamic retail banks was 9.9% and 18.5% respectively.

Looking further into these business loans, we will find that the majority of funding for SMEs came from conventional retail banks where they represented around 60% of total SME funding while 40% were from Islamic retail anks.

Efforts to stimulate lending to SME's remains a particular focus The plan to diversify beneficiaries of the financial support is being rolled out as BDB increases financing to projects in the educational, medical, and food production sectors.

Annex Graph 3- Percentage of SME loans out of total Loans (All Retail Banks)



Source: Financial Stability Survey March 2014

Bahrain has established Tamkeen to support the private sector and position it as the key driver of economic growth. Through the private sector support programs, Tamkeen assists SMEs in hiring well-trained local talent, obtaining sophisticated financial management systems, technological developments and with access to finance. Tamkeen works with banks, financial consultants and training institutions to fulfill its mandate.

A number of banks in Bahrain have partnered with Tamkeen to support SME's in Bahrain by introducing a number of initiatives with the aim of creating a strong foundation for local enterprises to achieve economic growth.

Decrease in retail bank profitability

As at end-March 2014, return-on-assets (ROA) decreased to 0.4% from 0.7% in March 2013. ROA for *locally-incorporated banks* decreased from 0.7% in March 2013 to 0.4% in March 2014. For *overseas banks*, ROA remained at 0.6% over the same period. Return-on-equity (ROE)[4] for *locally-incorporated banks* decreased from 7.4% in March 2013 to 4.0 % in March 2014. Net interest income (as a % of gross income) increased from 50.4% in March 2013 to 68.1% in March 2014. On the other hand, operating expenses as a proportion of gross income decreased from 32.5% in March 2013 to 41.2% in March 2014.

Liquidity position decreases

Between September 2013 and March 2014, bank deposits increased while non-bank deposits decreased for retail banks. Bank deposits increased from 21.9% in September 2013 to 26.1% in March 2014. Subsequently, non-bank deposits decreased from 78.1% to 73.9% over the same period. The overall loan-deposit ratio for the segment increased from 62.8% in September 2013 to 64.2% in March 2014. Liquid assets as a proportion of total assets showed a decrease over the period of September 2013 to March 2014 from 26.5% to 24.3%, respectively. Similarly, liquid assets as a proportion of the short-term liabilities presented a decrease from 37.7% to 33.5% over this period.

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

3.3 Conventional Wholesale Banks

Decrease in capital adequacy[5]

As at end-March 2014, the regulatory capital adequacy ratio for locally-incorporated wholesale banks was 21.6%, a decrease from the 22.4% registered in September 2013. The core capital ratio (ratio of Tier 1 capital to risk-weighted assets) decreased to 18.7% in March 2014 from the 19.1% registered in September 2013. On the other hand, the leverage ratio (ratio of assets over capital) showed an increase of 0.5% from the 5.5% registered in March 2013 to 6.0% in September 2013. The ratio of non-performing loans (NPLs) net of provisions to capital decreased from 5.3% September 2013 to 2.3% over the same period which is attributed to the decrease in non-performing loans.

Table 3-6: Capital Provisions Ratios for Local Conventional Wholesale Banks

Indicator	Sept. 2013	Mar. 2014
Capital Adequacy Ratio	22.4	21.6
Tier 1 Capital Adequacy Ratio	19.1	18.7
Leverage (Assets/capital)(times)	5.5	6.0
NPL's net of prov. to capital	5.3	2.3

Source: Central Bank of Bahrain

Decrease in non-performing loans of wholesale banks

As at end-March 2014, loans classified as non-performing dropped to 6.8%. *Locally-incorporated wholesale banks* experienced a decrease from 5.5 % in March 2013 to 3.8% of gross loans in September 2013. In addition, *overseas wholesale* banks witnessed a decrease in NPLs from 10.8% to 9.0% over the same period. The specific provisions as a proportion of NPLs witnessed an increase from 62.8% in September 2013 to 66.1% in March 2014%. The net NPLs decreased from 3.4% in September 2013 to 2.5% in March 2014.

Table 3-7: NPL Figures for Conventional Wholesale Banks

Indicator	Sept. 2013	Mar. 2014
NPL's (% Gross)	8.4	6.8
NPL's Local Banks	5.5	3.8
NPL's Overseas Banks	10.8	9.0
Specific provisions (% of NPLs) *	62.8	66.1
Net NPLs (% of net loans)	3.4	2.5

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.*

[5] 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.

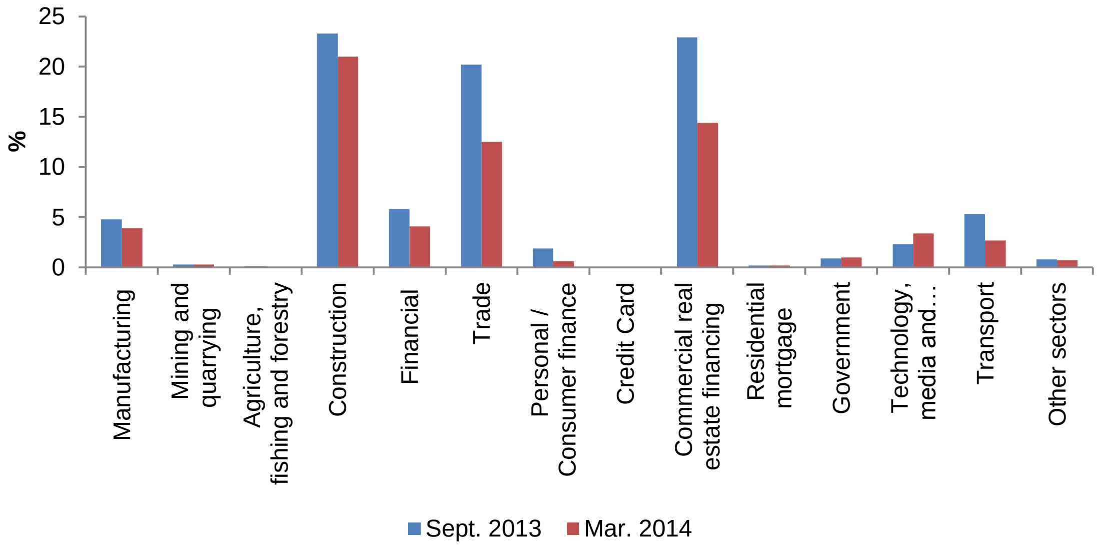
Available data on the sectoral breakdown of impaired loans shows that impairment in the “construction” was the highest between all sectors at 21.0% followed by the “commercial real estate financing” sector with an impairment of 14.4%. The biggest drop were in the “commercial real estate financing” sector which dropped by 8.5% followed by “trade” which decreased by 7.7%. The only increases in impairment were found in the “Technology, media and telecommunications and “Government” sectors which increased by 1.1% and 0.1% respectively.

Table 3-8: Conventional Wholesale Banks’ Impaired Loan Ratios by Sector (% of gross loans to sector)

	Sept. 2013	Mar. 2014	Change %
Manufacturing	4.8	3.9	(0.9)
Mining and quarrying	0.3	0.3	0.0
Agriculture, fishing and forestry	0.1	0.0	(0.1)
Construction	23.3	21.0	(0.3)
Financial	5.8	4.1	(1.7)
Trade	20.2	12.5	(7.7)
Personal / Consumer finance	1.9	0.6	(1.3)
Credit Card	-	0.0	0.0
Commercial real estate financing	22.9	14.4	(8.5)
Residential mortgage	0.2	0.2	0.0
Government	0.9	1.0	0.1
Technology, media and telecommunications	2.3	3.4	1.1
Transport	5.3	2.7	(2.6)
Other sectors	0.8	0.7	(0.1)
All Sectors	**7.0**	**5.1**	(1.9)

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 2014 shows that for *locally-incorporated wholesale banks,* the top recipient of loans remained the "manufacturing" sector, which accounted for 29.1% of total loans in March 2014 representing a decrease from the 30.4% in September 2013 (Table 3-10 and Chart 3-5).

Table 3-9: Distribution of Conventional Local Wholesale Banks' Lending (% total Loans)*

	Mar. 2013	Sept. 2013	Mar. 2014
Manufacturing	32.1	30.4	29.1
Mining and quarrying	3.0	3.3	2.9
Agriculture, fishing and forestry	2.3	2.2	2.5
Construction	7.0	7.7	7.3
Financial	23.6	22.1	21.4
Trade	9.1	9.0	10.2
Personal / Consumer finance	2.3	2.3	3.5
Credit Card	-	0.0	0.0
Commercial real estate financing	1.3	2.0	1.7
Residential mortgage	0.5	0.6	0.7
Government	0.7	1.4	1.4
Technology, media and telecommunications	2.4	2.4	2.3
Transport	6.2	7.3	6.6
Other sectors	9.7	9.4	10.4
Top two recipient sectors	**55.7**	**52.4**	**50.4**
Real Estate/ Construction Exposure**	**8.8**	**10.3**	**9.7**

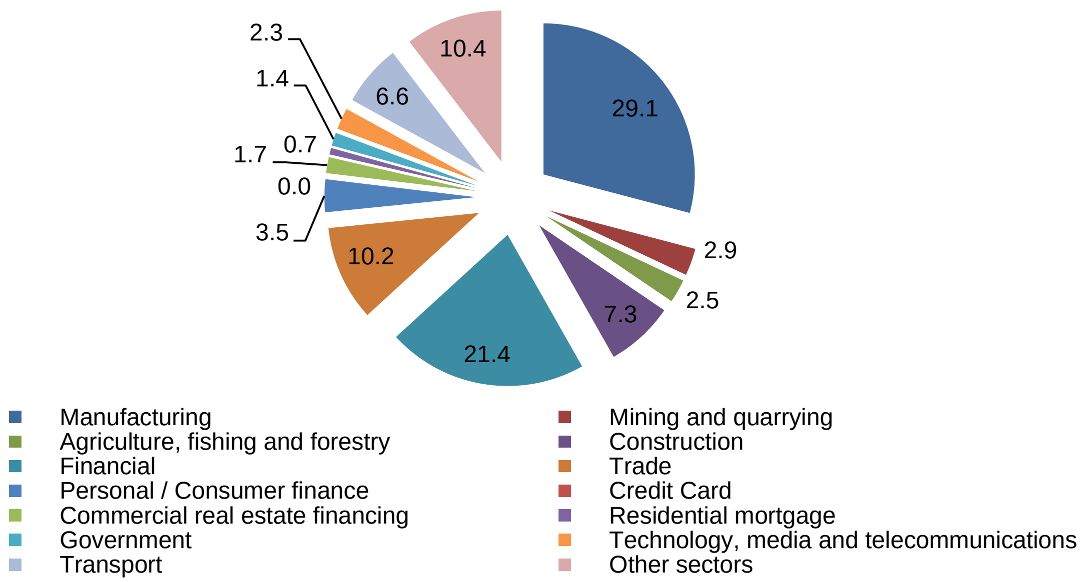
Source: Central Bank of Bahrain

**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 50.4% of total lending in March 2014, down from the 52.4% recorded in March 2014.

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



Source: Central Bank of Bahrain

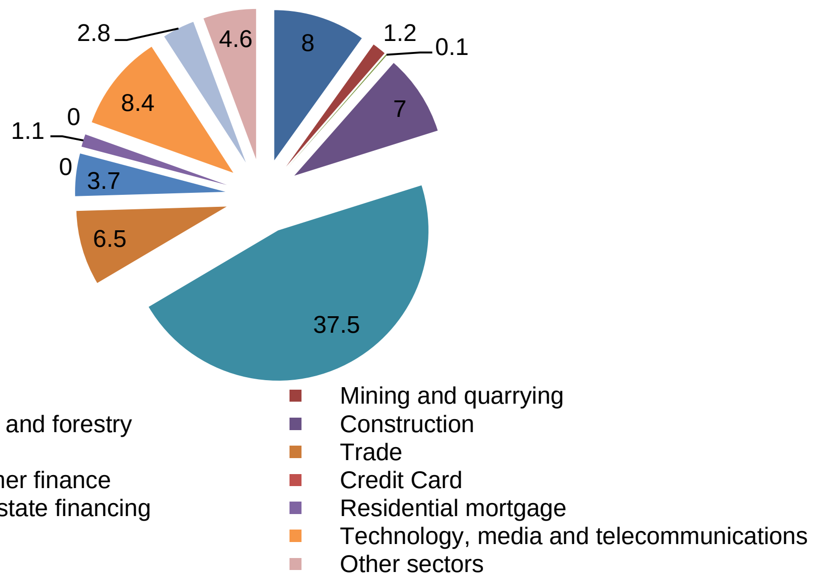
In *overseas wholesale banks*, the top recipient of loans in March 2014 was the "financial" sector, with 37.5% of total loans down from the 39.5% in September 2013 (Table 3-11 and Chart 3-6). The top 2 sectors (Financial and Technology, media and telecommunication) jointly increased to 56.6% in March 2014 from 54.6% in September 2013.

Table 3-10: Distribution of Conventional Overseas Wholesale Banks' Lending (% total Loans)*

	Mar. 2013	Sept. 2013	Mar. 2014
Manufacturing	11.2	11.3	8.0
Mining and quarrying	1.1	1.0	1.2
Agriculture, fishing and forestry	0.1	0.1	0.1
Construction	7.1	7.6	7.0
Financial	44.2	39.9	37.5
Trade	6.0	5.9	6.5
Personal / Consumer finance	0.5	0.4	3.7
Credit Card	-		
Commercial real estate financing	2.8	1.5	0.0
Residential mortgage	0.0	0.0	1.1
Government	6.3	9.6	0.0
Technology, media and telecommunications	4.1	3.0	8.4
Transport	4.5	5.2	2.8
Other sectors	12.1	14.7	4.6
Top two recipient sectors	**56.3**	**54.6**	**56.6**
Real Estate/ Construction Exposure**	**10.0**	**9.1**	**8.0**

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

Increased earnings and improved profitability

ROA for the conventional wholesale banking sector was at 0.5% in March 2014, an increase from the 0.4 in March 2014. The ROA for *local wholesale banks* increased from 0.3% to 0.4% over the same period. In addition, *overseas wholesale banks* also showed an increase from 0.5% to 0.6%. ROE for *local wholesale banks* increased from 2.2% to 2.5%. Net interest income as a proportion of gross income decreased from 46.0% to 35.2% in March 2014. Operating expenses as a proportion of gross income showed a decrease from 41.9 % in March 2013 to 39.3% in March 2014.

Liquidity position improves

As at end-March 2014, the overall loan-deposit ratio for conventional wholesale banks stood at 63.7%, an increase from the 60.1% in September 2013. The loan deposit ratio for *local wholesale banks* decreased to 63.6% in March 2014 from the 66.4% in September 2013. Over the same period, the loan deposit ratio for *overseas wholesale* bank increased from 55.7% to 66.4%.

Liquid assets for wholesale banks as a proportion of total assets increased to 19.4% in March 2014 from 16.9% in September 2013. *Locally incorporated wholesale banks* had a liquid asset ratio of 30.9% in March 2014 a decrease from the 31.5% in September 2013. Overseas wholesale banks had a lower ratio of 9.8%, lower than the 4.8% registered over the same period. Liquid assets as a proportion of short-term liabilities increased to 29.7% in March 2014 from 28.9% in September 2013. Lastly, the deposits from non-bank sources as a proportion of total deposits increased to 45.0% from 42.2% while bank deposits decreased from 60.0% to 55.0% over the same period.

3.4 Overall Assessment of the Conventional Banking Sector

The financial soundness indicators show that conventional retail and conventional wholesale sectors witnessed deteriorations to their capital positions. Capital adequacy ratios for conventional retail banks slightly decreased to 18.3% in September 2013. Capital adequacy ratio for conventional wholesale banks was 21.6%. Non-performing loans have shown an improvement between periods of September 2013 to March 2014 from 4.2% to 3.8%, for conventional retail banks. As for conventional wholesale banks, loans classified as non-performing were at 6.8% in March 2014 compared to 8.4% in September 2013. Loan concentration remains high for conventional retail and wholesale banks despite some decreases in some sectors.

As at end-March 2014, return-on-assets (ROA) decreased for conventional retail banks and increased conventional wholesale banks to stand at 0.4% and 0.5% respectively. Return-on-equity (ROE) for conventional *locally-incorporated banks* decreased to 4.0% from 7.4% in March 2013. ROA for the conventional wholesale and ROE for *local wholesale banks* increased from 2.2% to 2.5% over same period.

For conventional retail banks, liquid assets as a proportion of total assets showed a decrease over the period of September 2013 to March 2014 from 26.5% to 24.3%. Liquid assets for wholesale banks as a proportion of total assets increased to 19.4% in March 2014 from 16.9% in September 2013.

4. Islamic Banks

Chapter 4

Key Points

- Capital positions are stable for Islamic banks with increase for Islamic retail banks and slight decrease for Islamic Wholesale banks.
- Drop in non-performing facilities (NPFs) for Islamic banks.
- Concentration of facilities for both Islamic retail banks and Islamic Wholesale Banks remains.
- Improved for Islamic banks, with a decrease yet positive earnings for Islamic Wholesale banks
- Improved liquidity position for Islamic retail banks and 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 2013 and compared with end-March 2013.

This chapter offers macroprudential analysis of the Islamic banking sector based on a set of selected Financial Soundess Indicators (FSIs). The Annex presents selected FSIs for Islamic retail and Islamic wholesale banks.

4.2 Islamic Retail Banks

Slight increases in Capital Positions

The capital adequacy ratio of Islamic retail banks increased slightly from 17.5% in September 2013 to 17.7% in March 2014. Tier 1 capital also increased from 14.9% in September 2013 to 15.0% in March 2014.

Table 4-1 Capital Provisions Ratios for Islamic Retail Banks

Indicator	Sept. 2013	Mar. 2014
Capital Adequacy Ratio	17.5%	17.7%
Tier 1 Capital Adequacy Ratio	14.9%	15.0%
NPFs net of provisions to capital	30.8%	29.6%

Source: Central Bank of Bahrain

The ratio of non-performing facilities (NPFs) net of provisions to capital decreased from 30.8% to 29.6% for the same period.

Decrease in non-performing facilities

Non-performing facilities (NPFs) dropped to 12.6% in March 2014, compared to 13.1% in September 2013. Specific Provisoining increased from 39.1% in Setpemtber 2013 to 41.4% in March 2014.

A look at the non-performing facilities by sector indicates that the “construction” sector remains the sector with the highest impairment and increased by 3.0% from 32.6 in September 2013 to 35.6% of March 2014 followed by “manufacturing” and “commercial real estate financing” with 17.5% and 16.9% respectively.

Table4-2: NPF Figures for Islamic Retail Banks

Indicator	September 2013	March 2014
NPFs (% Gross)	13.1	12.6
Specific Provisions (% of NPFs)	39.1	41.4

Source: Central Bank of Bahrain

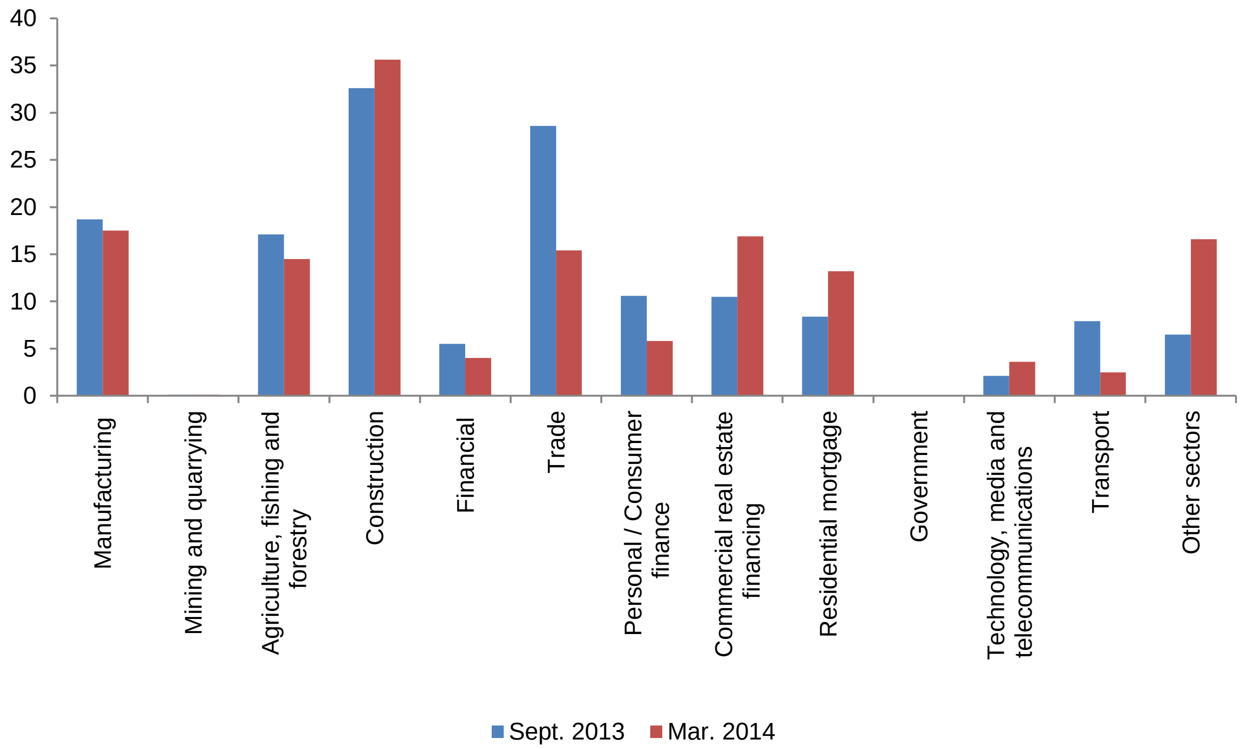
The biggest declines in NPF’s by sector was in the “Trade” Sector with a 13.2% decrease in NPFs from September 2013 to March 2014. The biggest increase in NPF’s was the “commercial real estate financing” sector with an increase of 6.4%

Table 4-3: Islamic Retail Banks' NPF Ratios by Sector
(% of gross facilities per sector)

	Sept. 2013	Mar. 2014	Change
Manufacturing	18.7	17.5	(1.2)
Mining and quarrying	0.1	0.1	0.0
Agriculture, fishing and forestry	17.1	14.5	(2.6)
Construction	32.6	35.6	3.0
Financial	5.5	4.0	(1.5)
Trade	28.6	15.4	(13.2)
Personal / Consumer finance	10.6	5.8	(4.8)
Commercial real estate financing	10.5	16.9	6.4
Residential mortgage	8.4	13.2	4.8
Government	0.0	0.0	0.0
Technology, media and telecommunications	2.1	3.6	1.5
Transport	7.9	2.5	(5.4)
Other sectors	6.5	16.6	10.1

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

Slight improvement 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 2014, the top recipient of financing was "manufacturing", surpassing "commercial real estate financing" at 16.8% up from 15.9% in September 2013. The top two recipients of financing ("manufacturing" and "commercial real estate financing") accounted for 33.5% of total facilities extended compared to 36.1% for the top two sectors in September 2013. . Moreover, the share of "trade" declined from 12.7% in September 2013 to 11.0% in March 2014.

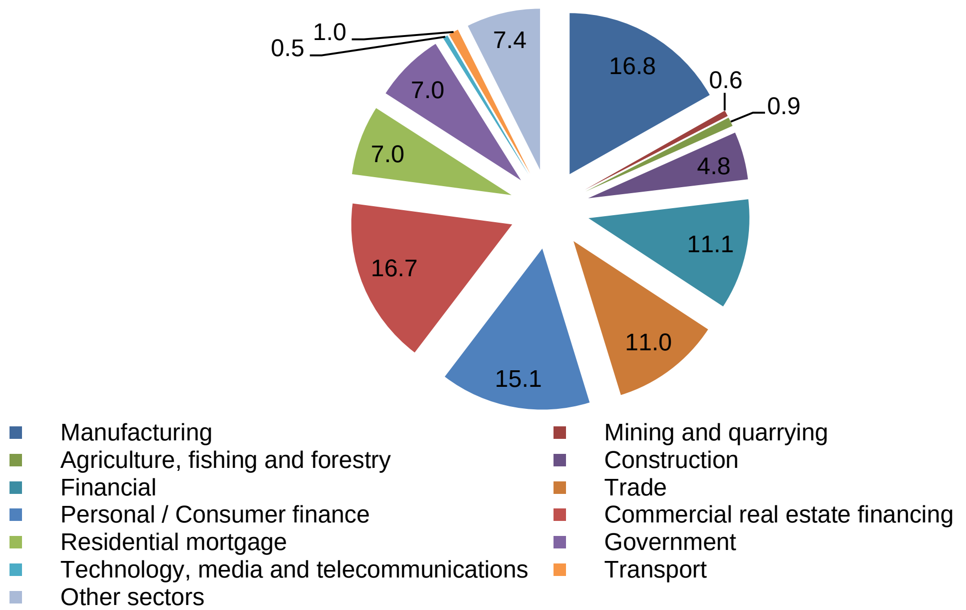
Table 4-4: Distribution of Islamic Retail Banks' Lending (% of total facilities)*

	Sept. 2013	Mar. 2014
Manufacturing	15.9	16.8
Mining and quarrying	0.5	0.6
Agriculture, fishing and forestry	0.9	0.9
Construction	4.3	4.8
Financial	10.6	11.1
Trade	12.7	11.0
Personal / Consumer finance	17.8	15.1
Commercial real estate financing	18.2	16.7
Residential mortgage	5.0	7.0
Government	7.4	7.0
Technology, media and telecommunications	0.5	0.5
Transport	0.9	1.0
Other sectors	5.1	7.4
Top two recipient sectors	**36.1**	**33.5**
Real Estate/ Construction Exposure**	**27.6**	**28.5**

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.*

On the other hand, "Real Estate/ Construction Exposure" exposure increased slightly from 27.6 % in September 2013 to 28.5% in March 2014

Chart 4-2: Distribution of Islamic Retail Bank's Lending (% of total facilities)



Source: Central Bank of Bahrain

Stable earnings

The return on assets (ROA) for Islamic retail banks remained constant at 0.1% in March 2014. Return on equity (ROE) increased from 0.5% in March 2013 to 1.3% in March 2014.

Increase in liquidity

The volume of liquid assets available to Islamic retail banks increased from 13.7% of total assets in September 2013 to 14.3% in March 2014. The ratio of total facilities to deposits increased from 78.2% in September 2013 to 78.9% in March 2014.

Table 4-5: Liquidity Measures for Islamic Retail Banks

Indicator	Sept. 2013	Mar. 2014
Liquid Assets (% of total assets)	13.7	14.3
Facilities – deposits ratio (%)	78.2	78.9

Source: Central Bank of Bahrain

4.3 Islamic Wholesale Banks

Decline in capital positions

As at end-March 2014, the CAR for Islamic wholesale banks declined to 24.6% against 25.0% in September 2013. In contrast, Tier1 capital increased slightly from 23.6% in September 2013 to 23.7% in March 2014. The ratio of NPFs net of provisions to capital also decreased during this period from 4.3% to 3.6% over the same period.

Table 4-6 Capital Provisions Ratios for Islamic Wholesale Banks

Indicator	Sept. 2013	Mar. 2014
Capital Adequacy Ratio	25.0	24.6
Tier 1 Capital Adequacy Ratio	23.6	23.7
NPFs net of provisions to capital	4.3	3.6

Source: Central Bank of Bahrain

Decrease in non-performing facilities (NPFs)

As at end-March 2014, NPFs for Islamic wholesale banks decreased to 5.1% from 5.4% in September 2013. Provisioning for NPF's increased from 72.8% to 75.5% over the same period.

The sector with the highest impairment was the "Technology, media and telecommunications" sector with 48.6% of NPF's in March 2014, up from the 0.3% in September 2013. This was followed by the "Agriculture, fishing and forestry" and "Construction" sectors.

Table4-7: NPF Figures for Islamic Wholesale Banks

Indicator	Sept. 2013	Mar. 2014
NPFs (% Gross)	5.4	5.1
Specific Provisioning (% of NPFs)	72.8	75.5

Source: Central Bank of Bahrain

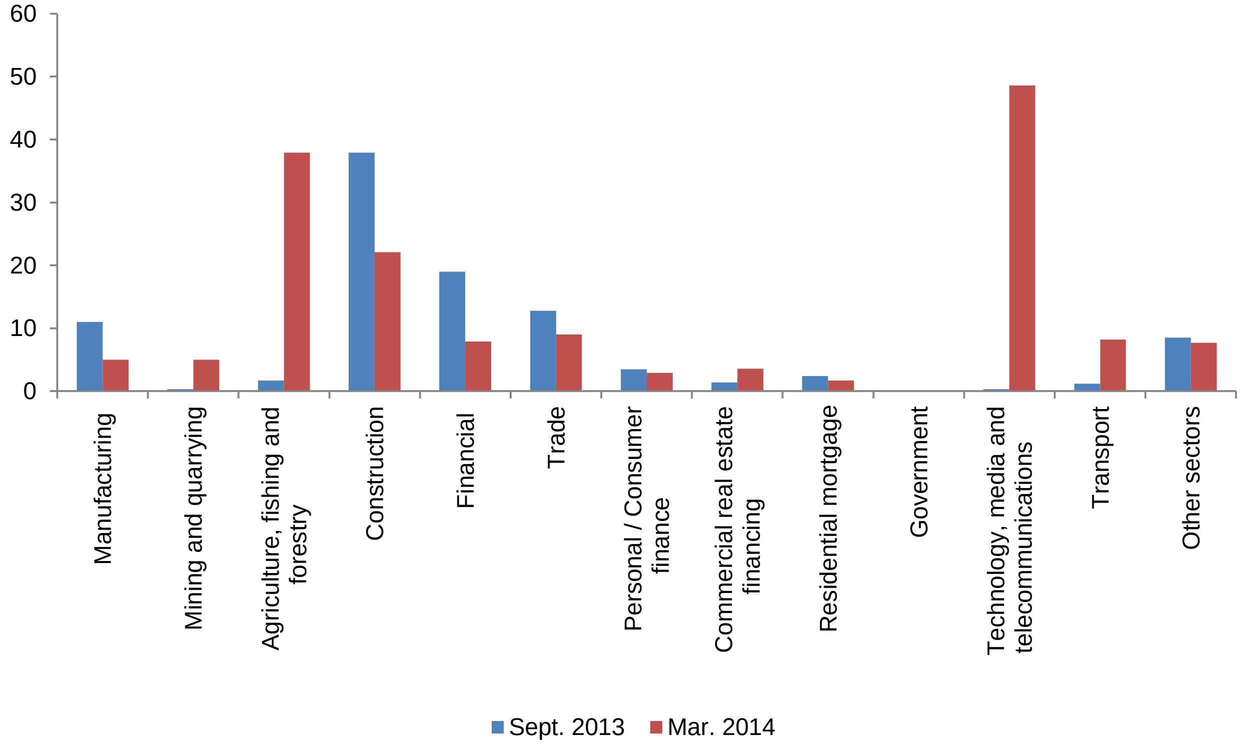
Available data on the sectorial breakdown of non-performing facilities shows that the biggest drop was in the construction sector with a decrease of 15.8% from 37.9% in September 2013 to 22.1% in March 2014. Followed by the "financial" sector with a decrease in non-performing facilities of 11.1% from September 2013 to March 2014. The biggest increase was in the "Agriculture" sector with an increase of 36.2%.

Table 4-8: Islamic Wholesale Banks' NPF Ratios by Sector (% of gross facilities per sector)

	Sept 2013	Mar. 2014	Change
Manufacturing	11.0	5.0	(6.0)
Mining and quarrying	0.3	5.0	4.7
Agriculture, fishing and forestry	1.7	37.9	36.2
Construction	37.9	22.1	(15.8)
Financial	19.0	7.9	(11.1)
Trade	12.8	9.0	(3.8)
Personal / Consumer finance	3.5	2.9	(0.6)
Commercial real estate financing	1.4	3.6	2.2
Residential mortgage	2.4	1.7	(0.7)
Government	0.0	0.0	0.0
Technology, media and telecommunications	0.3	48.6	48.3
Transport	1.2	8.2	7.0
Other sectors	8.5	7.7	(0.8)

Source: Central Bank of Bahrain

Chart 4-3: Islamic Wholesale Bank's NPF's by Sector (% of gross facilities per sector)



Source: Central Bank of Bahrain

Asset concentration remains high

At end-March 2014, the "Manufacturing" sector remained the top recipient of financing from Islamic wholesale banks, at 19.3%, surpassing "Financial" at 16.6%. The "Construction" sectors accounted for approximately 15.3% of facilities concentration.

Table 4-9: Distribution of Islamic Wholesale Banks' Lending (% total facilities)*

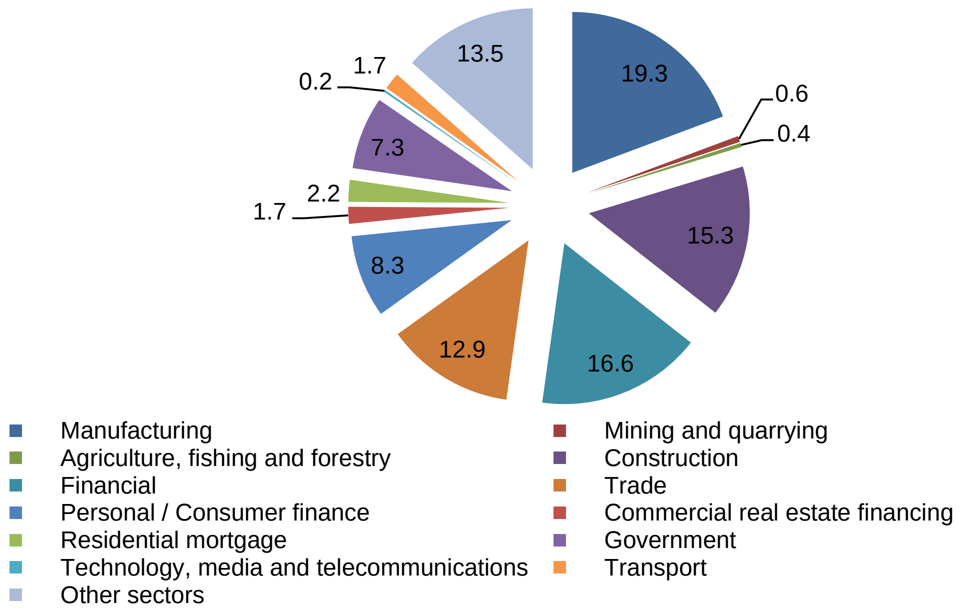
	Sep. 2013	Mar. 2014
Manufacturing	22.1	19.3
Mining and quarrying	0.5	0.6
Agriculture, fishing and forestry	0.3	0.4
Construction	13.4	15.3
Financial	17.9	16.6
Trade	12.0	12.9
Personal / Consumer finance	7.5	8.3
Commercial real estate financing	1.5	1.7
Residential mortgage	2.0	2.2
Government	7.3	7.3
Technology, media and telecommunications	0.2	0.2
Transport	3.9	1.7
Other sectors	11.3	13.5
Top two recipient sectors	**40.0**	**35.9**
Real Estate/ Construction Exposure**	**16.9**	**19.2**

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



Source: Central Bank of Bahrain

The top two recipient sectors in March 2014 ("manufacturing" and "financial") jointly represented (35.9%) of total financing, down from 40.0% in September 2013. On the other hand, the real estate/ construction exposure increased from 16.9% in September 2013 to 19.2% in March 2014.

Decrease earnings

The earnings performance of Islamic wholesale banks declined over the period from March 2013 to March 2014. Return on assets (ROA) decreased from 0.3% in March 2013 to 0.2% in March 2014. Similarly, return on equity (ROE) dropped from1.7% to 1.1% over the same period.

It should be noted however that operating expenses (as % of operating income) increased from 56.7% in September 2013 to 59.3% in March 2014.

Liquidity position improves slightly

As at end-March 2014, liquid assets of Islamic wholesale banks represented 22.6% of total assets, 1.5% higher than the 21.1% registered in September 2013. On the on the other hand, the facilities deposit ratio decreased to 67.2% compared to the 71.2% registered in September 2013.

Table 4-10: Liquidity Measures for Islamic Wholesale Banks

Indicator	Sept. 2013	Mar. 2014
Liquid assets (% of total)	21.1%	22.6%
Facilities-deposit ratio	71.2%	67.2%

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 while they declined for wholesale banks during the period between September 2013 and March 2014 reaching 17.7% and 24.6% respectively.

Non-performing facilities decreased in both banking sectors to reach 12.6% and 5.1% for Islamic retail and Islamic wholesale banks respectively. Facilities concentration has decreased in some sectors in retail Islamic banks and wholesale Islamic banks

The earnings picture looks better for Islamic retail banks with an increase in ROA and ROE, but a decrease for Islamic Wholesale banks.

Islamic retail banks experienced a strengthened liquidity position as the liquid asset ratio increased as well as the facilities to deposit ratio. Wholesale Islamic liquidity positions improved with liquid assets increased while facilities to deposit ratio decreased.

Part III:

Developments in the Equity Market and Payment Systems

5. Performance of Equity Market

Chapter

5

Key Points

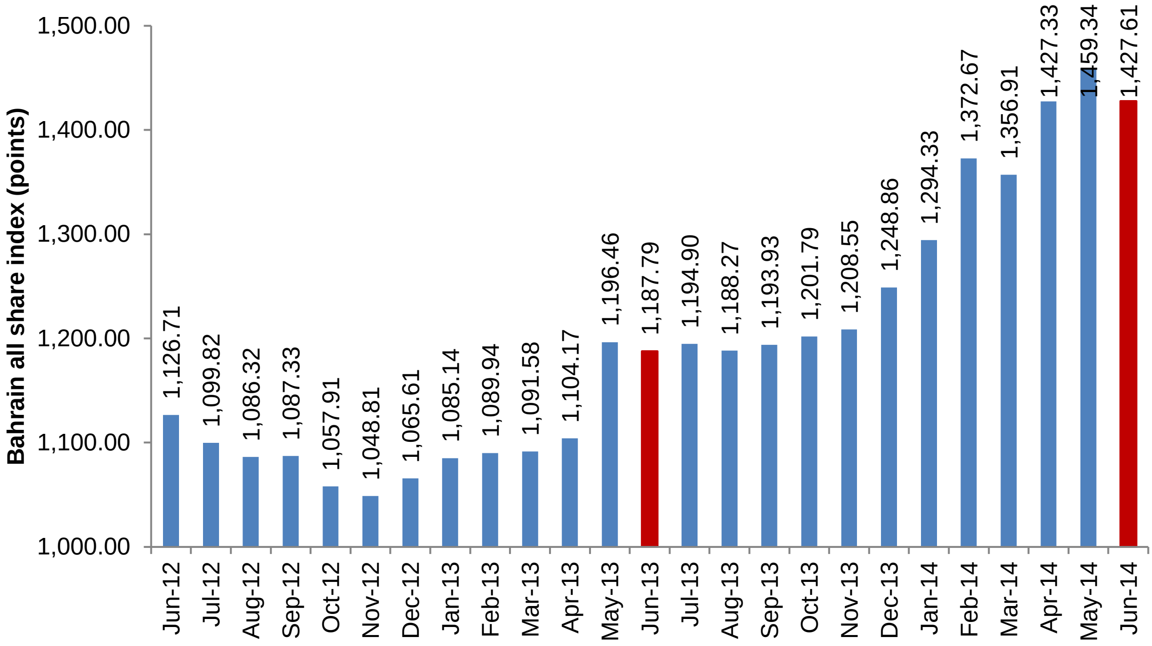
- Increase in the Bahrain All Share index
- Year-on-year growth in market capitalization
- Year-on-year growth in price-earning ratio
- GCC markets have shown notable increases in their year-on-year performance

5.1 Bahrain Market Trends

Increase in market index

A look at *year-on-year* data shows that the Bahrain All Share Index increased by 239.8 points (20%) between June 2013 and June 2014 (Chart 5-1). The index experienced steady increases from August 2013 to February 2014. However, the index experienced a slight dip in March 2014 amid global concerns over the Ukrainian crisis which undermined investors' confidence globally before picking up in the three consecutive months. The Bahrain all share index decreased by 31.2 (-2.2%) points in June 2014. With growing business and investors' optimism and planned government project expenditure, the index is likely to grow positively over the upcoming period.

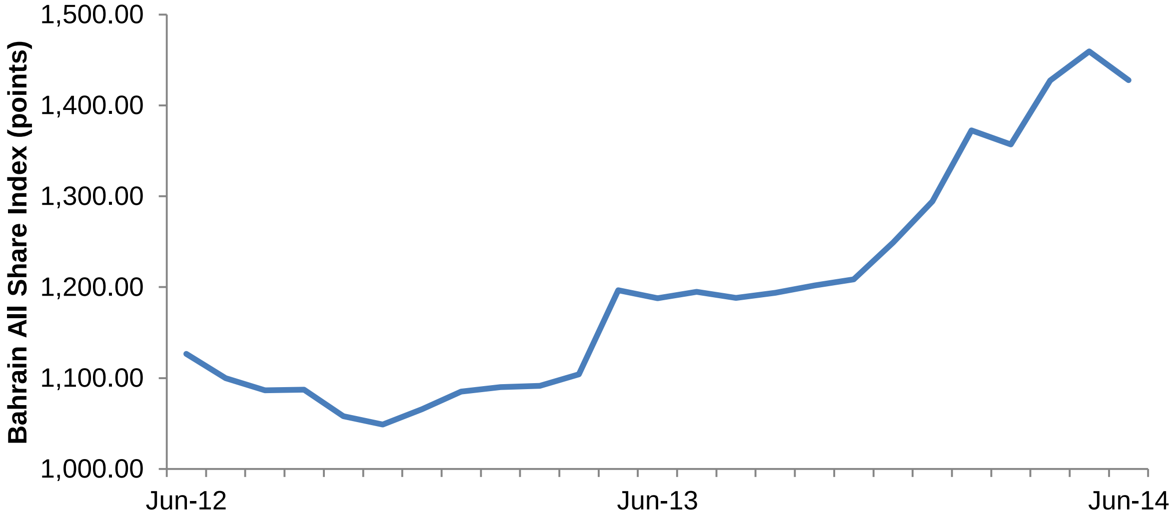
Chart 5-1: Recent Trends in the Bahrain All-Share Index, June 2013-June 2014.



Source of Data: Bahrain Bourse

Looking at the overall performance of the Bahrain All Share index since June 2012 (Chart 5-2), the index has performed positively in the last six months. The Bahrain All Share Index has experienced a stable increase in the period between June 2013 and June 2014, reflecting growing confidence in the Bahraini stock market.

Chart 5-2: Bahrain All-Share Index, June 2012-June 2014



Source of Data: Bahrain Bourse

Increase in market capitalization

As at end-June 2014, market capitalization of the Bahrain Bourse stood at BD 8.1 billion (Table 5-1). This level of market capitalization is 16.5% higher than the level as at end-December 2013 and 23.9% higher *year-on-year*.

Table 5-1: Market Capitalization on the Bahrain Bourse

(BD)

Sector	June 2013	Dec. 2013	June 2014	June 2013-Dec. 2013 (% Change)	June 2013-June 2014 (% Change)
Commercial banks	2,975,221,461	3,252,843,599	3,825,790,134	17.6	28.6
Investment	1,513,479,458	1,690,109,301	2,159,672,680	27.8	42.7
Insurance	144,213,624	166,687,991	174,549,943	4.7	21.0
Services	971,899,295	915,966,276	1,099,045,952	20.0	13.1
Industrial	761,246,021	761,544,011	647,368,316	(15.0)	(15.0)
Hotel and Tourism	180,773,416	175,800,031	207,494,503	18.0	14.8
Total	**6,546,833,275**	**6,962,951,209**	**8,113,921,529**	**16.5**	**23.9**

Source: Bahrain Bourse

A breakdown of market capitalization by sector indicates that Investment recorded the highest *year-on-year* increase in market capitalization (42.7.8%) followed by commercial banks (28.6%) and Insurance (21.0%). The Industrial sector is the only sector to witness a decrease with a *year-on-year* decrease in market capitalization of *negative* 15.0%. This was mainly due to the 17.4% decline in *year-on-year* earnings posted by Aluminium Bahrain which accounts for more than 98% of the sector's earnings.

Increase in price-earnings ratios

As June 2014, the price-earnings ratio (P-E ratio) for the stock market stood at 10.29, an increase from the 9.38 attained last year in June 2013 and the 10.07 in December 2013. The "Services" sector witnessed the highest *year-on-year* increase in the P-E ratio between June 2013 and June 2014. The Commercial banks and Insurance sectors witnessed a year on year decreases in the Price-Earning ratio.

Table 5-2: Price-Earning Multiples

Sector	Jun-13	Dec-13	Jun-14
Commercial banks	11.27	12.56	10.79
Investment	7.19	8.19	9.15
Insurance	10.91	12.55	10.13
Services	10.09	9.49	13
Industrial	7.69	7.69	7.95
Hotel and Tourism	12.28	11.92	12.88
Total Market	9.38	10.07	10.29

Source: Bahrain Bourse

The bulk of the value of shares traded in June 2014 was the "Commercial Banks" sector whose traded shares (by value) represented 76.2% of total shares traded up from 68.5% in December 2013. The Investment sector represented 10.2% of the total value of shares traded in June 2014 down from 19.4% in December 2013 (Table 5-3).

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

Sector	Jun-13	Dec-13	Jun-14
Commercial banks	78.8	68.5	76.2
Investment	10.4	19.4	10.2
Insurance	0.6	0.0	0.3
Services	7.8	9.3	6.5
Industrial	2.1	2.6	1.7
Hotel and Tourism	0.3	0.2	4.9

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

During June 2014, the three most active stocks in terms of volume traded were: Al Salam Bank's stock (43,807,923) followed by Al Baraka Banking Group's stock (4,025,166) and Ithmaar Bank's stock (3,810,211). The highest closing price of the most active stocks in June 2014 was Al Baraka Banking Group's at BHD 0.315.

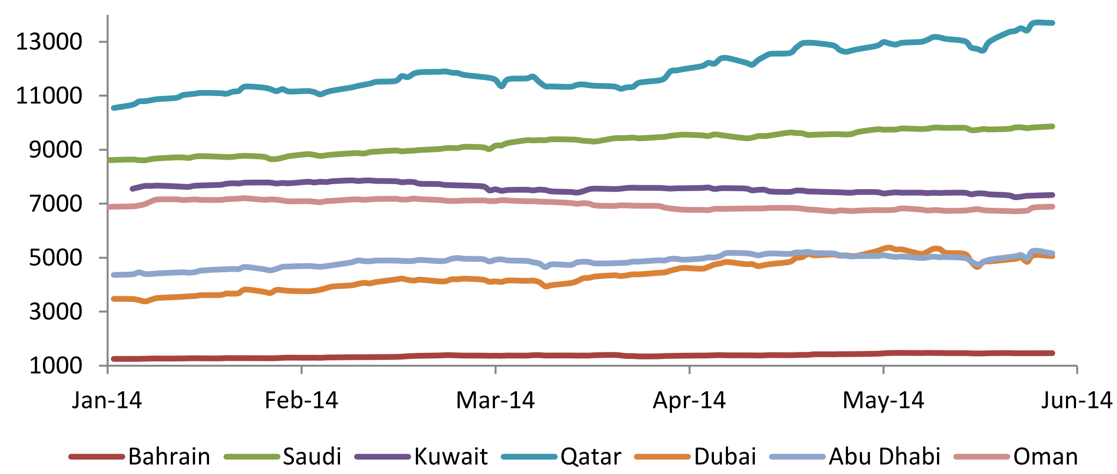
Table 5-4: Most Active Stocks in terms of volume

Sector	Volume	Value (BHD)	Closing price (BHD)
Al Salam Bank	43,807,923	9,962,594	0.224
Al Baraka Banking Group	4,025,166	1,327,573	0.315
Ithmaar Bank	3,810,211	206,920	0.050
Khaleeji Commercial Bank	3,613,839	180,842	0.050
Bahrain Tourism Co.	3,338,481	740,884	0.230

Source: Bahrain Bourse

5.2 GCC Market Trends

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



Sources: Bloomberg

The GCC Markets performed very well in the first quarter of 2014, supported by steady production over the GCC countries and high oil prices. Accommodative monetary policy in the GCC countries given its peg to the US dollar and expansionary fiscal policy that materialized through major investment projects (especially in the non-oil sector) reinforced investors' sentiments and business confidence. The Dubai stock market soared after UAE's success of winning the right to host the World Expo in 2020. Local firms are expected to initiate major projects in anticipation to host the World Expo of 2020. The real estate market and the tourism sector as well continued to contribute positively to the UAE markets. Kuwaiti market, however, has experienced a slight drop after the Capital Market Authorities embarked on stringent policies to clean up the market.

In other developments, the Saudi Tadawul All Share Index recorded a 25.5% y-o-y increase in 2013. The Saudi Market derived its strong performance from the strength of the petrochemical, telecom, and banking sectors as well as the upgrade in its status by Fitch from stable to positive. Fear, however, persists among some firms after the introduction of new labor market regulations that may affect earnings in key sectors of the economy. The new regulation levies fines on firms that employ more foreign nationals than Saudi nationals. It's likely to hurt sectors that are heavily dependent on foreign workers – construction for example. In a highly anticipated move, the Saudi Capital Market Authority is set to open up the stock market for foreign investors in the early stages of 2015 – the Saudi market is the biggest in the Middle East. The move will allow foreign investors to invest directly in Tadawul stock exchange by buying domestic stocks, when in the past investors were only allowed to purchase derivative and investment funds. Analysts expect large inflows of investment funds as a result of this measure.

The trend of growth in the GCC market indices is set to persist in the next quarter of 2014 given the recent regional developments. Expansionary fiscal policy in Qatar in preparation for hosting the world cup in 2022 is expected to boast the Qatari stock market and UAE's success of winning the right to host the World Expo in 2020 will reinforce investors' appetite to invest in the region.

Table 5-5: Stock Market Indices in GCC counties

Index	Jun-13	Dec-13	Jun-14	June 2013-December 2013 (%)	June 2013-June 2014 (%)
Bahrain All Share Index	1,187.7	1,248.8	1,427.6	5.1	20.2
Tadawul All Share Index	7,435.1	8,301.1	9,864.6	11.6	32.7
Kuwait Market Index	8,300.5	7,741.6	7,321.1	-6.7	-11.8
Qatar Exchange Index	9,158.7	10,396.3	13,696.9	13.5	49.6
Dubai Financial Market Index	2,338.0	2,987.1	5,056.3	27.8	116.3
Abu Dhabi Index	3,489.1	3,986.1	5,157.6	14.2	47.8
Muscat Securities Market Index 30	6,408.8	6,767.6	6,890.7	5.6	7.5-

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

Gulf stock markets soared in 2013, with almost all indices recording double-digit year on year growth (except for Kuwait and Muscat). The UAE markets rallied with the biggest year-on-year growth recorded in the Dubai Financial Market Index (116.3%) followed by Abu Dhabi Index (47.8%). The two indices benefited from expansionary fiscal policy carried on by the emirates to develop the infrastructure and real estate sector as well as growing confidence amid winning the World Expo in 2020. The Kuwait Market Index recorded a year on year decline of negative 11.8% as a result of market clean up by Capital Market Authorities. In the period between June 2013 and December 2013, all GCC market indices experienced varying degrees of increases, except for the Kuwait Market Index which dropped by negative 6.7%. The Dubai Financial Market Index and Abu Dhabi Index experienced the most increases of 27.8% and 14.2% respectively, while Bahrain All Share Index increased by 5.1%.

5.3 Overall assessment of the equity market

The performance of the Bahrain All Share Index has been upwardly trending with a 20.0% year-on-year growth in the Index and a 16.5% year-on-year increase in market capitalization. Bahrain All Share Index as well as market capitalization increased by 14.3% and 6.4% respectively compared to December last year. With few exceptions, most sectors of the economy exhibited a year on year increase in the price-earning ratio reflecting strong corporate earnings and improved markets overall. Corporate earnings increased by 18.6% in 2013, supported mainly by the banking sector and the insurance sector both of which recorded a year-on-year growth of 74.9% and 23.2% respectively in corporate earnings (Global, 2014). Furthermore, Bahrain Bourse continues to make efforts to strengthen its ties with other regional stock markets.

In other developments, Saudi stock market (Tadawul All Share Index) reached a 68 month high after Fitch upgraded the country. The rating agency cited strong balance sheets, labor market reforms, and government's commitment to combat unemployment and housing shortage as the underlying reasons behind the upgrade. In 2013, TASI's year on year corporate earnings grew by 6.8%, with the 'transport' and 'telecommunication' sectors recording a 50.7% and 31.8% increases respectively in year on year earnings. In the UAE, Dubai's DFM increased by 107.7% and Abu Dhabi's ADX surged by 63.1% in 2013. Dubai's and Abu Dhabi's corporate earnings rose by 36.8% and 14.5% respectively. Corporate earnings of the real estate sector rose by 89.6% in Dubai and 53.1% in Abu Dhabi (Global, 2014). The UAE stock markets were the best performers among their GCC peers.

Overall, the GCC stock markets are set to experience continuous positive growth in the later quarters of 2014. Expansionary fiscal policy, planned infrastructure projects in preparation for two major international events (The World Expo in Dubai and The World Cup in Qatar), and positive real economic growth across the GCC countries are going to boast the performance of the stock markets. Investors, however, should be wary of the Federal Reserve's plan to scale back its stimulus plan as it is going to lead to higher interests rates in the United States, and consequently in the GCC countries because of the hard peg. Growth in the GCC stock markets may slow down as the cost of funding starts to climb up.

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 increase in the volume and 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 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. According to the CBB, which operates all the clearing cheques, the total number of cheques processed at the CBB decreased by 6% in 2011 to its level in 2010. 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.

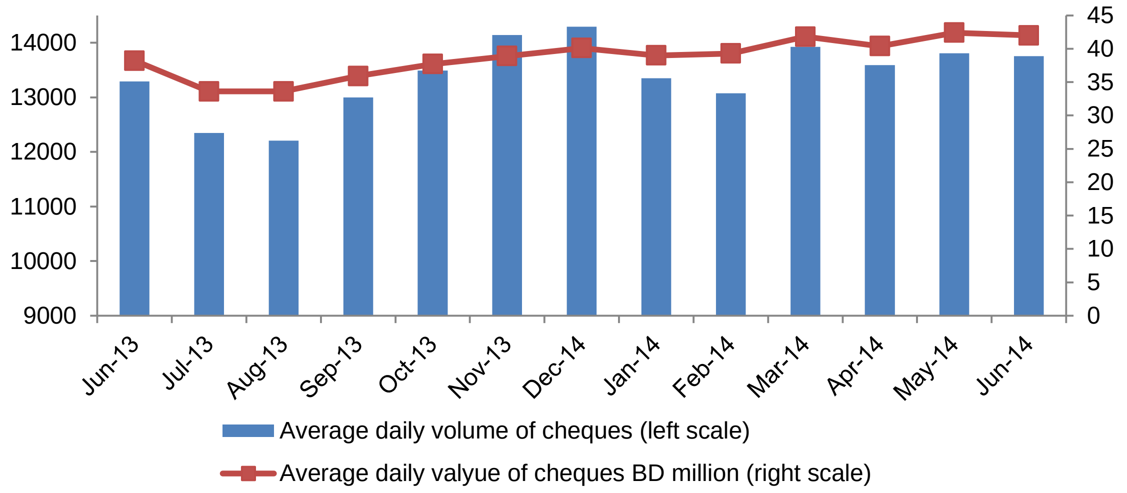
Year on year increase in average daily volume and value of cheques through ACS

In the period between December 2013 and June 2014, the average daily volume of cheques processed through the Automated Cheque Clearing System (ACS) decreased by 3.7% from 14,293 to 13,754 (year-on-year increase of 3.5%) (Chart 6-1). The average daily value of cheques increased by 4.7% from BD 40.1 million in December 2014 to BD 42.0 million in June 2014 (year-on-year increase of 9.9%).

The average daily volume kept fluctuating through Jan 2014 until June 2014; however the biggest increase was by 6.5% in March 2014 followed by a 2.4% decrease in April 2014. The average daily volume reached its peak in March 2014 of 13926 average daily transactions. The average daily volume had a dip in February 2014 by 2.0%. The average daily value of cheques was steady between January 2014 and June 2014. The highest value of cheques cleared was seen in May 2014 by BD 42.4 million whereas the lowest value of cleared cheques occurred in January 2014 both by BD 39.0 million. 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, Nov 2013-2014



Source: Central Bank of Bahrain

6.2.2 E-Payment systems

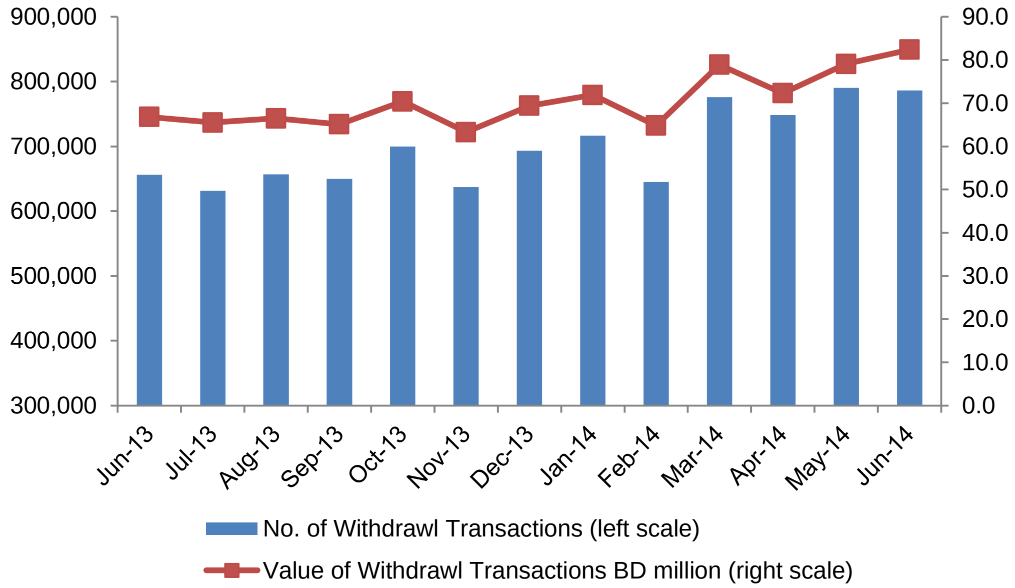
ATM clearing is based on a Deferred Net Settlement (DNS) system. The Benefit Company in Bahrain receives and processes all the ATM transactions. The GCC net, a leased line network across the GCC countries, provides for the communication backbone for the transmission of all the ATM transactions and settlement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

Year on year growth in number and value of ATM withdrawals

Between December 2014 and June 2014, the number of withdrawal transactions processed through the ATM Clearing System increased by 13.4% from 693,480 to 786,285 (year-on-year growth was 19.8%)(Chart 6-2). Similarly, in value terms, total withdrawals processed increased by 18.7% from BD 69.4 million to BD 82.4 (year-on-year growth was 23.4%).

There have been fluctuations in both the value and volume of transactions between December 2014 and June 2014. May 2014 witnessed the highest number of ATM withdrawals with an increase of 5.6% whereas the biggest decrease in the number of withdrawals took place in the month of February 2014 by almost 10.0%. The highest value of withdrawals was witnessed in June 2014 by BD 82.4 million and the lowest value of withdrawals in February 2014 by BD 64.8 million.

Chart 6-2: Number and Value of ATM Transactions, June 2013- June 2014



Source: The Benefit Company

Recent Developments

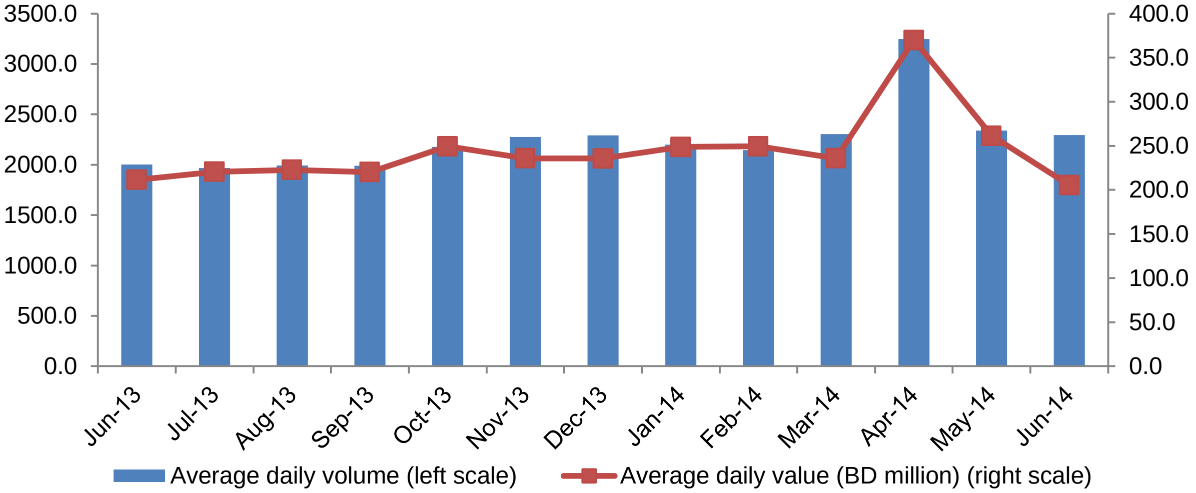
With the widespread use of internet and mobile services in Bahrain, another payment solution was introduced by banks. Nowadays, Bahraini household started paying their bill online (e-bill) with both internet and mobile bill. Moreover, the government of Bahrain encouraged the use of internet ICT tools 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 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 2013 and June 2014 is seen in Chart 6-4 below.

Chart 6-3: RTGS System- Average Daily Volume and Value of Payments Processed, Nov 2012 – Nov 2013



Source: Central Bank of Bahrain

Between December 2013 and June 2014, the *average daily volume of transfers* increased by only 0.1% from 2,291.7 to 2,294.8 (14.6% year-on-year increase). In addition, the value of these transfers decreased. In value terms, the *average daily value of transfers* witnessed a 12.8% decrease from BD 235.7 million in December 2013 to BD 205.5 million in June 2014 (2.8% year-on-year increase).

Annex:

Financial Soundness Indicators

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

(End of period)

	Mar-13	Sep-13	Mar-14
Capital Adequacy			
Total capital adequacy ratio (%) *	19.0	18.5	18.3
Tier 1 capital adequacy ratio (%) *	15.8	14.3	15.7
Leverage (assets/capital)(times)*	8.2	8.3	8.6
Non-performing loans net provisions to capital ratio (%)*	8.6	9.2	8.9
Asset Quality			
Non-performing loans (% of gross loans)	4.1	4.2	3.8
Specific provisions (% of NPLs)	54.4	53.2	55.2
Net non-performing loans (% of net loans)	1.9	2.0	1.7
Loan concentration (share of top-2 sectors) (%)	30.4	30.7	29.4
Real Estate/ Construction exposure (%) **	28.5	28.4	28.6
Earnings			
ROA retail banks (%)	0.7		0.4
ROA Local Retail banks (%)	0.7		0.4
ROA Overseas Retail banks (%)	0.6		0.6
ROE Local Retail banks (%)***	7.4		4.0
Net interest income (% of gross income)	50.4		68.1
Net fees & commissions (% of gross income)	12.0		15.3
Operating expenses (% of gross income)	32.5		41.2
Liquidity			
Liquid assets (% of total assets)	29.6	26.5	24.3
Liquid assets (% of short-term liabilities)	41.2	37.7	33.5
Loan-deposit ratio (%)	62.9	62.8	64.2
Deposits from non-bank sources (% of total deposits)	77.8	78.1	73.9

** 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 lending.*
**** ROE is defined as net profit over Tier 1 Capital.*
Source: Central Bank of Bahrain

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

(End of period)

	Mar-13	Sep-13	Mar-14
Capital Adequacy			
Total capital adequacy ratio (%) *	23.3	22.4	21.6
Tier 1 capital adequacy ratio (%) *	19.9	19.1	18.7
Leverage (assets/capital)(times)*	5.4	5.5	6.0
Non-performing loans net provisions to capital ratio (%)*	5.4	5.3	2.3
Asset Quality			
Non-performing loans (% of gross loans)	8.5	8.4	6.8
Specific provisions (% of NPLs)	64.4	62.8	66.1
Net non-performing loans (% of net loans)	3.2	3.4	2.4
Loan concentration (share of top-2 sectors) (%)	55.5	51.7	47.7
Real Estate/ Construction exposure (%) **	9.5	9.6	8.8
Earnings			
ROA retail banks (%)	0.4		0.5
ROA Local Wholesale banks (%)	0.3		0.4
ROA Overseas Wholesale banks (%)	0.5		0.6
ROE Local Wholesale banks (%)***	2.2		2.5
Net interest income (% of gross income)	46.0		35.2
Net fees & commissions (% of gross income)	43.2		37.3
Operating expenses (% of gross income)	41.9		39.3
Liquidity			
Liquid assets (% of total assets)	18.2	16.9	19.4
Liquid assets (% of short-term liabilities)	31.4	28.9	29.7
Loan-deposit ratio (%)	59.4	60.1	63.7
Deposits from non-bank sources (% of total deposits)	40.0	42.2	45.0

** 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

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

(End of period)	Mar-13	Sep-13	Mar-14
Capital Adequacy			
Total capital adequacy ratio (%) *	18.2	17.5	17.7
Tier 1 capital adequacy ratio (%) *	15.7	14.9	15.0
Leverage (assets/capital)(times)*	7.4	7.8	8.0
Non-performing facilities net provisions to capital ratio (%)*	32.1	30.8	29.6
Asset Quality			
Non-performing facilities(% of gross facilities)	13.8	13.1	12.6
Specific provisions (% of NPFs)	36.6	39.1	41.4
Net non-performing facilities (% of net facilities)	8.7	8.0	7.4
Facilities concentration (share of top-2 sectors) (%)	39.3	36.1	33.5
Real Estate/ Construction exposure (%) **	23.0	27.6	28.5
Earnings			
ROA (%)	0.1	0.1	0.1
ROE (%)***	0.5	1.1	1.3
Net income from own funds, current accounts and other banking activities (% of operating income)	63.4	63.2	74.0
Net income from jointly financed accounts and Mudarib fees (% of operating income)	27.1	27.4	18.8
Operating expenses (% of gross income)	85.6	87.1	77.8
Liquidity			
Liquid assets (% of total assets)	12.8	13.7	14.3
Facilities-deposit ratio (%)	78.9	78.2	78.9
Current accounts from non-banks (% of non-capital liabilities, excl. URIA)	21.3	22.6	22.8

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

(End of period)

	Mar-13	Sep-13	Mar-14
Capital Adequacy			
Total capital adequacy ratio (%) *	26.1	25.0	24.6
Tier 1 capital adequacy ratio (%) *	25.2	23.6	23.7
Leverage (assets/capital)(times)*	5.8	5.8	6.1
Non-performing facilities net provisions to capital ratio (%)*	7.0	4.3	3.6
Asset Quality			
Non-performing facilities(% of gross facilities)	5.3	5.4	5.1
Specific provisions (% of NPFs)	53.4	72.8	75.5
Net non-performing facilities (% of net facilities)	2.5	1.5	1.3
Facilities concentration (share of top-2 sectors) (%)	47.1	40.0	35.9
Real Estate/ Construction exposure (%) **	14.6	16.9	19.2
Earnings			
ROA (%)	0.3	0.6	0.2
ROE (%)***	1.7	3.6	1.1
Net income from own funds, current accounts and other banking activities (% of operating income)	68.2	65.6	65.2
Net income from jointly financed accounts and Mudarib fees (% of operating income)	31.4	32.9	33.3
Operating expenses (% of gross income)	55.8	56.7	59.3
Liquidity			
Liquid assets (% of total assets)	21.8	21.1	22.6
Facilities-deposit ratio (%)	67.6	71.2	67.2
Current accounts from non-banks (% of non-capital liabilities, excl. URIA)	44.0	43.1	42.4

** 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