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Financial Stability Directorate

Financial Stability Report

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Preface

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

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

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

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

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

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

Chapter 4 assesses the financial condition and performance of the conventional insurance industry and Chapter 5 reviews recent trends on the equity market. Chapter 6 focuses on stability issues relating to the payment and settlement systems.

Unless indicated otherwise, this report analyzes data covering the period between end-September 2009 and end-March 2010.

Executive Summary

Overall assessment

The Bahraini financial system did not experience a systemic crisis and is expected to begin its slow recovery in 2010. However, the sector is still suffering from the effects of the financial crisis mainly in the form of decreased earnings which has affected some banking segments. In terms of asset quality, the banking sector presents a mixed picture. While non-performing loans decreased for conventional retail and Islamic wholesale banks, they increased for Islamic retail and conventional wholesale banks. Liquidity positions also are divided as conventional retail banks and Islamic wholesale banks improve and Islamic retail banks deteriorate. This may indicate that the paths to recovery will differ among the various banking segments.

International and domestic macroeconomic trends

Advanced economies, according to IMF forecasts, are expected to recover more slowly than emerging markets with an expected growth rate of 2.3% in 2010 and sustained in 2011. *Emerging and developing economies* will grow by 6.3% in 2010 and by 6.5% in 2011. Inflation remains low as expectations are well-anchored and output gaps remain large. Despite this expected improvement, risks to financial stability are still eminent given the fragile nature of this recovery. Higher budget deficits as a result of the financial crisis have increased sovereign indebtedness.

Bahrain's economy is projected to begin its recovery in 2010 as oil prices increase and the financial sector starts to heal. Real GDP growth decelerated from 6.3% in 2008 to 3.1% in 2009 as a result of the financial crisis. Inflation fell from 3.5% in 2008 to 2.8% in 2009. In 2010, government finances are expected to improve and inflation is set to increase as oil prices rebound and the effects of the crisis diminish. Bahrain raised $1.25 billion of debt (6% of GDP) with a bond issue in March that was six times oversubscribed implying continued international confidence in Bahrain's economic outlook.

The non-financial sector

The debt ratio for *households* has fallen further, despite interest rates on personal loans remaining within the same range. Debt levels in the *business sector* have increased as rates also remained within the same range.

Outstanding personal loans between September 2009 and March 2010 show that the household debt burden decreased. Personal loans to GDP fell from 21.9% as at end-September 2009 to 20.3% by the end of March 2010. Interest rates remained within a similar range of 7.7%. The ratio of business loans to GDP rose from 48.3% to 49.2% over the same period reflecting renewed confidence in businesses. Average interest rates on business loans have remained within the same range.

The construction and real estate sector recovered gradually in 2009 and then more rapidly during the first quarter of 2010 with a total of 513 new commercial licenses issued for construction, real estate and associated activities in the first quarter or 2010. For the *construction and real estate sector*, the decrease in material prices as well as increased liquidity (due to higher oil prices) indicated increased activity, particulary in new construction projects.

The banking sector

The Bahraini banking sector is still experiencing some effects of the global financial turmoil. Non-performing loans/facilities have increased in some banking segments. Additional downside risks stems from the fact that some banking segments continued to show high levels of asset concentration and income prospects are not particularly bright for many banks (especially Islamic wholesale banks).

Capital adequacy ratios for conventional locally incorporated retail banks slightly increased from 19.8% in September 2009 to 20.0% in March 2010. As economic activity has started to pick up slightly in the first quarter of 2010, loan delinquencies have begun to slowly decrease. Non-performing loans (NPLs) for conventional retail banks amounted to 5.9% of gross loans, lower than the 6.2% recorded in September 2009. The loan portfolio of locally incorporated retail banks remain concentrated. Return-on-assets (ROA) for locally-incorporated and overseas banks decreased to 0.3% and to 1.3% respectively. Bank deposits decreased while non-bank deposits increased for retail banks. Consequently, the overall loan-deposit ratio for the segment decreased to 76.2%, compared to 77.7% in September 2009.

Capital adequacy ratio for locally-incorporated wholesale banks stood at 20.6%, a slight decrease from September 2009. Asset quality continues to deteriorate for wholesale banks. Locally-incorporated and overseas wholesale banks showed an increase in the NPL ratio reaching 7.4% and 6.0% respectively. The top two sectors accounted for 55.2% of total lending, up from the 48.2% recorded for September. Earnings improved in March 2010 after the net losses experienced in September 2009.

As for Islamic banks, the capital adequacy ratio of Islamic retail banks fell to 20.7% while increasing to 34.6% for Islamic wholesale banks. The asset quality of Islamic retail banks has continued to deteriorate, with non-performing facilities (NPFs) in March 2010 increasing to 11.1%. On the other hand, NPF's for Islamic wholesale banks decreased to 8.1% in March 2010. Asset concentration risks continue to be an issue with regard to Islamic retail and wholesale banks. The return on assets (ROA) for Islamic retail and wholesale banks fell to 0.4% and -1.3%, respectively. Similarly, Return on equity (ROE) also decreased from 5.0% to 2.5% in Islamic retail banks and from –1.2% to -5.5 for Islamic wholesale banks.

The insurance industry

There are no financial stability concerns in the insurance industry despite a decline in net income. Capital levels witnessed a minor decrease during the review period, from 23.8% in September 2009 to 22.5% as at end-March 2010. The level of insurance receivables of gross premiums increased from 54.1% in September 2009 to 123.9% in March 2010. The *risk retention ratio* declined further reaching 68.1% in March 2010. The *expense ratio* (ratio of expenses to earned premiums) increased from 26.3% March 2009 to 29.2% in March 2010 along with a 7.7% decline in net income over the same period.

Equity markets

Similar to other GCC stock markets, the global financial crisis has impacted the performance of the Bahraini Stock Exchange, with declines in market capitalization and in the main price index. As at end-October 2009, market capitalization of the Bahrain Stock Exchange (BSE) stood at BD 6.4 billion, equivalent to 82.1% of 2009 nominal GDP, 4.4% down *year-on-year*. The Bahrain All Share Index lost a total of 171.87 points (a 10.6% decrease) between May 2009 and May 2010. There are now signs of a recovery in the market as investor confidence begins to be restored, albeit tentatively.

Payments and settlement system

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

Chapter

1

1. International and Domestic Macro-Financial Developments [1]

Key Points

Global recovery stronger than expected

Inflation remains low

Sovereign credit risk increases

Bahrain expected to begin recovery

[1] This chapter draws on various projections and analysis contained in the IMF's *World Economic Outlook*, April 2010 and *Global Financial Stability Report*, April 2010.

1.1 *International Developments*

Global recovery stronger than expected

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

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

The global revival is turning out better than expected due to an increase in overall confidence. However, in many economies the rebound has been moderate as a result of the severity of the recession. In 2010, according to the IMF, world output is expected to rise to 4.2%, an upward revision of 1 percentage point from the IMF's projections in October 2009 (Table 1-1).

Table 1-1: Global Output Growth—2008-2011 (% changes)

	2008	2009	2010*	2011*
World	**3.0**	**-0.6**	**4.2**	**4.3**
Advanced Economies	**0.5**	**-3.2**	**2.3**	**2.4**
United States	0.4	-2.4	3.1	2.6
Euro Area	0.6	-4.1	1.0	1.5
Japan	-1.2	-5.2	1.9	2.0
Emerging and Developing Economies	**6.1**	**2.4**	**6.3**	**6.5**
Developing Asia	**7.9**	**6.6**	**8.7**	**8.7**
---China	*9.6*	*8.7*	*10.0*	*9.9*
---India	*7.3*	*5.7*	*8.8*	*8.4*
Middle East	**5.1**	**2.4**	**4.5**	**4.8**
Africa	5.5	2.1	4.7	5.9

**IMF projections*
Source: International Monetary Fund, World Economic Outlook, April 2010.

Advanced economies are expected to recover more slowly than emerging markets since many advanced countries are coping with structural changes. As a group, the *advanced economies* are expected to grow by 2.3% in 2010 which is expected to be sustained in 2011. The positive development in advanced economies is due to the slowing deterioration and recent improvements in the U.S. labor markets along with a recovering corporate bond market which helped foster investment. *Emerging and developing economies* will grow by 6.3% in 2010 and by 6.5% in 2011, driven mainly by strong growth in China and India.

Sovereign Credit Risk Increases

Despite this improvement in recovery, risks to financial stability are still eminent given the fragile nature of this recovery and the continuing repair of balance sheets. Moreover, there is an increasing concern over sovereign credit risk, especially in advanced countries. Higher budget deficits as a result of the financial crisis have increased sovereign indebtedness as the G-7 sovereign debt levels as a proportion of GDP are reaching 60-year highs. This longer term solvency issue can lead to short-term strains in funding markets which can then be transmitted to the banking system and across borders thus making it a significant financial stability matter.

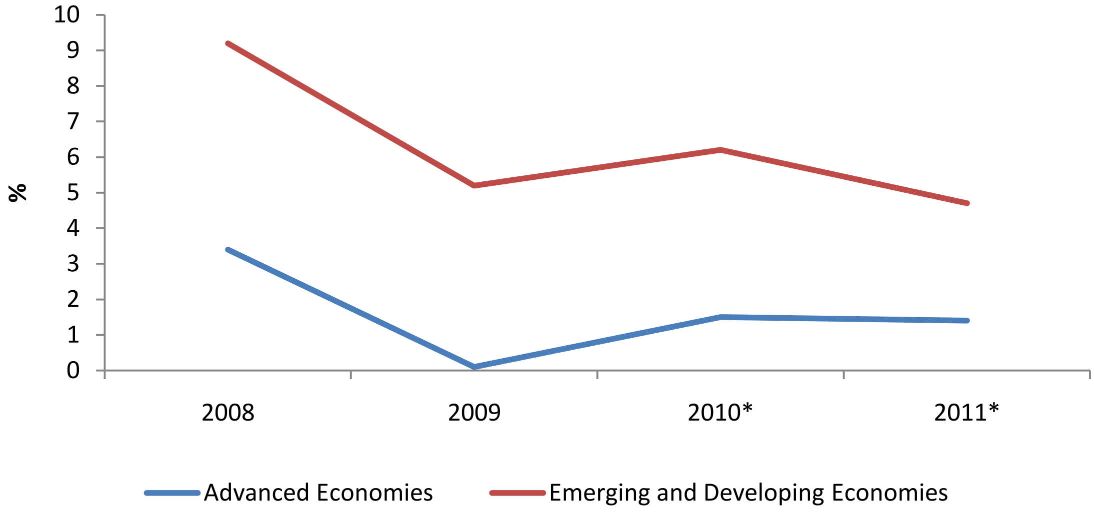
Deteriorating sovereign credit risk can easily spill over to the financial sector given the close linkages between the public sector and domestic banks. A sudden drop in sovereign debt prices can cause losses for banks which hold large portfolios of government bonds. On the liability side, bank wholesale funding costs will generally increase in line with sovereign spreads based on the assumption that domestic institutions cannot be less risky than their government.

Financial sector linkages can also transport one country's sovereign credit problems to other economies. As higher domestic government borrowing in a country crowds out private lending, multinational banks may pull out from cross-border banking activities. Similarly, other economies that rely on international debt borrowing or on banks from countries with sovereign risk problems could be at risk of financial instability as well or at least perceived to be. Consequently, the careful management of sovereign risks is imperative for the preservation of financial stability and avoiding the further exacerbation of the crisis.

Inflation remains low

The deterioration of the global economy in 2008 and 2009 led to concerns about deflation. However, with the improving growth in output, these concerns are contained. Nevertheless, inflation remains low as expectations are well-anchored and output gaps remain large.

Chart 1-1: Global Consumer Prices, 2008-2011 (%)*



**2010 and 2011 IMF projections*
Source: International Monetary Fund, World Economic Outlook, April 2010

In advanced economies, inflation is projected to increase from a low of 0.1% in 2009 to 1.5% in 2010 and 1.4% in 2011 (Chart 1-1). Similarly, emerging and developing economies are expected to witness an increase in inflation from 5.2% in 2009 to 6.2% in 2010, which will then decrease to 4.7% in 2011.

1.2 Domestic Developments

Bahrain expected to begin recovery

Bahrain's economy is projected to begin its recovery in 2010 as oil prices increase and the financial sector starts to heal. The financial crisis affected Bahrain in 2009, as GDP dropped from 6.3% in 2008 to 3.1% in 2009[2]. As output decreased, so did inflation which fell from 3.5% in 2008 to 2.8% in 2009. Lower oil prices also led to a fiscal deficit amounting to 9.5% of GDP after rollover in 2009.

In 2010, government finance is expected to improve and inflation is set to increase as oil prices rebound and the effects of the crisis diminish. Furthermore, Bahrain raised $1.25 billion of debt (6% of GDP) with a bond issue in March that was six times oversubscribed implying continued international confidence in Bahrain's economic outlook.

[2] Source: Central Informatics Organization (CIO).

Bahrain's expected recovery is potentially fragile given the uncertain international economic climate created by the European debt crisis. Credit, market, and liquidity risks may increase as a result of this uncertainty, but this crisis is predicted to be of a much lesser intensity than the 2008 global financial crisis that Bahrain faced relatively well. Therefore, it is expected that Bahrain will generally fare better in 2010 than in 2009.

Chapter

2

2. The Non-Financial Sector

Key Points

Household borrowings fall as rates remain constant

Business debt ratios increase

Activity has recovered in the construction and real estate sector

A rise in the number of permits for new construction may signal the beginning of increased activity

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.

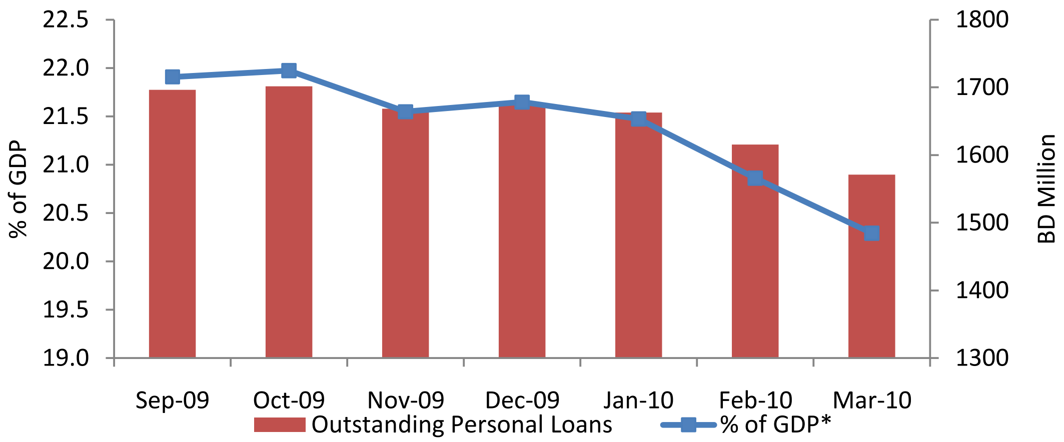
The construction and real estate sector receives special attention because this sector is usually highly sensitive to developments in macroeconomic conditions and financial institutions in Bahrain have direct and indirect exposures to the sector.

2.2 Households

Debt ratio falls

Outstanding personal loans, used as a proxy for household borrowing, for the period shows that the household debt burden decreased between the period September 2009 and March 2010. Personal loans to GDP fell from 21.9% as at end-September 2009 to 20.3% by the end of March 2010. This was due to a decline of in outstanding personal loans from BD 1,696.5 million to BD 1,571.3 million during the same period (Chart 2-1).

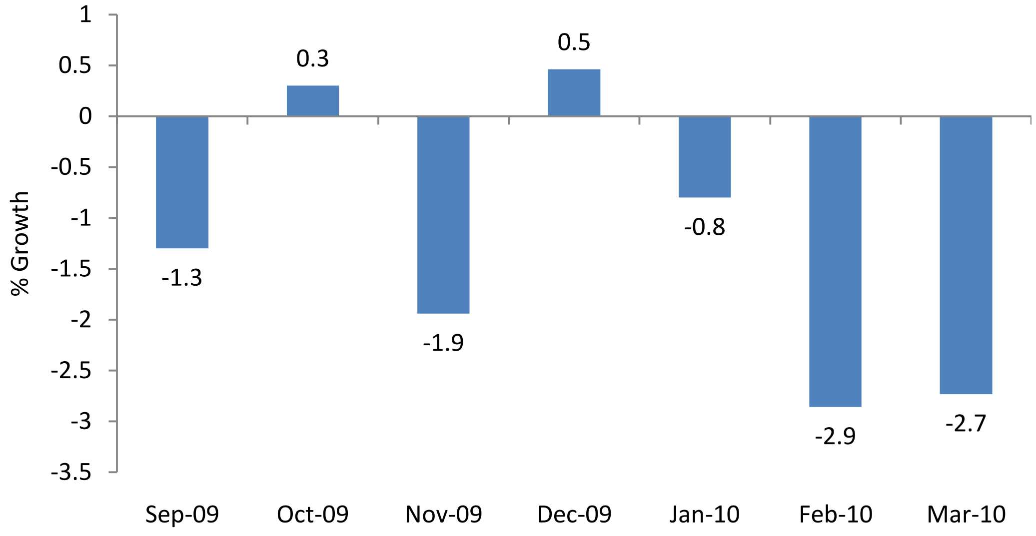
Chart 2-1: Personal Loans and Advances (Volume and % of GDP)



**Using 2009 GDP, provisional data*
Source: Central Bank of Bahrain

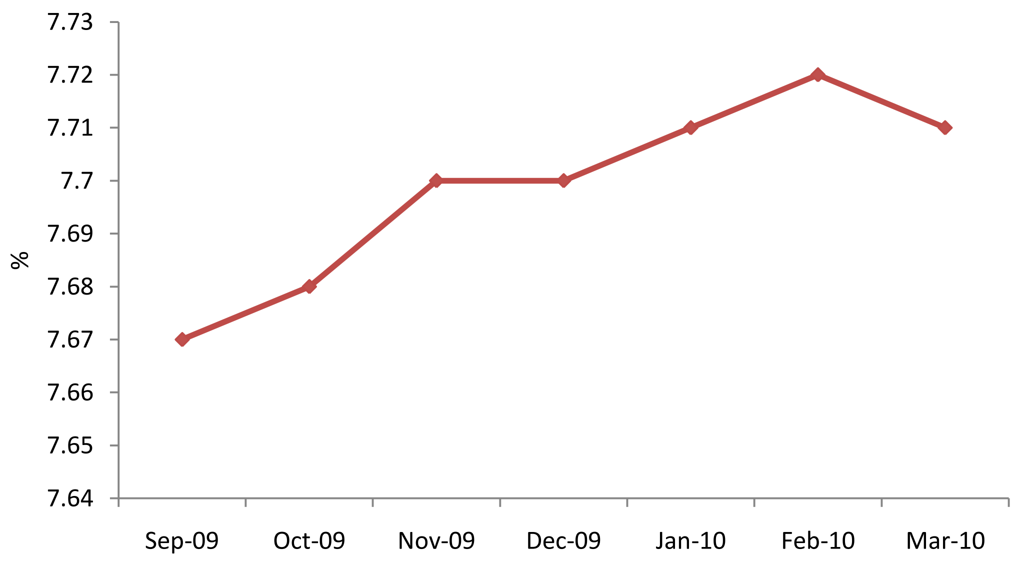
Coupled with the decrease in outstanding personal loans, nominal GDP declined from BD 8,235.3 million in 2008 to BD 7,743.6 million in 2009, yet the decrease in personal loans outstripped the decline in GDP indicating that economic activity remained sluggish during the period. Despite interest rates remaining within a similar range (7.7%), outstanding personal loans shrank by 7.4% between September 2009 and March 2010 as banks tightened lending (Charts 2-2 and 2-3).

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



Source: Central Bank of Bahrain

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



Source: Central Bank of Bahrain

Positive trends for household income

Employment trends alongside wage data are the indicators used to guage houshold income and the ability of households to service their debts. As at the end of 2010:Q1, overall employment in Bahrain stood at 489,657 compared to 486,071 at the same time in 2009. This is a growth of 3,586 jobs or 0.7%.

It is noteworthy that the level of employment in the private sector increased while the level of employment in the public sector decreased during this period. Private sector employment increased from 445,330 to 449,010 and public sector employment decreased from 40,741 to 40,647 during the same period. Therefore the growth in employment was driven purely by the private sector. Given that 80.7% of this growth was due to an increase in non-bahraini employment in the private sector, this growth is not necessarily a distinct indication of increased household income.

Wage data has also been positive during the period. As at end-March 2010, average private sector wages stood at BD 276 per month, compared to BD 266 per month at the end of 2009:Q2 (Table 2-1). Over the same period, average monthly public sector wages also rose from BD 805 per month to BD 821 per month.

Table 2-1: Average Monthly Wages (BD)

	2008:Q1	2008:Q2	2008:Q3	2008:Q4	2009:Q1
Private Sector	269	266	266	266	276
Public Sector	802	805	778	811	821

Sources: General Organisation for Social Insurance and Civil Service Bureau

The private sector accounted for over 91.7% of total employment, a trend of increased employment and improved average private sector wages connotes an improving ability of workers to service debt out of current income (on average).

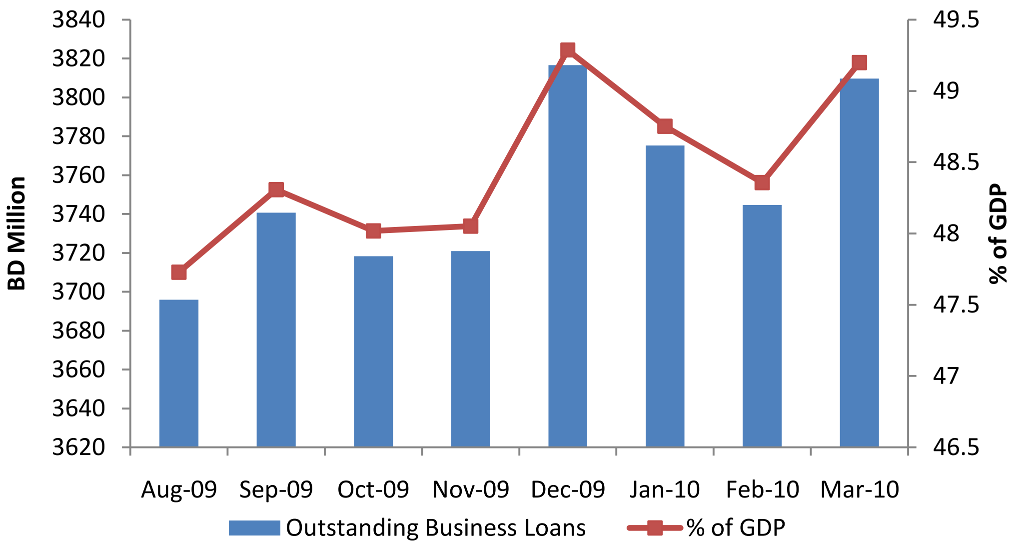
Furthermore, the decrease in global food prices and the increased strength of the US dollar since the beginning of 2010 should help individual workers service debts. Since imported food items feature heavily in the consumption baskets of households in Bahrain, the increased purchasing power of households should allow for easier facilitiation of debt servicing.

2.3 Business Enterprises

Business debt ratio increases

Between September 2009 and March 2010, the ratio of business loans to GDP rose from 48.3% to 49.2% (Chart 2-3). This trend reflects the renewed confidence in businesses after a turbulent period resultant of the global financial crisis. Also, it is noticeable that outstanding business loans have a cyclical nature where there was an increase followed by 2 months of decreases during each quarter (Chart 2-4).

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



Source: Central Bank of Bahrain

Over the period, average interest rates on business loans have remained within the same range, fluctuating slightly but eventually remaining at unchanged at 6.82% by end-March 2010.

2.4 Construction and Real Estate

Rebound in real estate licenses and construction permits

Despite cooling significantly from highs in 2006, the construction and real estate sector recovered gradually in 2009 and then more rapidly during the first quarter of 2010. In the first quarter of 2010, a total of 513 new commercial licenses were issued for construction, real estate and associated activities, compared to 433 licenses in 2009:Q4 (Table 2-2).

The split of the new licenses granted was fairly even during the latest quarter as 275 of the new licenses granted were for real estate companies and 238 were granted to construction companies.

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

	2009:Q1	2009:Q2	2009:Q3	2009:Q4	2010:Q1
Construction	166	179	204	190	238
Real Estate, Rentals and Associated Activities	203	264	222	243	275
Total	**369**	**443**	**426**	**433**	**513**

Source: Ministry of Industry and Commerce

The total number of construction permits issued by the Ministry of Municipalities Affairs and Agriculture rose from 639 in 2009:Q4 to 731 in 2010:Q1 (Table 2-3). Most of the increase occurred in the "new construction" category. The increase in oil prices and recovery of the previously tighter liquidity conditions may have eased the pressure on companies and explain the increase in permits.

Table 2-3: Selected Construction Permits by Type

	2009:Q1	2009:Q2	2009:Q3	2009:Q4	2010:Q1
Demolition and New construction	26	10	16	16	19
New construction	893	764	618	622	709
Reclamation	1	3	3	1	3
Total	**920**	**777**	**637**	**639**	**731**

Sources: Ministry of Municipality Affairs and Agriculture

2.5 Overall Assessment of the Non-Financial Sector

Available data shows that the debt ratio for *households* has fallen further, despite interest rates on personal loans remaining within the same range. It can be inferred that household debt levels have improved as proxies for income data indicate that purchasing power has somewhat increased. Debt levels in the *business sector* have increased as rates also remained within the same range. It is noteworthy that business sector debt follows a cyclical trend, and this trend has been upward since the start of 2010.

For the *construction and real estate sector*, the decrease in material prices as well as increased liquidity (due to higher oil prices) indicated increased activity, particulary in new construction projects. However, these levels are nowhere near the heights reached in previous years as developers and agents are more cautious about economic prospects. With future trends still uncertain, this situation will continually need to be monitored.

Chapter

3

3. Financial Condition and Performance of the Banking Sector

Key Points

Slight increase in capital positions for conventional retail banks and decrease for conventional wholesale banks

Loan portfolios in conventional retail and wholesale banks remain concentrated

Decrease in capital positions for Islamic retail while they improve for Islamic wholesale

Increase in non-performing facilities for Islamic retail and decrease for Islamic wholesale

High concentration of assets in all Islamic retail and wholesale banks

Decline in earnings in all bank segments, with negative earnings in Islamic wholesale

3.1 Overview

This chapter analyzes the banking sector under the following categories: conventional retail banks (section 3.1), conventional wholesale banks (section 3.2), Islamic retail banks (section 3.3), and Islamic wholesale banks (section 3.4). Section 3.5 provides an overall assessment of the banking industry. Unless specified otherwise, the analysis in this chapter is based on consolidated financial data (Bahraini and non-Bahraini operations), as at end-March 2010.

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

3.2 Conventional Retail Banks

Retail banks slightly boost capital cushion[3]

Capital adequacy ratios for conventional retail banks slightly increased from 19.8% in September 2009 to 20.0% in March 2010. At a larger degree, the core capital ratio (ratio of Tier 1 capital to risk-weighted assets) rose to 17.2% from 15.8% in September 2009. Improvements in capital adequacy ratios were achieved by the direct addition of more capital rather than a reduction in risk weighted assets. Since bank lending continues to remain below pre-crisis levels, the slight boost in capital cushions is a means of strengthening resilience to any future shocks.

Slow decrease in non-performing loans

As economic activity has started to pick up slightly in the first quarter of 2010, loan delinquencies have begun to slowly decrease. As at end-March 2010, non-performing loans (NPLs) for conventional retail banks amounted to 5.9% of gross loans, lower than the 6.2% recorded in September 2009. Although local retail banks continue to show poorer asset quality than their overseas counterparts, their NPLs have decreased while those of overseas retail banks have increased. For *local retail banks*, the average NPL ratio dropped from 7% in September 2009 to 6.3% in March 2010, while the NPL ratio for *overseas retail banks* increased from 4.2% in September 2009 to 4.6% in March 2010.

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

Available data on the sectoral breakdown of impaired loans[4] indicates that half the sectors experienced a decrease in impairment between September 2009 and March 2010 (Table 3-1). The most notable decrease was in "construction/real estate" which fell from 3.7% to 2.3%. "Agriculture, fishing and forestry" underwent the largest drop from an impaired loan ratio of 44.1% in September 2009 to 5.0% in March 2010. However, given that this category accounts for only 0.3% of retail banks' total loans and advances, it is not deemed very significant.

Table 3-1: Retail Banks' Impaired Loan Ratios by Sector (% of gross loans to the sector)

	September 2009	March 2010
Consumer and Personal	4.5	5.2
Government	1.2	0.0
Construction/Real estate	3.7	2.3
Manufacturing	2.6	2.7
Mining & Quarrying	0.0	0.0
Agric, Fishing and Forestry	44.1	5.0
Financial	7.2	7.1
Trade	7.0	8.3
Services	1.7	2.3

Source: Central Bank of Bahrain

The highest impaired loan ratios were found in "Trade" which increased from 7.0% to 8.3% over the same period, followed by "Financial" which stood at 7.1%, down from 7.2% in September 2009. This indicates that trade and finance are the sectors most affected by the financial crisis and which continue to feel its repercussions. "Consumer and Personal" also appears to be affected with an increase in impaired loans ratio from 4.5% in September 2009 to 5.2% in March 2010.

Loan portfolios remain concentrated

Although the majority of sectors experienced slight decreases in concentration, the loan portfolio of *locally incorporated retail banks* remain concentrated. The "construction/real estate" sector continued to account for the highest concentration of loans at 33.4% in March 2010, up from 31.8% in September 2009 (Table 3-2). The top two recipient sectors ("construction/real

[4] 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.

estate and "consumer/personal") jointly represented 53.8% of loans in March 2010 compared to 53.4% in September 2009.

Notably, the largest decrease was in "financial" which fell from a high of 11.4% in September 2009 to 9.9% in March 2010. Similarly, "consumer and personal" also decreased from 21.6% in September 2009 to 20.4% in March 2010.

Table 3-2: Distribution of Local Retail Banks' Lending (% shares)*

	Mar. 2009	Sept. 2009	Mar. 2010
Consumer and Personal	19.9	21.6	20.4
Government	2.7	3.9	4.4
Construction/Real estate	23.9	31.8	33.4
Manufacturing	17.2	12.6	12.5
Mining & Quarrying	1.6	0.5	0.6
Agric, Fishing and Forestry	0.3	0.4	0.3
Financial	11.2	11.4	9.9
Trade	9.9	8.2	7.8
Services	13.3	9.6	10.7

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

End-March 2010 numbers continue to show high concentration risk for *overseas retail banks* (Table 3-3). The top recipient of loans was the "services" sector with 35.4% of total loans in both March 2010 and September 2009. The top two recipients of loans ("services" and "manufacturing") jointly accounted for 56.2% of total loans, up from 55.6% of total loans in September 2009.

Table 3-3: Distribution of Overseas Retail Banks' Lending (% shares)*

	Mar. 2009	Sept. 2009	Mar. 2010
Consumer and Personal	9.3	11.3	12.2
Government	2.2	1.0	0.9
Construction/real estate	11.8	12.8	12.2
Manufacturing	27.8	20.2	20.8
Mining & Quarrying	1.3	0.2	0.2
Agric, Fishing and Forestry	0.3	0.1	0.1
Financial	11.6	7.9	6.8
Trade	12.2	11.1	11.3
Services	23.5	35.4	35.4

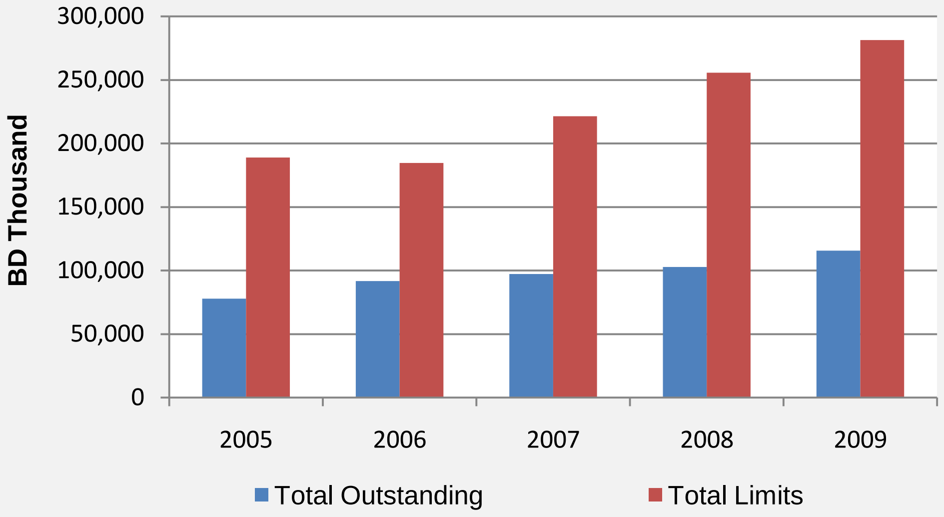
Source: Central Bank of Bahrain
**Figures may not add to a hundred due to rounding*

Box 1: Credit Card Lending in Bahrain

There are fifteen credit card issuers in Bahrain of which 13 are retails banks (3 Islamic and 10 conventional) and two are financing companies.

There has been a general increase in total credit card outstanding receivables (includes both rollover amounts[5] and delinquency amounts[6]) and in total credit card limits in Bahrain over the past 5 years. Total outstanding receivables increased from BD 77.9 million in 2005 to BD 115.7 in 2009, a 48.5% increase. Except for a slight fall to BD 184.6 million in 2006, total credit card limits have been steadily increasing to reach BD 281.4 million in 2009, a 48.9% increase from BD 189.0 million in 2005. These increases are attributed to increases in the number of credit card providers and customer reliance on credit (Box Chart 1).

Box Chart 1: Total Credit Limits & Outstanding (2005-2009)



Source: Central Bank of Bahrain.

The total amount of credit card receivables outstanding reached BD 115.7 million at end-December 2009, an increase of 9.3% compared with end-June 2009. The total amount of receivables outstanding includes both *rollover amounts* and *delinquency amounts.* Total credit card limits have increased

[5] ***Rollover amount***, represents "borrowing" and is the amount within total receivables in respect of which the cardholder has not fully repaid the statement balance but has at least made the minimum amount of payment required by the bank

[6] ***Delinquency amount*** is the total amount of credit card receivables overdue for more than 90 days and remains unpaid at the last day of the reporting month.

slightly from BD 280.4 million in June 2009 to BD 281.4 million in December 2009, a 0.4% increase (Box Table 1).

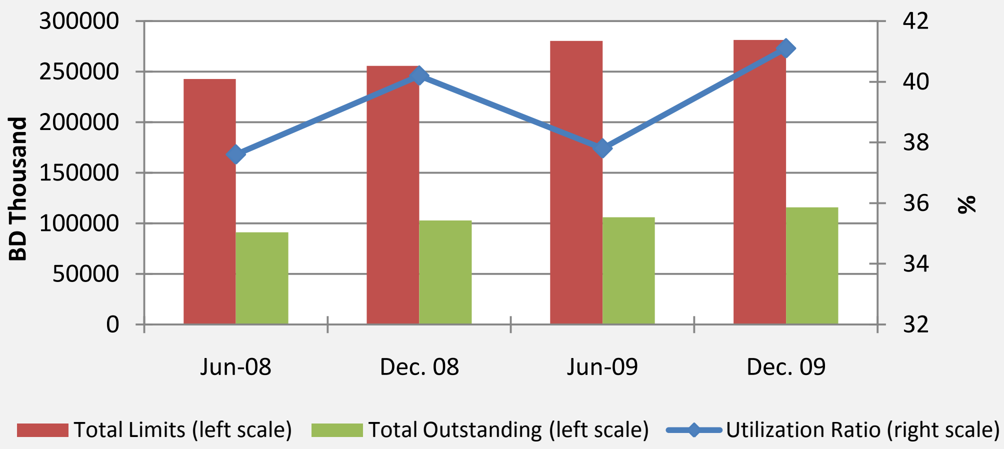
Box Table1: Total Credit Limits and Outstanding (June 09-Dec. 09)

	June 2009	December 2009	% Change
Total Outstanding	105.9	115.7	9.3
Total Limits	280.4	281.4	0.4

Source: Central Bank of Bahrain

The *utilization ratio*, measured by dividing total outstanding by total limits, indicates how much of the created limits are used by cardholders. Observing the trend from June 2008 to December 2009, there is a gradual increase in both the total credit limits and in the total outstanding receivables (Box Chart 2). The utilization ratio, however; was not as steady. It increased from 37.6% in June 2008 to 40.2% in December 2008 only to drop back to 37.8% in June 2009. This decrease is due to the total limits increasing at a faster pace than the total outstanding receivables. Yet, as of end of December 2009, the utilization ratio reached a high of 41.1% signifying that more customers are utilizing the available credit limits.

Box Chart 2: Total Credit Limits & Outstanding (June 08-Dec. 09)



Source: Central Bank of Bahrain

Fall in retail bank profitability

As at end-March 2010, return-on-assets (ROA) for *locally-incorporated banks* was 0.3%, down from the 0.9% recorded for September 2009. For *overseas banks*, ROA was 0.4%, compared to 1.3% in September 2009. Return-on-equity

(ROE)[7] for *locally-incorporated banks* dropped from 8.1% to 2.8% from September 2009 to March 2010.

A breakdown of data on retail banks' earnings shows that the fall in earnings was driven by increases in equity and in assets which grew by 17.5% and 6.5% respectively over the mentioned period. The drop in earnings can also be attributed to the decrease in their net interest income from 66.1% of total income in September 2009 to 64.4% in 2010.

Liquidity position improves

Between September 2009 and March 2010, bank deposits decreased while non-bank deposits increased for retail banks. Bank deposits went from contributing 33.2% of total deposits in September 2009 to 28.0% of total deposits in March 2010. Non-bank deposits, the largest form of deposits in retail banks, increased by 11.6% over the same time period thereby indicating an increase in the proportion of stable funds available to retail banks.

Consequently, the overall loan-deposit ratio for the segment decreased to 76.2%, compared to 77.7% in September 2009. Also, liquid assets as a proportion of total assets increased from 18.0% in September 2009 to 22.4% in March 2010. Similarly, liquid assets as a proportion of short-term liabilities also rose from 28.6% to 32.6% over this period.

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

3.3 Conventional Wholesale Banks

Capital adequacy decreases slightly[8]

As at end-March 2010, the regulatory capital adequacy ratio for locally-incorporated wholesale banks stood at 20.6%, a slight decrease from the 21.0% recorded in September 2009. The core capital adequacy position (ratio of Tier 1 capital to risk-weighted assets) decreased as well from 18.3% to 17.5% over the same period.

Increase in non-performing loans

Asset quality continues to deteriorate for wholesale banks. As at end- March 2010 loans classified as non-performing (NPLs) amounted to 6.4% of gross loans, up from the 4.5% recorded in September 2009. *Locally-incorporated wholesale banks* show an NPL ratio of 7.4%, higher than the 6.2% of September 2009. *Overseas wholesale banks* experienced a larger NPL ratio increase from 3.7% to 6.0% over this period.

Table 3-4: Wholesale Banks' Impaired Loan Ratios by Sector (% of gross loans to sector)

	September 2009	March 2010
Consumer and Personal	2.5	2.5
Government	0.1	0.0
Construction/Real estate	4.1	7.7
Manufacturing	1.2	1.7
Mining & Quarrying	0.01	0.0
Agric, Fishing and Forestry	1.9	2.3
Financial	4.8	3.3
Trade	8.2	18.7
Services	1.4	1.8

Source: Central Bank of Bahrain

Available data on the sectoral breakdown of impaired loans shows a jump in the impairment rate for the "trade" sector from 8.2% in September 2009 to 18.7% in March 2010 (Table 3-4). It should be noted that "trade" was only 0.6% in March 2009. A significant increase was also recorded for "construction/real estate" (from 4.1% to 7.7%). These two sectors could explain the increase in NPLs. On the other hand "financial" decreased from 4.8% to 3.3% over the same period.

[8] 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.

Loan portfolios remain concentrated by sector

An examination of lending patterns as at end-March 2010 shows that for *locally-incorporated wholesale banks*, the top recipient of loans ("manufacturing") accounted for 33.5% of total loans, up from 29% in September (Table 3-5). Also, the top two sectors (manufacturing and services) accounted for 55.2% of total lending, up from the 48.2% recorded for September. "Trade" experienced the fastest drop in concentration from 13.4% in September 2009 to only 8.1% in March 2010.

Table 3-5: Distribution of Local Wholesale Banks' Lending (% shares)*

	Mar. 2009	Sept. 2009	Mar. 2010
Consumer and Personal	3.3	2.4	3.1
Government	2.5	2.1	2.6
Construction/Real estate	13.0	13.7	10.2
Manufacturing	27.2	29.0	33.5
Mining & Quarrying	1.1	1.6	1.4
Agric, Fishing and Forestry	0.6	1.1	1.3
Financial	20.3	17.5	18.0
Trade	14.1	13.4	8.1
Services	17.8	19.2	21.7

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

In *overseas wholesale banks*, the top recipient of loans in March 2010 was the "services" sector, with 30.5% of total loans (vs. 31.6% in September) (Table 3-6). The top 2 sectors (services and financial) jointly represented 57.5% of total loans, up from the 54.9% recorded for September 2009.

Table 3-6: Distribution of Overseas Wholesale Banks' Lending (% shares)*

	Mar. 2009	Sept. 2009	Mar. 2010
Consumer and Personal	0.3	0.5	0.5
Government	7.0	7.4	8.1
Construction/Real estate	8.5	9.6	7.3
Manufacturing	21.1	18.2	15.7
Mining & Quarrying	3.2	2.7	4.0
Agric, Fishing and Forestry	0.3	0.6	0.4
Financial	21.9	23.3	27.0
Trade	5.9	6.1	6.5
Services	31.7	31.6	30.5

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

Earnings increase for wholesale banks

Earnings improved in March 2010 after the net losses experienced in September 2009. Return-on-assets (ROA) for the group was *positive* 0.1% compared to a *negative* 0.3% recorded in September 2009. ROA for *local wholesale banks* was slightly higher than *overseas wholesale banks* (0.3% vs. 0.1%). ROE for *local wholesale banks* increased from 1% to 1.8% from September 2009 to March 2010.

Mixed picture on liquidity

As at end-March 2010, the overall loan-deposit ratio for conventional wholesale banks stood at 85.4%, up from 81.5% in September 2009. The loan deposit ratio for *overseas wholesale banks* was 93.0% (compared to 90.2% in September 2009), while the loan-deposit ratio for local wholesale banks rose to 71.1% from 67.3% in September.

Liquid assets for wholesale banks decreased slightly from representing 20.4% of total assets in September 2009 to 19.9% in March 2010. While locally *incorporated wholesale bank*s had a liquid asset ratio of 31.0% in March 2010, *overseas wholesale banks* had a much lower ratio of 12.8%.

On a positive note, 34.5% of wholesale bank deposits were from non-bank sources, up from the 31.5% observed in September 2009.

3.4 Islamic Retail Banks

Decrease in capital positions

The capital adequacy ratio of Islamic retail banks fell to 20.7% by the end of March 2010 after rising to 24.5% by the end of September 2009. Correspondingly, the Tier 1 capital ratio also fell to 19.7%, a drop from the 22.2% in September 2009.

Increase in non-performing facilities

The asset quality of Islamic retail banks has continued to deteriorate, with non-performing facilities (NPFs) in March 2010 standing at 11.1%, a significant increase from the 5% in September 2009 and 3.5% in March 2009. A look at the sectoral breakdown of non-performing facilities indicates that the "services" sector now shows the highest level of NPF (21.9%), followed by "personal/consumer finance" (11.6%), and "construction/real estate" (12.1% each).

High asset concentration

As is the case with conventional retail banks, asset concentration risks continue to be an issue with regard to Islamic retail banks. As at end-March 2010, the top recipient of financing (construction/real estate) accounted for 35.5%, up from the 33.7% in September 2009. However, the top two recipients of financing (construction/real estate and financial) jointly represented 60.5% of total financing at end –March 2010, a minimal decrease from the 60.8% of total financing as at end-September 2009.

Decline in earnings

The return on assets (ROA) for Islamic retail banks fell to 0.4% in March 2010, down from the 0.8% in September 2009. Similarly, the return on equity (ROE) decreased from 5.0% to 2.5%. Available data shows that 79.4% of Islamic retail banks' income were in the form of net income from own funds, current accounts and other banking activities, while 20.5% of income came from jointly financed accounts and Mudarib fees. Operating costs fell to 54.6% of operating income, down from the 70.2% September 2009.

Liquidity picture worsens

The volume of liquid assets available to Islamic retail banks fell to 12.2% in March 2010 from 16.5% in September 2009. At the same time, the ratio of total facilities to deposits rose from 79.2% in September 2009 to 83.3% in March 2010.

3.5 *Islamic Wholesale Banks*

Improvement in capital position

As at end-March 2010, the regulatory capital adequacy ratio (CAR) for Islamic wholesale banks stood at 24.6%, up from the 22.7% in September 2009. The core capital ratio (ratio of Tier 1 capital to risk-weighted exposures) increased from 22.0% in September 2009 to 24.3% in March 2010.

Decline in non-performing facilities (NPFs)

As at end-March 2010, NPFs in Islamic wholesale banks decreased to 8.1%, compared to the 10.7% recorded for Sept 2009. A look at the sectoral breakdown of non-performing facilities shows that "manufacturing" had the highest level of NPF's 13.9% (lower than the 18.5% in September 2009), followed by "construction/real estate" and "services" both recording 12.9%.

Increased asset concentration

As at end-March 2010, the "financial" sector was the top recipient of financing from Islamic wholesale banks, accounting for 28.3% of total financing facilities. In September 2009, the top sector was the "services" sector representing 25.4% of total financing facilities. Also, the top two recipient sectors in March 2010 (services and financial) jointly represented 51.7% of total financing, compared to 47.1%% for the top-2 in September.

Negative earnings

The earnings performance of Islamic wholesale banks continues to be a concern. As a group, they registered net losses in the period to March 2010, with return on assets (ROA) deteriorating to -1.3% from the -0.3% in September 2009. Return on equity (ROE) also worsened from –1.2% in September 2009 to -5.5% in March 2010.

Net income from own funds, current accounts and other banking activities was -173.2% of operating income, a significant decrease from the 69.3% in September 2009. Another concern was the alarming jump in operating expenses from 82.2% of operating income in September 2009 to 785% in March 2010, resulting in a net *loss* for the year of BD 333.2 million.

Liquidity position improves

As at end-March 2010, liquid assets of Islamic wholesale banks represented 24.9% of total assets, an increase from the 21.3% in September 2009. Moreover, Islamic wholesale banks continued to reduce the facilities-deposit ratio, from 86.6% in September 2009 to 82.7% in March 2010.

3.6 *Overall Assessment of the Banking Sector*

The Bahraini banking sector is still experiencing the effects of the global financial turmoil. Non-performing loans/facilities have increased in some banking segments, with the NPF ratio reaching double-digits for Islamic retail (11.1%). All banking segments continued to show high levels of asset concentration and income prospects are not particularly bright for many banks (especially Islamic wholesale banks with negative earnings) in the current operating environment.

Economic activity is expected to start its revival in 2010 and therefore asset quality and earnings are predicted to improve yet at a slow delicate pace. Recovery may have begun in some banking segments as there is an improvement in the asset quality and liquidity positions of conventional retail banks. Earnings, however, might take some time to improve.

Chapter

4

4. Financial Condition and Performance of the Insurance Industry [9]

Key Points

Capital levels witnessed a minor decrease

Increase in the level of insurance receivables

Decrease in net income

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

4.1 Insurance Sector Trends

Improved capital and solvency positions

Capital levels for the Bahraini insurance sector witnessed a minor decrease during the review period, from 23.8% in Sept 2009 to 22.1% as at end-march 2010. As has been the case for the past three years, available capital exceeds required margins of solvency for both general and life business lines.

Insurance receivables increase and re-insurance ceded

The level of insurance receivables of gross premiums increased from 54.1% in September 2009 to 123.9% in March 2010. This is due to a decline of 49.0% in gross premiums from September 2009 to March 2010 and can be attributed to the effects of the global crisis on the prompt payment of premiums.

The risk retention ratio (net premiums written/gross premiums) continued to decline reaching 68.1% in March 2010 compared to 74.2% in September 2009 and 78.4% in March 2009. It has been pointed out in previous FSRs that this trend is attributable to uncertainties in the operating environment which has encouraged Bahraini insurers to pass along more underwriting risks to re-insurers, thus sharing risks more broadly in the current challenging environment.

Net income decreases

Insurance companies experienced a decline in net income of 7.7% year-on-year.

The *expense ratio* (ratio of expenses to earned premiums) increased in March 2010 to 29.2% from 26.3% in March 2009.

The *claims ratio* (ratio of claims incurred to premiums earned) increased to 59.4% in March 2010 compared to the 54.4% in March 2009.

As a result of these trends, the *combined ratio* (claims ratio plus expense ratio) in March 2010 was 88.6%, higher than the lower than the 80.7% ratio recorded in March 2009.

4.2 *Overall assessment of the insurance sector*

Solvency margins remain substantial and companies continue to share risks more broadly with re-insurance companies. Net income remains positive despite a decline. One area of concern is the increase in insurance receivables in the period up to March 2010 compared to the last financial stability report, reversing previous success in lowering the level of receivables.

Chapter

5

5. Performance of Equity Markets

Key Points

Year-on-year decline in market capitalization

Nonetheless, some sectors such as "hotel and tourism" recorded increases in market capitalization between October 2009 and May 2010

GCC markets have shown year on year decline

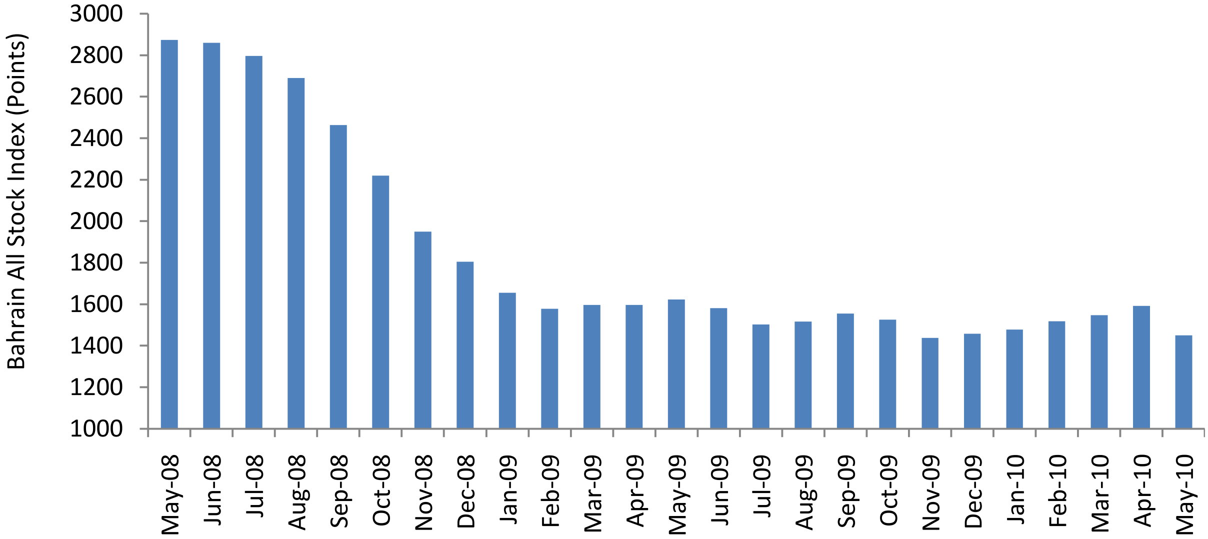
Market activity is likely to remain subdued for a few more months

5.1 Bahrain Market Trends

Downward trend in market index

A look at year-on-year data shows that the Bahrain All Share Index lost a total of 171.87 points (a 10.6% decrease) between May 2009 and May 2010 (Chart 5-1). The performance of the index has been considerably steady over the past year and did not experience any major decreases similar to the ones in 2008. The index decreased from May 2009 to July 2009 before increasing until September 2009 to be followed by another downturn. The index increased steadily from November 2009 until April 2010 before decreasing in May 2010.

Chart 5-1: Recent Trends in the BSE All-Share Index, May 2009-May 2010



Source of Data: Bahrain Stock Exchange

Slight increase in market capitalization

As at end-October 2009, market capitalization of the Bahrain Stock Exchange (BSE) stood at BD 6.4 billion, equivalent to 82.1% of 2009 nominal GDP (Table 5.1). This level of market capitalization is about 1.2% lower than the level as at end-October 2009 but 4.4% down *year-on-year*.

Table 5-1: Market Capitalization on the Bahrain Stock Exchange

(BD Million)

Sector	May 2009	Oct. 2009	May 2010	Oct 2009- May 2010 % change	May 2009- May 2010 % change
Commercial banks	2,321.0	2,335.1	2,402.1	2.9	3.5
Investment	2,820.1	2,382.0	2,431.7	2.1	-13.8
Insurance	196.5	1,67.4	174.2	4.1	-11.3
Services	1,142.6	1,219.9	1,154.8	-5.3	1.1
Industrial	13.9	17.5	16.6	-5.1	19.4
Hotel and Tourism	154.2	160.9	179.2	11.4	16.2
TOTAL	**6,648.3**	**6,282.9**	**6,358.7**	1.2	-4.4

Source: Bahrain Stock Exchange

A breakdown of market capitalization by sector indicates that the “Industrial”, “Hotel and Tourism”, “Commercial banks”, and “Services” sectors recorded year-on-year gains of 19.4%, 16.2%, 3.5%, and 1.1% respectively. The largest decline occurred in the “Investment” sector, where market valuation fell by 13.8%.

Many sectors registered an increase in market capitalization from the period of October 2009 to May 2010, with the highest being in the “Hotel and Tourism” sector (11.4%) and other sectors having modest gains. The only two declines were in the “Services” and “Industrial” sectors with declines of 5.3% and 5.1% respectively. That shows that there are signs of recovery from the impact of the global financial crisis.

Rise in price-earning ratios

As at May 2010, the price-earning ratio (P-E ratio) for the stock market stood at 11.40, an increase form the 7.28 and 7.81 attained in October 2009 and May 2009 respectively (Table 5-3). While the “Insurance” and “Industrial” experienced the biggest decreases in PE ratios and the “Services” sector experienced a minimal decrease between October 2009 and May 2010, all other sector saw increases in P-E ratios over the same period.

Table 5-2: BSE—Price-Earning Multiples

Sector	May 2009	Oct. 2009	May 2010
Commercial banks	9.80	9.83	13.08
Investment	6.44	4.93	14.99
Insurance	19.42	19.32	9.05
Services	7.25	7.74	7.68
Industrial	7.35	9.29	6.87
Hotel and Tourism	7.77	8.11	8.80
Total Market	**7.81**	7.28	11.40

Source: Bahrain Stock Exchange

Aggregate trading levels remain low

Trading continues to be thin on the BSE, with the turnover ratio (value of trading as a share of market capitalization) at around 0.11% compared to the 0.12% registered in Oct 2009 and 0.26% in May 2009. The bulk of the value of shares traded were in the "Commercial banks" sector, whose share of traded shares (by value) surged form 31.2% in October 20009 to 47.0% in May 2010 (Table 5-4). Other increases in value of shares traded were in the "Services" sector from 22.1% in October 2009 to 28.1% in May 2010 and the "Insurance sector that noticeably increased from 1.8% to 11.6% over the same period.

However, the biggest downward change occurred in the "Investment" sector, where the value of shares traded plummeted from 41.5% in October 2009 to 12.6% in May 2010.

Table 5-3: BSE—Value of Shares Traded by Sector (% shares of total trading)*

Sector	May 2009	Oct. 2009	May 2010
Commercial banks	29.4	31.2	47.0
Investment	50.0	41.5	12.6
Insurance	0.0	1.8	11.6
Services	20.5	22.1	28.1
Industrial	0.0	0.0	0.0
Hotel and Tourism	0.1	0.0	0.7

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

5.2 GCC Market Trends

A look at GCC market indices indicates year-on-year fall in all GCC markets with the exception of the Muscat Exchange, with small gain of 1.4%. The biggest year-on-year decreases in market indices in GCC markets was in Kuwait (-17.8%), followed by Dubai (-15.9%), and then by Bahrain (-10.6%).

If we concentrate on the period between October 2009 and May 2009, it appears that all GCC stock market indices were witnessing a decline with the biggest decreases in Dubai (-28.1%) and Abu Dhabi (-13.9%). However, it has to be noted that the declines are not as major as the previous declines registered early 2009.

Table 5-4: Stock Market Indices in GCC counties

Index	May 2009	Oct. 2009	May 2010	Oct.02009 - May 2010 change (%)	May 2009 - May 2010 change (%)
Bahrain All Share Index	1,622.15	1,525.83	1,450.28	-5.0	-10.6
Tadawul All Share Index	5,893.34	6,268.55	6,120.52	-2.4	3.9
Kuwait Market Index	8,150	7,347.5	6,699.7	-8.8	-17.8
Doha Stock Market 20 Index	6,980.76	7,135.08	6,785.96	-4.9	-2.8
Dubai Financial Market Index	1878.09	2,197.52	1,579.54	-28.1	-15.9
Abu Dhabi Index	2,679.41	3,023.10	2,604.17	-13.9	-2.8
Muscat Securities Market Index 30	6,209.960	6,354.920	6,294.430	-1.0	1.4

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

5.3 Overall assessment of the equity market

The global financial crisis continued to impact the performance of the Bahraini Stock Exchange, with declines in market capitalization and in the main price index. With the increase in oil prices, performance of GCC indices is expected to improve and shake off the effects of the crisis with a strong correlation to the movement in oil prices.

Available data indicates there are now signs of a recovery in the market as investor confidence begins to be restored, albeit tentatively. Despite the developments, the Bahrain Stock Exchange (BSE) continues to make efforts to strengthen its ties with other stock markets in an effort to offer a more attractive and profitable investment environment

Chapter

6

6. Payment and Settlement Systems

Key Points

Increase in the volume and value of transfers through the RTGS

Volume and value of cheques processed through the ACS also increased

Number of ATM withdrawals and value rose

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

6.1 Overview

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

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 Stock Exchange (BSE). This section describes recent trends in the *RTGS, ACS and ATM components* of the payments system.

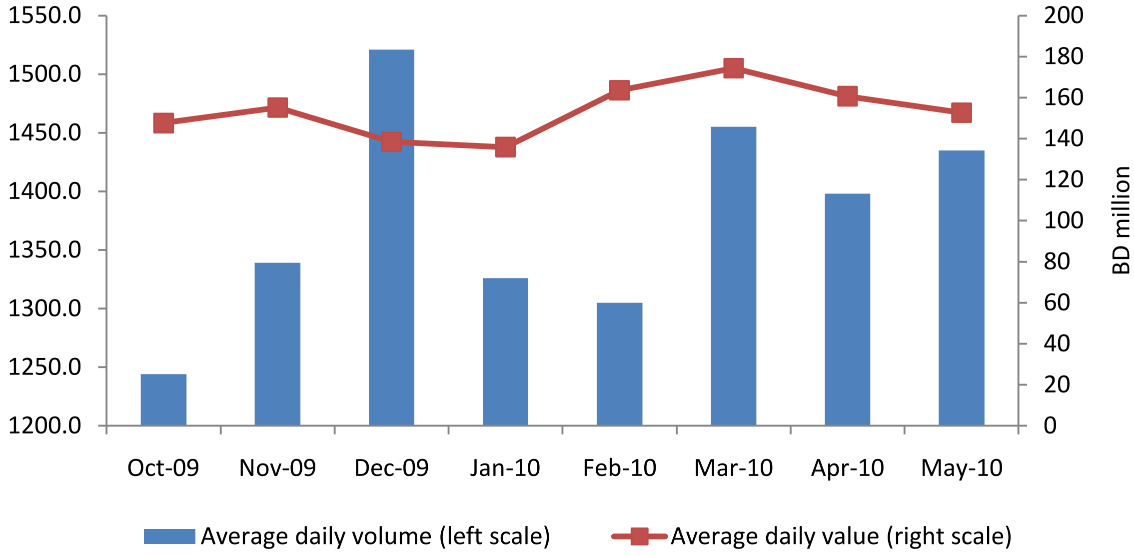
6.2 Key Trends in the Payments and Settlement Systems

Increase in volume and value of payments through RTGS

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

Chart 6-1 shows the volume and value of payments passing through the RTGS system between October 2009 and May 2010. Over this period, the *average daily volume of transfers* increased by 15.4% from 1,244 in October 2009 to 1,435 in May 2010. In value terms, there was a 3.4% increase in transfers was from a daily average of BD 147.6 million in October 2009 to BD 152.7 million in March 2010.

Chart 6-1: RTGS System: Average Daily Volume and Value of Payments Processed, October 2009 to May 2010

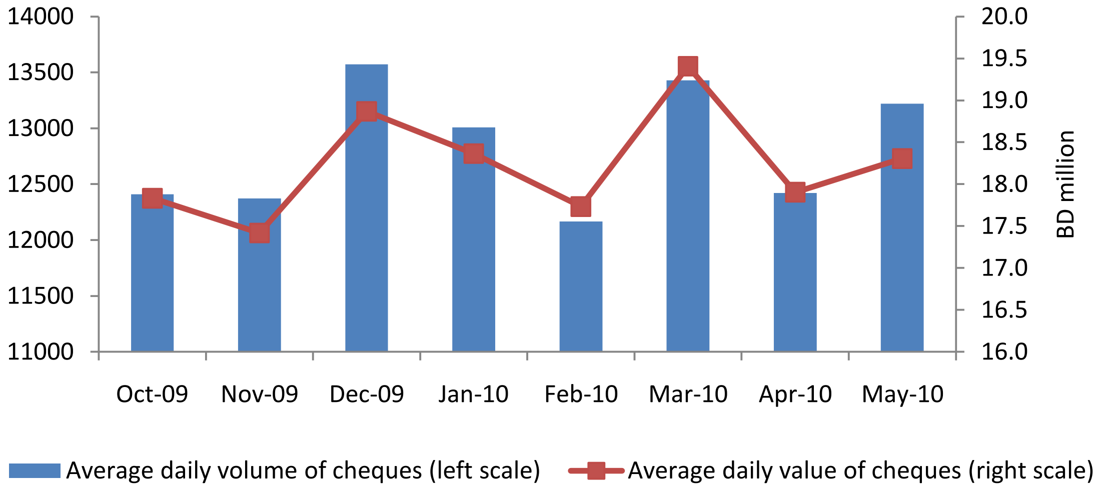


Source: Central Bank of Bahrain

Increase in average daily volume and value of cheques though ACS

In the period between October 2009 and May 2010, the *average daily volume* of cheques processed through the Automated Cheque Clearing System (ACS) increased from 12,409 in October 2009 to 13,220, an increase of 6.5% (Chart 6-2). The *average daily value of cheques* also increased from BD17.8 million in October 2009 to BD 18.3 million in May 2010 (2.8%).

Chart 6-2: ACS System: Average Daily Volume and Value of Payments Processed, May 2009 to October 2009

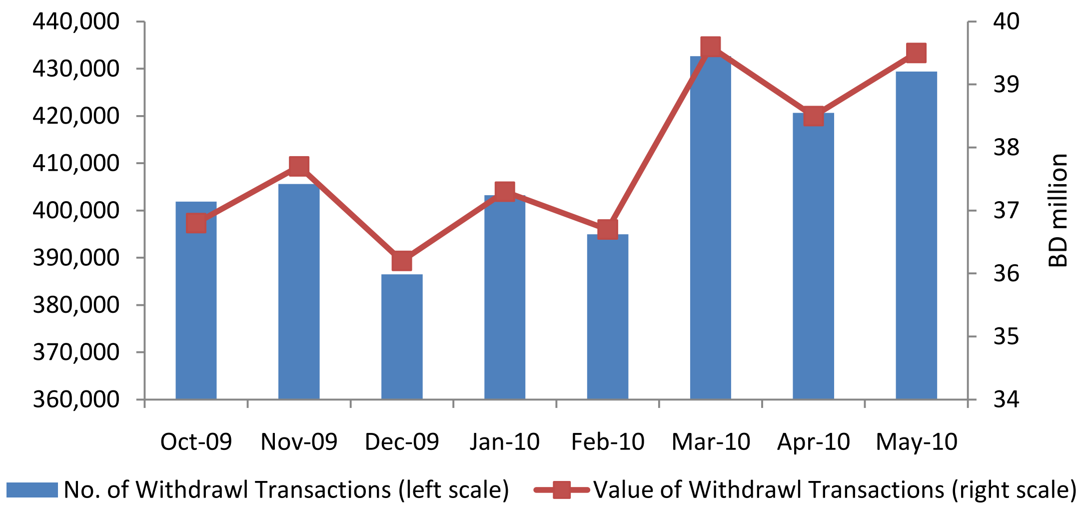


Source: Central Bank of Bahrain

Increase in number and value of ATM withdrawals

Between May 2009 and October 2009, the *number of withdrawal transactions* processed through the ATM Clearing System increased from 401,904 to 429,381 (6.8% growth) (Chart 6-3). Similarly, in *value terms*, total withdrawals processed increased from BD36.8 million in October 2009 to (7.3% growth).

Chart 6-3: Number and Value of ATM Transactions, October 2009- May 2010



Source: The Benefit Company

6.3 Overall assessment of the payments and settlements system

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

7. Annex: Banking Soundness Indicators

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

	March 2009	September 2009	March 2010
Capital Adequacy			
Total capital adequacy ratio (%) *	16.2	19.8	20.0
Tier 1 capital adequacy ratio (%) *	12.6	15.8	17.2
Leverage (assets/capital)(times)*	9.9	7.1	7.2
Asset Quality			
Non-performing loans (% of gross loans)	5.4	6.2	5.9
Specific provisions (% of NPLs)	37.9	46.7	51.9
Loan concentration (share of top-2 sectors) (%)	43.8	44.9	45.9
Earnings			
ROA Local retail banks (%)	0.4	0.9	0.3
ROA Overseas retail banks (%)	0.6	1.3	0.4
ROE Local retail banks (%)	5.7	8.1	2.8
Net interest income (% of gross income)	58.3	66.1	64.4
Net fees & commissions (% of gross income)	16.8	18.5	18.9
Operating expenses (% of gross income)	43.9	59.4	54.6
Liquidity			
Liquid assets (% of total assets)	18.4	18.0	22.4
Liquid assets (% of short-term liabilities)	30.9	28.6	32.6
Loan-deposit ratio (%)	68.4	77.7	76.2
Deposits from non-bank sources (% of total deposits)	63.4	66.8	28.0

** Locally-incorporated banks only*
*** 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)

	March 2009	September 2009	March 2010
Capital Adequacy			
Total capital adequacy ratio (%) *	20.4	21.0	20.6
Tier 1 capital adequacy ratio (%)*	17.8	18.3	17.5
Leverage (assets/capital)(times)*	5.9	5.2	5.8
Asset Quality			
Non-performing loans (% of gross loans)	1.6	4.5	6.4
Specific provisions (% of NPLs)	40.1	42.0	59.7
Loan concentration (share of top-2 sectors) (%)	50.3	49.5	52.3
Earnings			
ROA Local wholesale banks (%)	0.5	0.1	0.3
ROA Overseas wholesale banks (%)	0.03	-0.7	0.1
ROE Local wholesale banks (%) **	3.9	1.0	1.8
Net interest income (% of gross income)	113.9	65.9	44.5
Net fees & commissions (% of gross income)	10.7	24.0	34.8
Operating expenses (% of gross income)	29.0	108.3	67.3
Liquidity			
Liquid assets (% of total assets)	14.6	20.4	19.9
Liquid assets (% of short-term liabilities)	29.6	36.7	31.8
Loan-deposit ratio (%)	79.8	81.5	85.4
Deposits from non-bank sources (% of total deposits)	27.4	31.5	65.5

** Locally-incorporated banks only*
*** 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)

	March 2009	September 2009	March 2010
Capital Adequacy			
Total capital adequacy ratio (%) *	22.4	24.5	20.7
Tier 1 capital adequacy ratio (%) *	21.8	22.2	19.7
Leverage (assets/capital)(times)*	6.7	5.8	6.6
Asset Quality			
Non-performing facilities (% of gross facilities)	3.5	5.0	11.0
Specific provisions (% of NPFs)	46.2	44.0	24.0
Concentration of facilities (share of top-2 sectors) (%)	48.0	60.8	60.5
Earnings			
ROA (%)	0.5	0.8	0.4
ROE (%) **	3.5	5.0	2.5
Net income from own funds, current accounts and other banking activities (% of operating income)	77.4	72.9	79.4
Net income from jointly financed accounts and Mudarib fees (% of operating income)	23.1	18.5	20.5
Operating expenses (% of operating income)	56.6	70.2	54.6
Liquidity			
Liquid assets (% of total assets)	21.0	16.5	12.2
Facilities-deposit ratio (%)	74.6	79.2	83.3
Current accounts from non-banks (% of non-capital liabilities, excl. URIA)	14.3	16.5	44.1

** Locally-incorporated banks only*
*** ROE is defined as net profit over Tier 1 Capital.*
Source: Central Bank of Bahrain

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

	March 2009	September 2009	March 2010
Capital Adequacy			
Total capital adequacy ratio (%) *	25.2	22.7	24.6
Tier 1 capital adequacy ratio (%) *	25.2	22.0	24.3
Leverage (assets/capital)(times)*	4.4	4.5	4.1
Asset Quality			
Non-performing facilities (% of gross facilities)	5.3	10.7	8.1
Specific provisions (% of NPFs)	38.9	34.4	93.2
Concentration of facilities (share of top-2 sectors) (%)	51.0	47.1	51.7
Earnings			
ROA (%)	-0.2	-0.3	-1.3
ROE (%) **	-1.0	-1.2	-5.5
Net income from own funds, current accounts and other banking activities (% of operating income)	79.8	69.3	-173.2
Net income from jointly financed accounts and Mudarib fees (% of operating income)	21.9	31.1	265.2
Operating expenses (% of operating income)	87.8	82.2	785.8
Liquidity			
Liquid assets (% of total assets)	24.6	21.3	24.9
Facilities-deposit ratio (%)	108.0	86.6	82.7
Current accounts from non-banks (% of non-capital liabilities, excl. URIA)	21.6	26.6	25.9

** Locally-incorporated banks only*

*** ROE is defined as net profit over Tier 1 Capital.*

Source: Central Bank of Bahrain

END