



Financial Stability Directorate

Financial Stability Report

February 2014

Financial Stability Report February 2014

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

www.cbb.gov.bh

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

Table of Contents

Table of Contents	i
List of Tables	iii
List of Charts.....	iv
Preface.....	1
Executive Summary	2
Part I: Recent Developments in the International Financial Markets.....	5
1. Financial Stability Overview	6
1.1 Overview	7
1.2 Global Macro-financial Environment	8
1.2 Recent Trends in the Global Economy	8
1.3 Recent development in the Bahraini financial sector	14
1.3.1 Assessing the resilience of the Bahraini financial sector.....	14
1.3.2 Is the Bahraini Banking system resilient?.....	22
2. Non-Financial (Household and Business) Sector Overview	24
2.1 Overview	25
2.2 The Bahraini Households Sector	25
2.3 The Bahraini Corporate Sector.....	27
2.4 Construction and Real Estate	28
2.5 Overall Assessment of the Non-Financial Sector.....	29
Part II: Performance of the Banking Sector.....	30
3. Conventional Banks	31
3.1 Overview	32
3.2 Conventional Retail Banks	32
3.3 Conventional Wholesale Banks	36
3.4 Overall Assessment of the Conventional Banking Sector.....	39
4. Islamic Banks.....	40
4.1 Overview	41
4.2 Islamic Retail Banks.....	41
4.3 Islamic Wholesale Banks.....	44
4.4 Overall Assessment of the Islamic Banking Sector.....	46

Part III: Developments in the Equity Market and Payment Systems.....	47
5. Performance of Equity Market	48
5.1 Bahrain Market Trends	49
5.2 GCC Market Trends	52
5.3 Overall assessment of the equity market	53
6. Payment and Settlement Systems	54
6.1 Overview	55
6.2 Retail Payments.....	55
6.2.1 Cheques and paper based instruments	55
6.2.2 E-Payment systems	57
6.3 Wholesale Payments.....	62
6.4 Payment system and the degree of the financial inclusion in Bahrain	63
Annex: Financial Soundness Indicators.....	65

List of Tables

Table 1-1: Evolution of the size of the Banking sector in Bahrain since 2007	15
Table 3-1 Capital Provisions Ratios for Local Conventional Retail Banks	32
Table 3-2: NPL Figures for Conventional Retail Banks	33
Table 3-3: Retail Banks' Impaired Loan Ratios by Sector (% of gross loans to the sector)	33
Table 3-4: Distribution of Local Retail Banks' Lending (% shares)*	34
Table 3-5: Distribution of Overseas Retail Banks' Lending (% shares)*	34
Table 3-7: Capital Provisions Ratios for Local Conventional Wholesale Banks.....	36
Table 3-8: NPL Figures for Conventional Wholesale Banks.....	36
Table 3-9: Wholesale Banks' Impaired Loan Ratios by Sector (% of gross loans to sector)	37
Table 3-10: Distribution of Local Wholesale Banks' Lending (% shares)*	37
Table 3-11: Distribution of Overseas Wholesale Banks' Lending (% shares)*	38
Table 4-1 Capital Provisions Ratios for Islamic Retail Banks.....	41
Table 4-2: NPF Figures for Islamic Retail Banks.....	41
Table 4-3: Islamic Retail Banks' NPF Ratios by Sector (% of gross facilities to sector)	42
Table 4-4: Distribution of Islamic Retail Banks' Lending (% shares)*	42
Table 4-5: Liquidity Measures for Islamic Retail Banks	43
Table 4-7 Capital Provisions Ratios for Islamic Wholesale Banks *	44
Table 4-8: NPF Figures for Islamic Wholesale Banks	44
Table 4-9: Islamic Wholesale Banks' NPF Ratios by Sector (% of gross facilities to sector).....	45
Table 4-10: Distribution of Islamic Wholesale Banks' Lending (% shares)*	45
Table 4-11: Liquidity Measures for Islamic Wholesale Banks.....	46
Table 5-1: Market Capitalization on the Bahrain Bourse	50
Table 5-2: Price-Earning Multiples	50
Table 5-3: Value of Shares Traded by Sector (% shares of total value traded)*	51
Table 5-4: Most Active Stocks in November 2013 in terms of volume	51
Chart 5-4: GCC Indices June 2013 – November 2013	52
Table 5-5: Stock Market Indices in GCC counties	53
Table 6-1: Evolution of the number of ATMs in Bahrain	57
Table 6-2: Evolution of the number of POS and EFTOPOS in Bahrain.....	58
Table 6-3: Classification and Number of cards issued in Bahrain	59
Table 6-4: Financial Inclusion Indicators Bahrain.....	63
Table 6-5: Number of customer accounts*	64

List of Charts

Chart 1-1: Real GDP Growth in some Europeans countries (Quaterly%)	9
Chart 1-2: Real GDP Growth in Advanced Economies (Quaterly%)	9
Chart 1-3: Quaterly Real GDP Growth in BRICS	10
Chart 1-4: Real GDP Growth in GCC Countries (YoY %)	10
Chart 1-5: Yields on 10 Year Sovereign Bonds.....	11
Chart 1-6: Five Year Spreads on Credit Default Swaps	12
Chart 1-7: Global Equity Market Indices (Re-indexed to January 2008)	12
Chart 1-8: Various Currencies Against US dollar	13
Chart 1-9: Retail Banks' Assets (BD Billion).....	15
Chart1-10: Cathégorization of Retail Banks' Assets (BD Billion).....	16
Chart 1-11: Retail Banks' Assets (%) by Geographical Classification (2007)	17
Chart 1-12: Retail Banks' Assets (%) by Geographical Classification (2012)	17
Chart 1-13: Retail Banks' Assets (%) by.....	17
Chart 1-14: Wholsale Banks' Assets (USD Billion).....	18
Chart 1-15: Wholsale Banks' Assets (USD Billion).....	18
Chart 1-16: Wholesale Banks Assets by: Geographical Classification (2007) *	19
Chart 1-17: Wholesale Banks Assets by: Geographical Classification (2012) *	19
Chart 1-18: Wholesale Banks Assets by: Geographical Classification (September 2013) *	19
Chart 1-19: Total Deposits and total Domestic Credit (BD Million).....	21
Chart 2-1: Personal Loans and Advances (Volume and % of GDP)	25
Chart 5-1: Recent Trends in the Bahrain All-Share Index, November 2012-November 2013.	49

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:
 - o Chapter 1 reviews recent international and domestic macro-financial developments.
 - o 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:
 - o Chapter 3 evaluates the financial condition and performance of conventional banks
 - o Chapter 4 evaluates the financial condition and performance of Islamic banks.
- Part III: looks at the developments in equity market and payment and settlement systems.
 - o Chapter 5 reviews recent trends on the equity market.
 - o 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-March 2013 and end-September 2013.

Executive Summary

Global Macro Financial Environment Overview

During the first half of 2013, the U.S. economy continued to grow at a modest but uneven rate. Asset performance and profitability have been improving progressively. Nonetheless, risks to the recovery still exist. The global macro-financial environment has witnessed a new strengthening trend. Nevertheless, financial market volatility has amplified, principally in the second half of 2013 when the Federal Reserve announced that it could scale back its asset purchase program later this year, which generated a rise in yields and declines in prices of a variety of risk assets. In Europe, the European Central Banks 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.

During the previous period, global economic activity improved slightly but it remains subdued and growth remains uneven across countries and regions as well. Despite the recent 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. Markets remain sensitive to signs of indecisive political support for reforms needed to safeguard the stability of the currency union

The Bahrain's financial sector was resilient in the face of the different financial turbulences it had encountered in the past five years. The banking sector continues performing efficiently during 2012. As European leaders emphasized that the current crisis will end by spring 2013, we could expect that the economy of Bahrain and the regional economies would improve in a better global environment. Therefore, we could expect a growth in the banking and financial sector in Bahrain.

The Non-Financial Sector Overview

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 April 2013 to September 2013. Business loans and advances remained constant at an average of 43.2% of GDP.

Commercial licenses issued for construction increased steadily throughout the first three quarters of 2013, while real estate has seen a drop from 445 licenses in Q1 2013 to 364 licenses issued in Q3 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 18.5% in September 2013. Capital adequacy ratio for locally-incorporated wholesale banks was 22.4%. Loan delinquencies have shown a slight increase for conventional retail banks while remaining unchanged for wholesale banks. Loan concentration remains relatively stable for conventional retail and wholesale banks despite some decrease in some sectors.

As at end-September 2013, return-on-assets (ROA) increased to 1.4 from 0.7% in March 2013. Return-on-equity (ROE) for *locally-incorporated banks* increased from 7.4% in March 2013 to 15.0 %. ROA for the conventional wholesale banking sector was at 1.0% in September 2013, an increase from the 0.4% in March 2013. ROE for *local wholesale banks* nearly doubled from 2.2% to 4.3%. For conventional retail and wholesale banks, liquid assets as a proportion of total assets showed a decrease to 26.5% and 16.9% respectively.

Islamic Banks

The financial soundness indicators show that Islamic banks' (retail and wholesale) capital positions declined during the period. The capital adequacy ratio of Islamic retail banks decreased from 18.2% in March 2013 to 17.5% in March 2013. As at end-September 2013, the CAR for Islamic wholesale banks declined to 25.0% against 26.1% in March 2013.

The earnings picture looks better Since ROA and ROE witnessed growth. Non-performing facilities (NPFs) for Islamic retail banks dropped to 13.6% in September 2013 and 5.4% for Islamic wholesale banks. Facilities concentration has decreased for retail Islamic banks and wholesale Islamic banks. Moreover, Islamic retail banks experienced a strengthened liquidity position as the liquid asset ratio increased while the facilities to deposit ratio decreased slightly. Wholesale Islamic liquidity positions weakened slightly while liquid assets reduced marginally and facilities to deposit ratio increased.

Performance of Equity Markets

A look at *year-on-year* data shows that the Bahrain All Share Index increased by 159.74 points (15.2%) between November 2012 and November 2013. As at end-November 2013, market capitalization of the Bahrain Bourse stood at BD 6.7 billion (Table 5-1). This level of market capitalization is 13.6% higher than the level as at end-June 2013 and 17.0% higher *year-on-year*.

Trading increased in the Bahrain Bourse, with the turnover ratio (value of trading as a share of market capitalization) at around 0.32% in November 2013, an increase from the 0.26% in June 2013 and 0.09 in November 2012. The bulk of the value of shares traded in November 2013 was the "Investment" sector whose traded shares (by value) represented 79.8% of total shares traded. However, commercial banks shares represented 16.4% of the total shares traded in November 2013, down from 80.3% in June 2013.

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) increased by 6.4% (year-on year increase of 4.7%). The average daily value of cheques increased by 1.8%.

The availability of cash has increased over the past decade, thanks to the growing number of ATMs. The number of ATM's in Bahrain grew in 2012 by a total of 33 ATM's reaching a total 483 compared to 450 ATM's in 2011. Between May 2013 and November 2013, the number of withdrawal transactions processed through the ATM Clearing System decreased by 3.8% (year-on-year growth was 15.9%). in value terms, total withdrawals processed decreased by 2.1% (year-on-year growth was 10.2% growth).

Between May 2013 and November 2013, the *average daily volume of transfers* increased by 13.6% (22.6% year-on-year increase). The *average daily value of transfers* witnessed a 11.5% (20.3% year-on-year increase).

Part I:

Recent Developments in the International Financial Markets

Chapter

1

1. Financial Stability Overview

Key Points

Recent indicators show tentative signs of an improved growth outlook

Global financial market sentiment has improved since the previous report but it remains fragile.

Fiscal and banking sector problems in the Eurozone remain a serious threat to global financial stability

The Bahraini financial sector is performing effectively with no major financial stability concerns.

1.1 Overview

It has been almost six years since the onset of the financial crisis and the global economy remains unable to sustain a decent recovery. Despite the renewed robustness of financial markets and confidence returning in several economies, overall growth has continued to be weak and the situation has even de-generated in some countries.

During the first half of 2013, the U.S. economy continued to grow at a modest but uneven rate. Asset performance and profitability have been improving progressively. Nonetheless, risks to the recovery still exist. Uncertainty with respect to the U.S fiscal imbalances and the fear of an eventual exit from the Federal Reserve's quantitative easing could inhibit growth at the margin. Similarly, the recovery in the Euro Area is proceeding, albeit at a very slow pace. The weakness in household consumption stemming from the adjustment of internal and external imbalances and more particularly from de-leveraging is projected to decline sluggishly. The weakness in the domestic demand reveals the erosion of real disposable incomes that were affected by rising energy and food prices and especially from fiscal consolidation. To ensure financial stability in the Eurozone, the European Stability Mechanism (ESM) could use up to €60 billion to recapitalize banks directly. The ESM is expected to be effective for bank recapitalizations in late 2014; however it is still not clear whether banks affected by the recent crisis would be eligible to receive ESM support.

Despite the improvement in some macroeconomic indicators, notably in Greece and Cyprus, and the recent positive signs of growth, the recovery in the Euro Area is still fragile. In fact profitability of the Euro Area banking system remains low and non-performing loan ratios have recently increased. A number of banks in the Euro Area still cannot access wholesale capital markets. Thus there is still a chance that negative outcomes in the region could hurt global financial stability. This shows that banks are still exposed to a variety of risks. The most important risks are linked to the fragmentation of financial markets.

With regards to emerging market economies, some countries such as China and India have still not experienced a significant rebound and have not yet reached pre-crisis growth levels. These countries have recently experienced huge outflows of capital following several key speeches by the chairman of the Federal Reserve, Ben Bernanke, who indicated that the US Federal Open Market Committee would slow down its program of asset purchases. Consequently, asset prices in emerging economy declined notably in BRICS countries followed by huge movements of capital into developed economies' assets.

The MENA region, as an important bloc of the world economy, was not immune from the global macroeconomic weaknesses. Despite the recent economic performance realized over the last decade, the global financial crisis followed by the “Arab Spring” and recently the European sovereign debt crisis have disrupted the regional macroeconomic stability, and produced further 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

Recently, the global macro-financial environment has witnessed a new strengthening trend. Nevertheless, financial market volatility has amplified, principally in the second half of 2013 when the Federal Reserve announced that it could scale back its asset purchase program later this year, which generated a rise in yields and declines in prices of a variety of risk assets. In Europe, the European Central Banks 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.

1.2 Recent Trends in the Global Economy

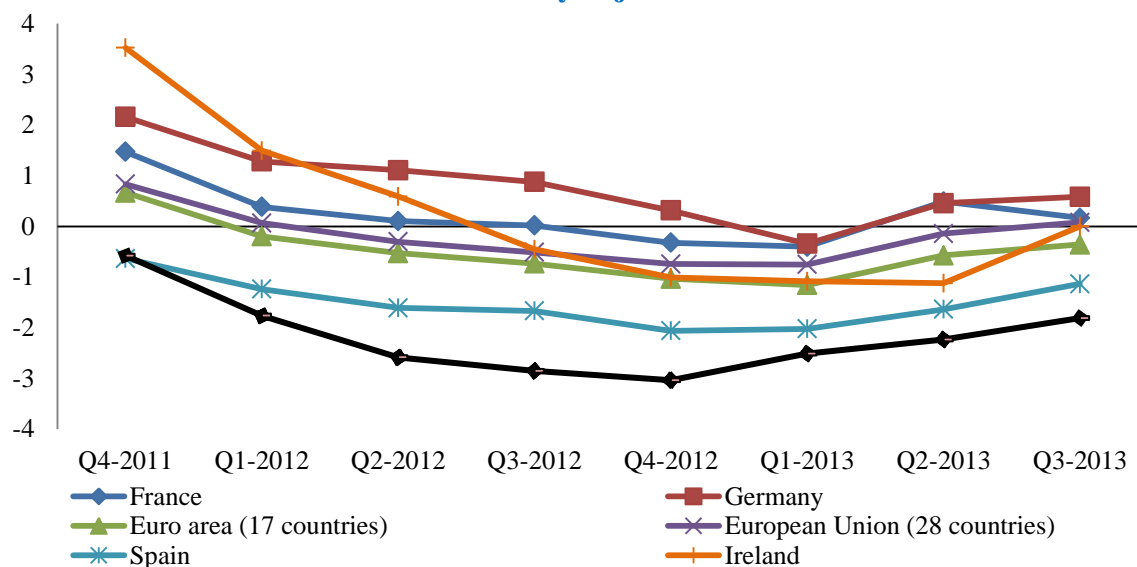
A- GDP Growth

During the previous period, 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 the Euro Area (17 countries) has experienced a recession during the first three quarters of 2013 while the Eurozone (27 countries) has experienced a recession during the first two quarters but the signs of recovery appeared in the third quarter of the current year with a positive growth rate of 0.08%. The risks surrounding the economic outlook for the Euro Area are evaluated to be on the downside. The recent volatility in the financial and money markets associated with the global uncertainties could impede the recovery of the Eurozone as the economic conditions remain fragile.

At a country level study, Germany remains the best performing economy in the Eurozone. After a contraction in the first quarter of 2013, the German economy grew by 0.5 and 0.6 per cent in the second and the third quarters respectively.

In France, economic activity remains weak but the country recorded a positive growth in the second and the third quarters of the current year by 0.48% and 0.16 % respectively. In Italy and Spain, GDP continues to be negative for the ninth consecutive quarter but with the pace of contraction slowing continuously.

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

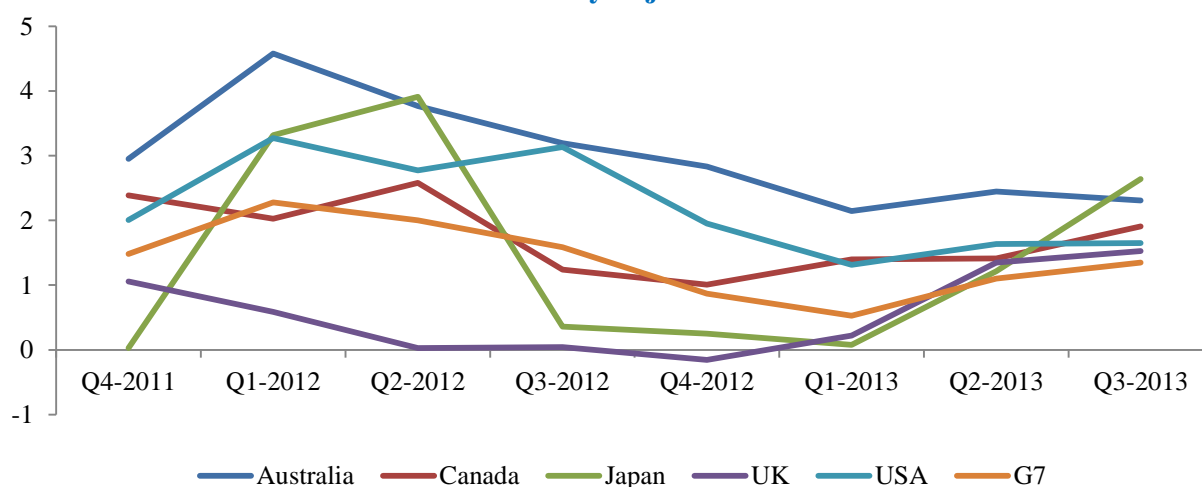


* Growth rate compared to the same quarter of previous year, seasonally adjusted

Source: OECD Quarterly National Accounts

Regarding non-European countries (Chart 1-2), the economic condition improved slightly, especially in Japan which recorded a positive GDP growth of 2.6% in the third quarter of 2013 and economic activity has remained robust, supported by expansionary fiscal and monetary policies. Recently, the Bank of Japan expected the recovery to speed up by the beginning of 2014 and it forecasts real GDP growth to reach 3 per cent by the end of 2014. In the United States, growth was positive (0.6%) in the beginning of the 2013 but the fiscal consolidation program initiated in March 2013 hampered the pace of growth. The private demand has been quite robust, as the gradual improvement in household balance sheets has supported housing investment and private consumption.

Chart 1-2: Real GDP Growth in Advanced Economies (Quarterly%)
Seasonally adjusted

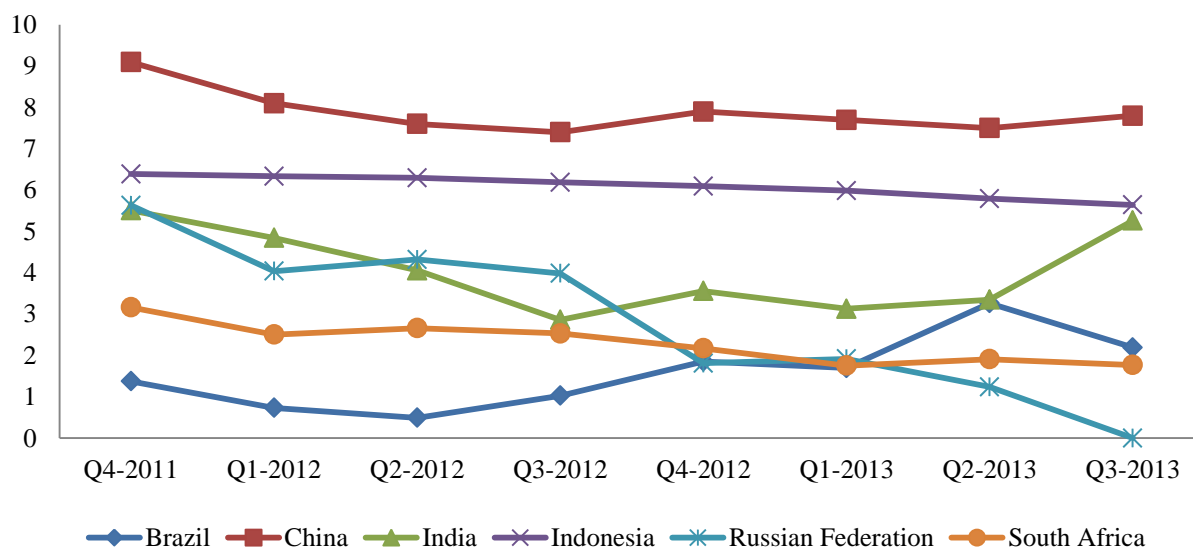


* Growth rate compared to the same quarter of previous year, seasonally adjusted

Source: OECD Quarterly National Accounts

Turning now to emerging economies (Chart 1-3), they have experienced a fairly broad-based slowdown in the first two quarters of 2013 notably following the announcement of Chairman Bernanke in late May suggesting that the Federal Reserve may taper its asset purchase program known as QE. Consequently, these countries have experienced huge amount of capital outflows which had immediate impact on growth. The BRICS countries (Brazil, Russia, India, China, and South Africa), growth was positive (5.6%) but it is far from its previous level (10.75% in 2007).

Chart 1-3: Quaterly Real GDP Growth in BRICS

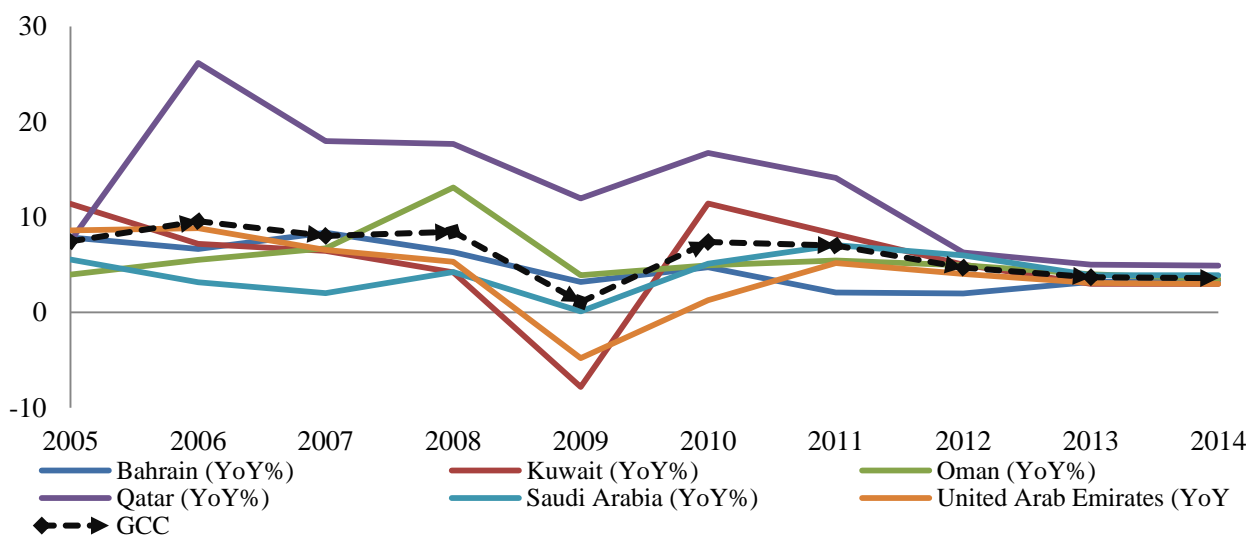


Growth rate compared to the same quarter of previous year, seasonally adjusted

Source: OECD Quarterly National Accounts

Regarding the GCC region, solid economic growth was experienced (5.2%) in 2012, thanks to high oil and energy prices which in turn boosted the regional economy and reduced the weight of debts. The IMF forecasts that GCC economic performance will continue to improve further in 2013 and 2014 (chart 1-4) with a growth rate of 3.7 and 4.1% respectively.

Chart 1-4: Real GDP Growth in GCC Countries (YoY %)



Growth rate compared to the same quarter of previous year, seasonally adjusted

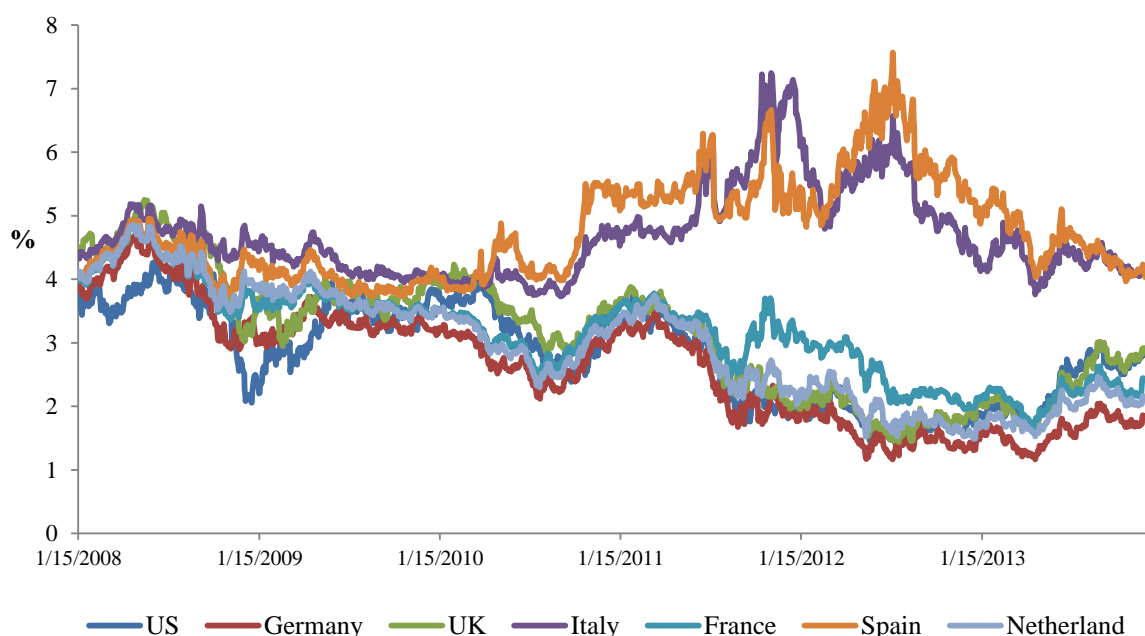
Source: Bloomberg

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. The rise could trigger market volatility, expose interest rate risk among investors and borrowers, and impede economic recovery.

It appear that the highly accommodative monetary policy (quantitative easing program) by major central banks have calmed the volatility of stock market and reduced the systemic risk. As we can see in Chart 1-5, recent actions by central banks and policymakers have narrowed modestly the spreads on euro area periphery government bonds.

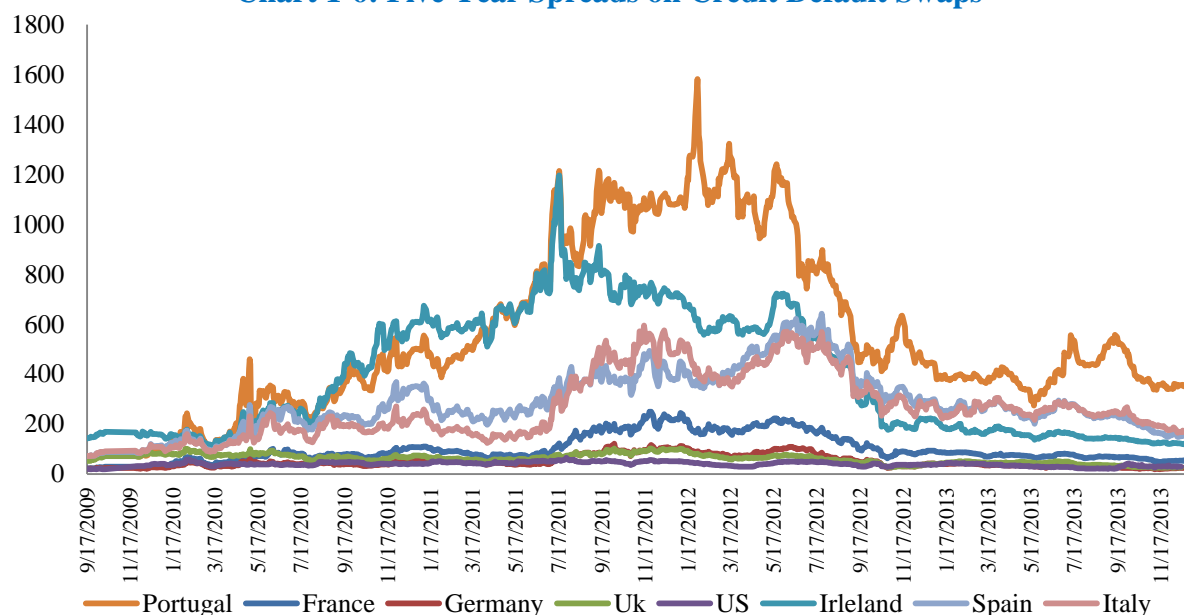
Chart 1-5: Yields on 10 Year Sovereign Bonds



Source: Bloomberg

CDS spreads are a fundamental metric of default risk. Broadly, a higher spread on the CDS implies a greater risk of default for the reference entity. Chart 1-6 provides information as to how financial markets perceive the risk of default on corporate and sovereign debt. It illustrates spreads on five-year CDS in some European countries and the US since 2009. Prior to the crisis, CDS spreads were low for all of the referenced countries, showing that investors placed low probabilities on these countries defaulting on their debt. The policy measures launched by the European Central Bank have declined the financing cost and increased liquidity and profitability of banks.

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



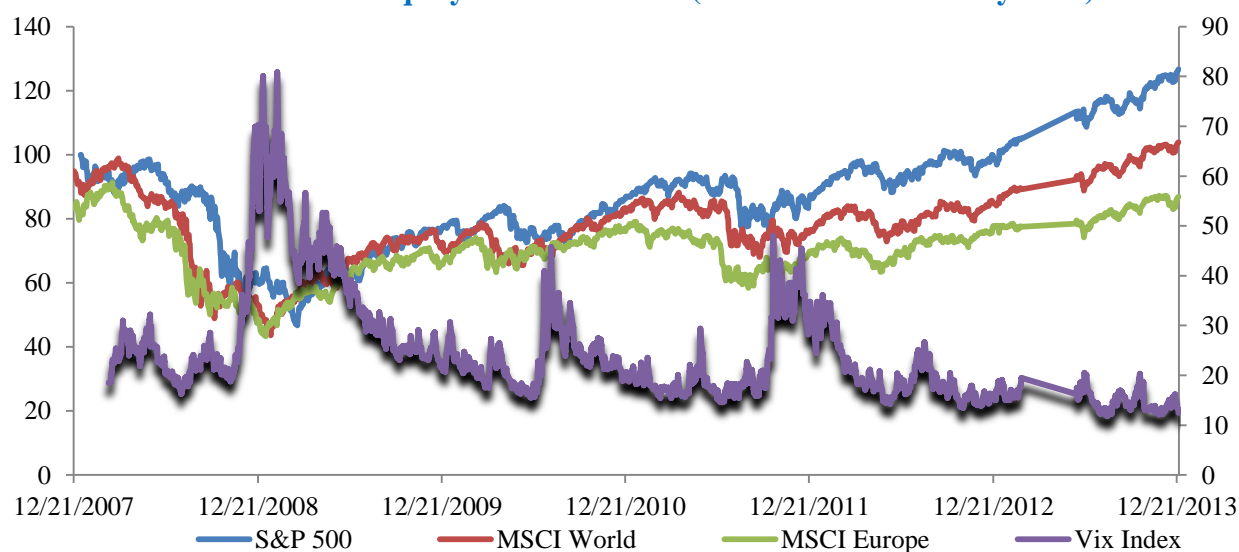
Source: Bloomberg

Consequently, financing conditions have improved for many banks and deposit flows have stabilized. Furthermore, the average five-years CDS spreads declined considerably (Chart 1-6) in most advanced economies, but it is still relatively high in peripheral countries, notably in Portugal and Spain.

Regarding global equity markets, chart 1-7 below shows that following a period of hesitation and uncertain sentiments, 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.

In the middle of May 2013, European equity prices were 25% higher than a year earlier. In its monthly bulletin published in April, the European Central Bank (ECB) pointed to signs of a renewed growth momentum.

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



Source: Bloomberg

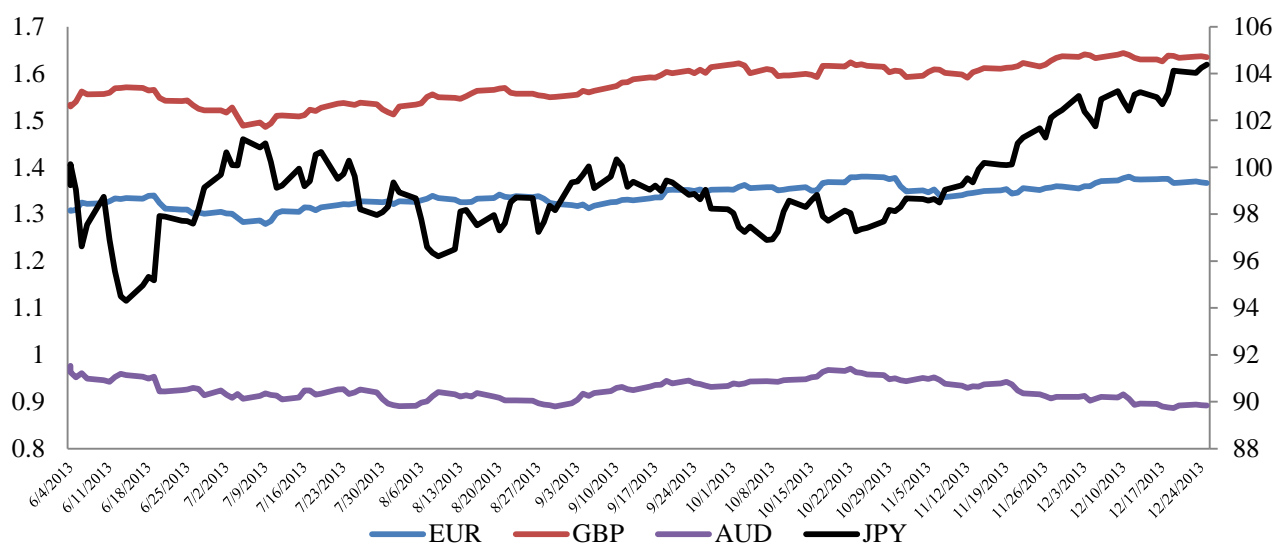
C- Volatility of the major currencies

The Euro was relatively stable against the US dollar as compared to the previous volatilities. It recorded the highest rate in October 24th 2013 with US \$1.3805 and also recorded the lowest rate by July 9th 2013 (US \$1.2792). On average the Euro was exchanged at around US\$ 1.33 during the second half of 2013 (chart 1.8). The rebound 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. Moreover, the dollar depreciated after the Fed announced it would reduce its monthly asset purchases by \$10 billion, bringing them down to \$75 billion.

Regarding the Pound, it appreciated slightly during the second quarter of 2013 moving from US\$1.48 in July 2013 to US\$1.64 in December 2013. Regarding the Australian Dollar, it depreciated slightly in the second half of 2013 and it recorded its lowest level of the year in December 25th when AUD \$1 was exchanged against US \$0.8916.

Finally, the Japanese Yen was stable during the third quarter of 2013 and then it appreciated slightly against the US dollar over the fourth quarter. In the end of December 2013, the dollar was exchanged against JPY104.38, the strongest since April 2009.

Chart 1-8: Various Currencies Against US dollar



Source: Bloomberg

C- The Eurozone and the Global financial stability

Despite the recent 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. Markets remain sensitive to signs of indecisive political support for reforms needed to safeguard the stability of the currency union. Another risk to global financial stability relates to the exit from highly accommodative monetary policy by major central banks, with potential costs to being either too early or too late. 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 continue to weigh negatively on the global financial market. The weak economic performance in Europe, combined with potentially a period of low interest rates and continued weak market growth remain key concerns in European and international markets. Moreover, the fiscal imbalances in PIIGS countries (Portugal, Italy, Ireland, Greece, and Spain) remain unsustainably high, with the prospect of painful deleveraging persisting for a number of years. Ensuring sustainable economic growth is the only path to restore confidence of investors, but until now it remains the principal challenge for European policymakers.

1.3 Recent development in the Bahraini financial sector

As already mentioned in the previous financial stability report, Bahrain's financial sector was resilient in the face of the different financial turbulences it had encountered in the past five years. First, there was the financial crisis which lead to a global liquidity squeeze, then the shocks of the two wholesale banks, Awal and The International Banking Corporation (TIBC), being put into administration, followed by the Islamic banks' exposure to the leveraged real estate market, the events of February and March 2011 and now the debt crisis in Europe which is becoming an international financial issue.

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.

1.3.1 Assessing the resilience of the Bahraini financial sector

a- 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 2013, the banking sector in Bahrain was made up of 129 institutions of which 29 are retail banks, 74 are wholesale banks and 26 are representative offices. In the third quarter of 2013, the total assets of the banking sector amounted to USD 185.32 billion. Bahrain's banking sector represented 11.9 times of GDP in 2006 and 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 2011, the size of the banking sector fell by almost 50% to 6.8 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 4.5 in 2011. Further, Table 1 shows that the size of the retail banking sector diminished slightly during the same period and it recorded an increase in 2012 to become 2.47 times the GDP. Despite the contraction in the banking size, the Bahraini financial and banking sector are still performing well and represent 15.6% of GDP in 2012 (CIO Bulletin 2013/Q1). There are no major or minor effects of the drop of the overall size of the banking sector in the economy of Bahrain. This shows that the weight of wholesale banks in Bahrain is not significant compared to domestic banks. Therefore, we can conclude

that retail banks in Bahrain are the main engine for the financial sector growth in the Kingdom.

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

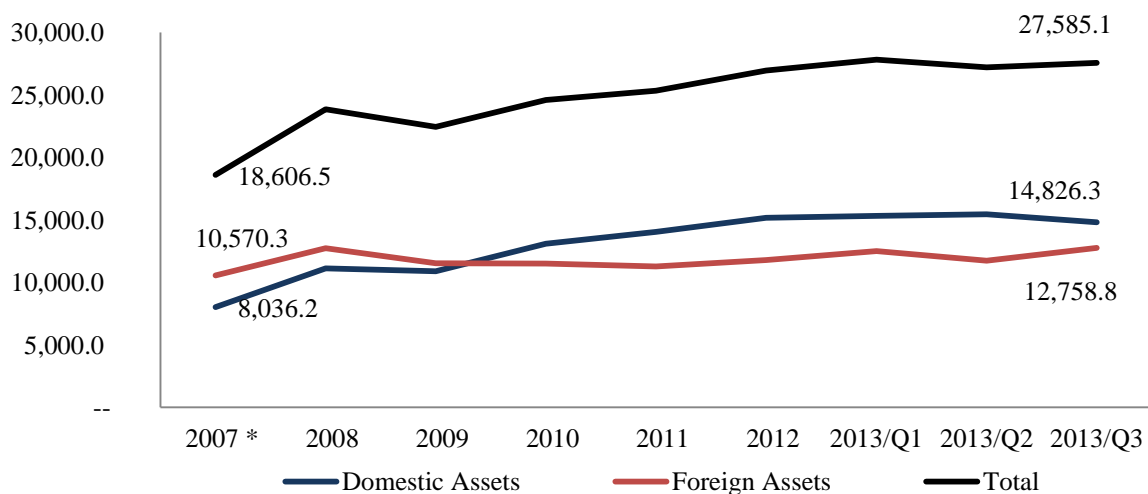
	2007	2008	2009	2010	2011	2012	2013/ Q1	2013/ Q2	2013/ Q3
Size of the Banking sector (times GDP)	13.4	11.5	11.5	11.5	6.8	6.9	6.4	6.3	6.1
Consol. B.S. Retail (USD billion)	49.5	63.5	59.8	65.4	67.3	71.7	74.0	72.35	73.36
<i>As times of GDP</i>	2.69	2.9	3.09	3.38	2.32	2.47	2.43	2.38	2.41
Consol. B.S. Wholesale (USD billion)	196.3	188.9	162.	157.7	129.0	127	121.3	119.9	111.9
<i>As times of GDP</i>	10.7	8.6	8.4	8.1	4.5	4.4	4.1	4.0	3.7

Source: CBB Statistical Bulletin

b- Market Capacity

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 27.5 billion in as of September 2013 (see Chart 1-9).

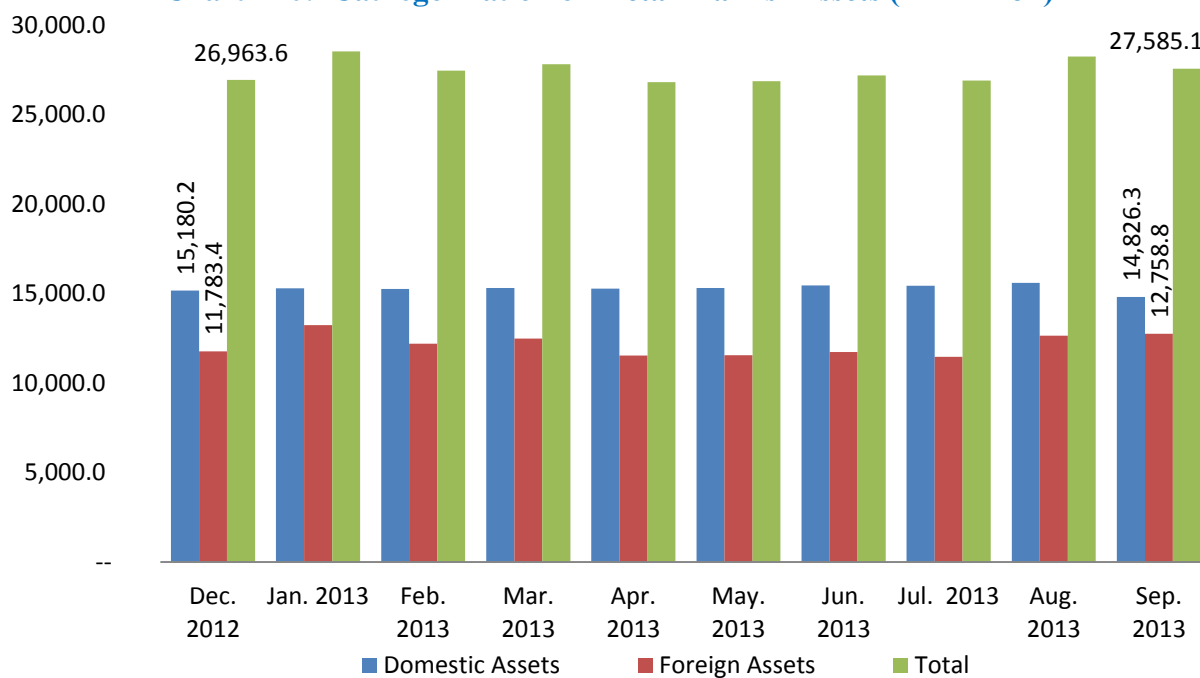
Chart 1-9: Retail Banks' Assets (BD Billion)



Source: Central Bank of Bahrain

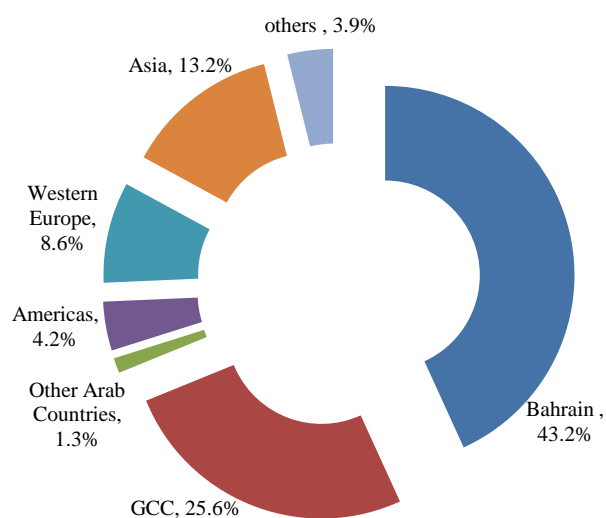
Retail banking total assets continued growing since December 2012 moving from BD 26.9 billion to BD 27.5 billion as of end-September 2013 (see Chart1-10). This increase in retail banking assets was driven by domestic assets which contributed to 46.2% of total assets at end-September 2013, up from 43.7% at end-December 2012.

Chart1-10: Categorization of Retail Banks' Assets (BD Billion)

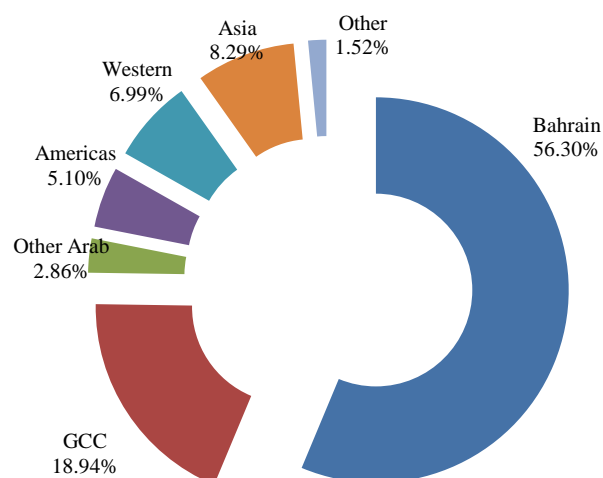


Source: Central Bank of Bahrain

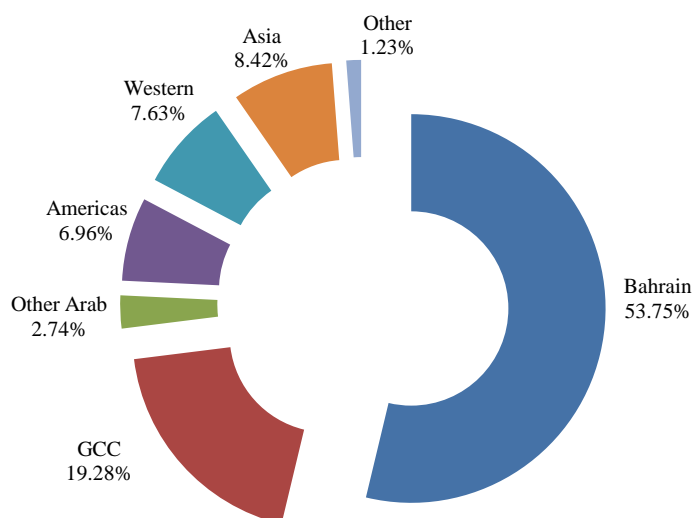
According to the charts below, it is crucial to notice that most of the 46.25% of foreign assets are GCC assets (19.28%). The level of Western and American in retail banking assets was 13% in 2007; which became 14.6% at the end of September 2013. This shows that the retail banking sector in Bahrain is lightly exposed to foreign risk from U.S and Western Europe.

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 (2012)

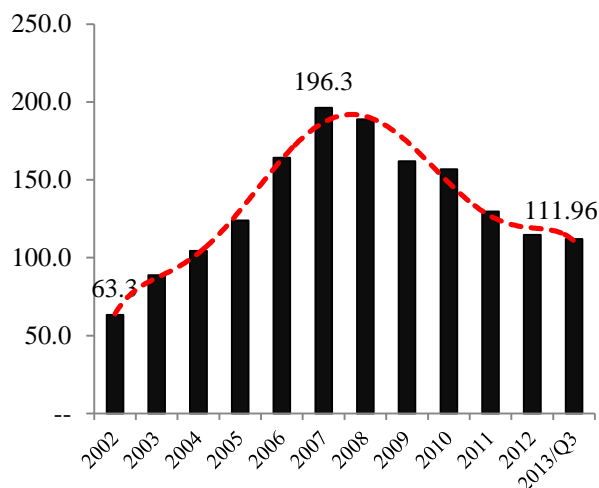
* For conventional and Islamic retail banks
Source: Central Bank of Bahrain

Chart 1-13: Retail Banks' Assets (%) by Geographical Classification (September 2013)

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

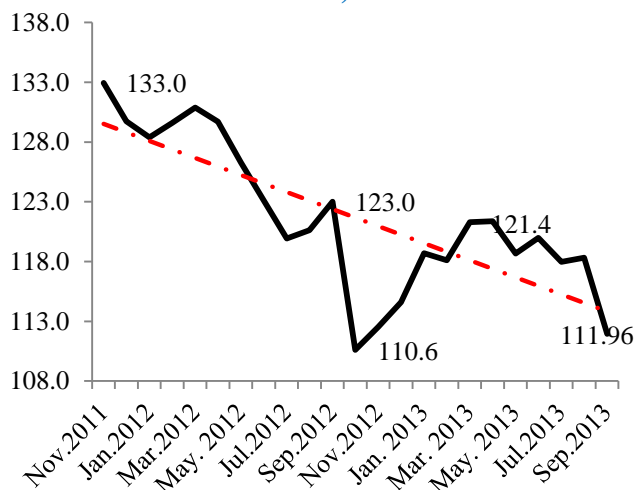
In contrast to the retail banking sector, the wholesale banking sector witnessed a drop in its total assets from USD 196.3 billion in 2007 to USD 111.96 billion as at end-September 2013, hence a decrease of 42.9%. (See Chart 1-14/15)

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



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

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



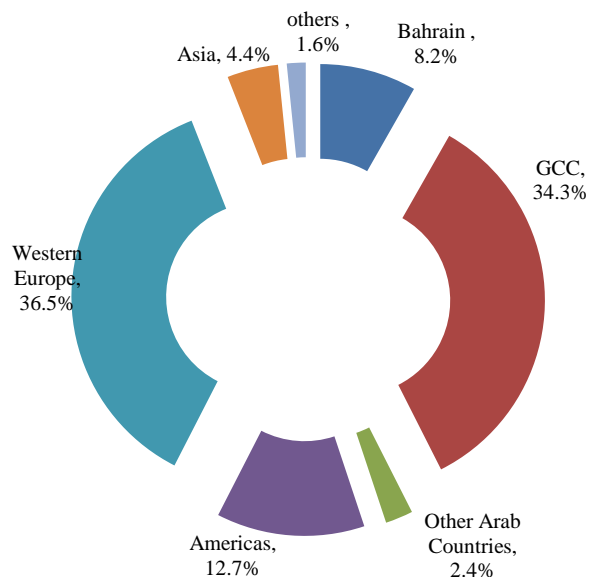
* For conventional and Islamic wholesale banks
Source: Central Bank of Bahrain

It is crucial to note that the most important drop is recorded in the GCC area which fell from 34.0% in 2007 to 27.5% at end-September 2013 (see chart 1-16/17).

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

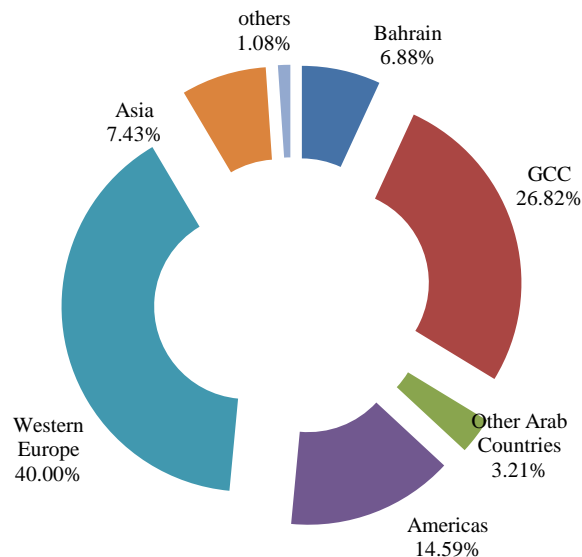
- Despite the subprime crisis, the share of America's total assets has slightly decreased from 13.0% of total assets in 2007 to 12.9% at end- September 2013.
- Despite the European sovereign debt crisis, the share of Western Europe's total assets remained stable during the past three years.
- There is a further increase of Asian assets which moved from 4.0% from 2007 till 2011 to 7.9 % at end-September 2013.
- GCC total assets dropped by 45.8% between 2007 and at end-September 2013.

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



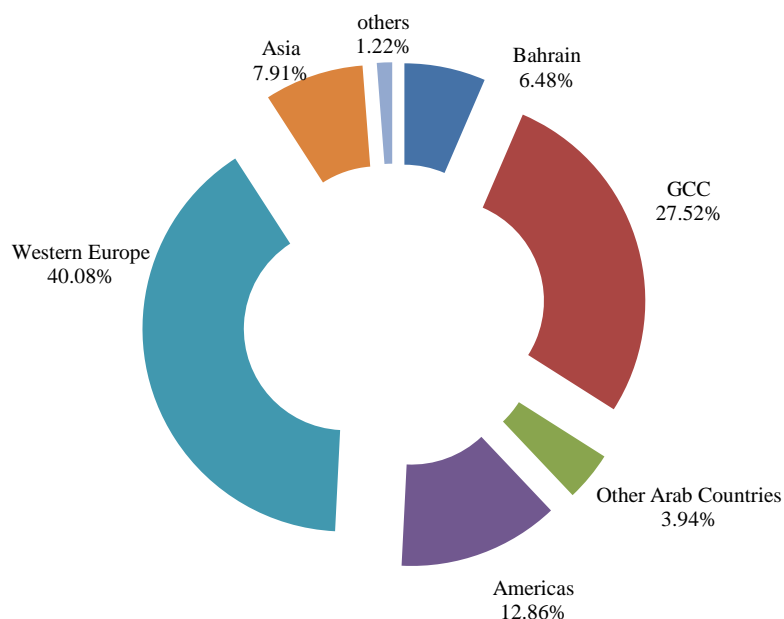
* For conventional and Islamic retail banks
Source: Central Bank of Bahrain

Chart 1-17: Wholesale Banks Assets by: Geographical Classification (2012) *



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

Chart 1-18: Wholesale Banks Assets by: Geographical Classification (September 2013) *



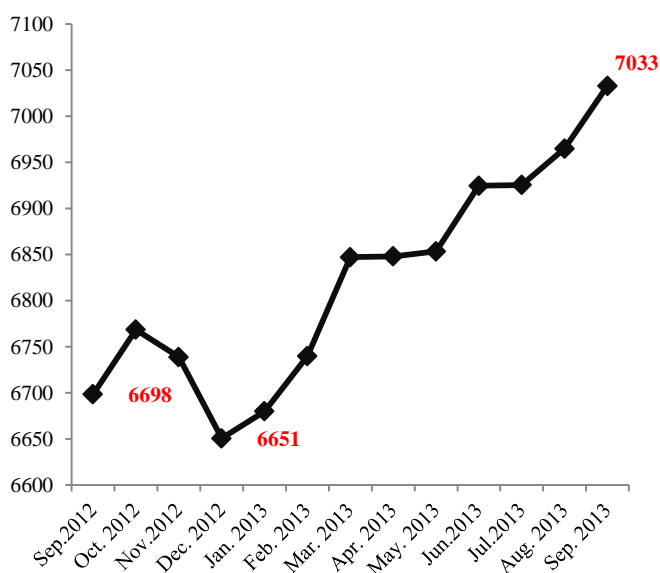
* For conventional and Islamic retail banks
Source: Central Bank of Bahrain

c- Credit Conditions

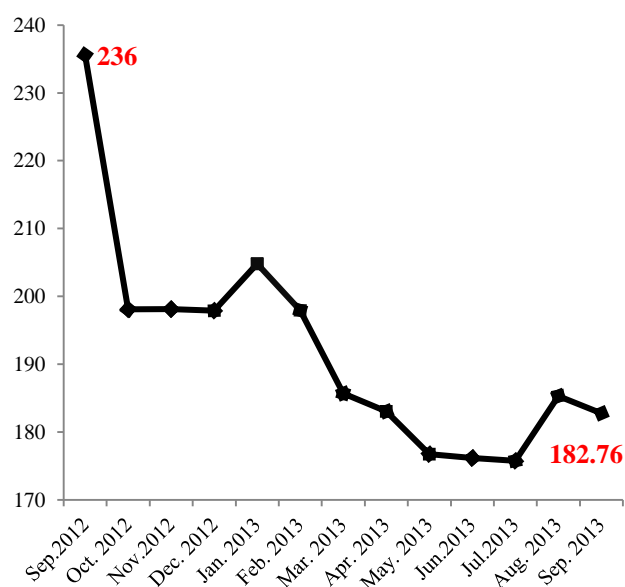
The credit condition also improved during the recent period. After a drop in December 2012, credit to the private sector continue to grow and reached BD 7033 million at the end of September 2013, this level is higher than all previous years, including 2008 (chart 1-19). The recent higher growth in credit 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 restore of confidence in the kingdom of Bahrain.

On the contrary, banks' lending to the government decreased during the past 12 months, moving from BD 236 million in September 2012 to BD 182.8 million at end-September 2013 (chart 1-20).

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



**Chart 1-20: Loans to Government
(BD Million)***



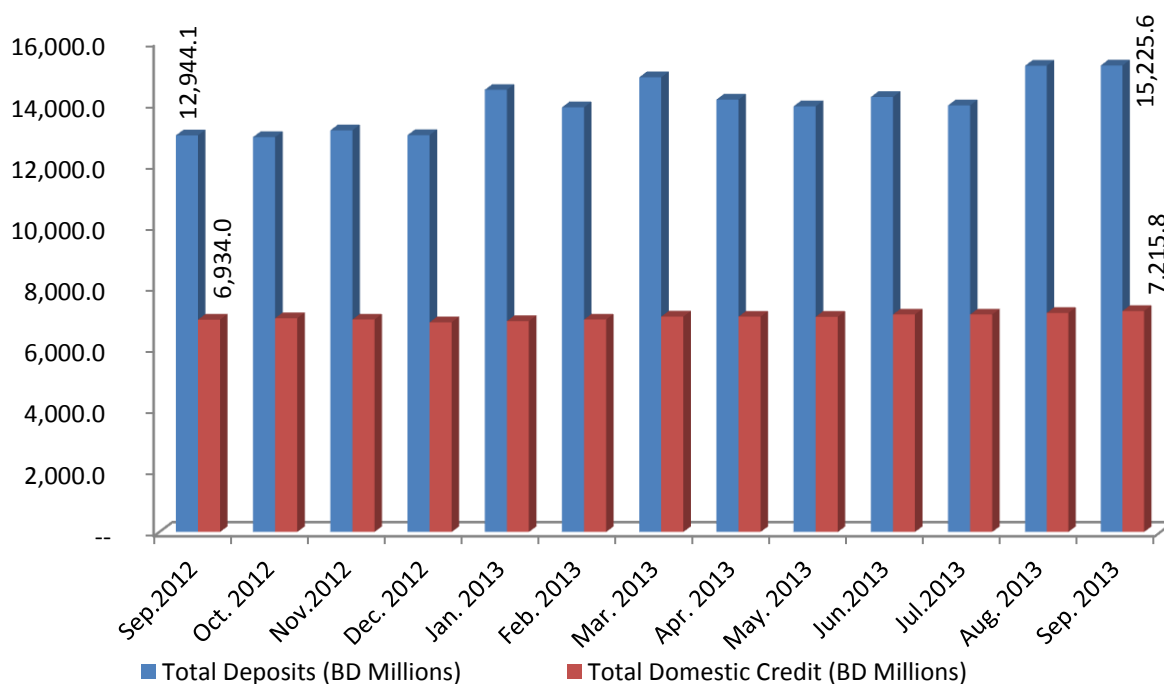
Source: Central Bank of Bahrain

*Excluding securities

Total deposits, they reached BD15225.6 million in February 2013 which is the highest level since 2008. Interestingly, this was followed by an increase in total domestic credits which moved from BD 6964 million in September 2012 to BD 7215.8 million at end-September 2013 (chart 1-21).

Despite the high availability of liquidity (the total deposits represent 124.4% of GDP in June 2013) Total domestic Credit remains moderate in Bahrain; it represents only 62.2 % of GDP.

Chart 1-19: Total Deposits and total Domestic Credit (BD Million)

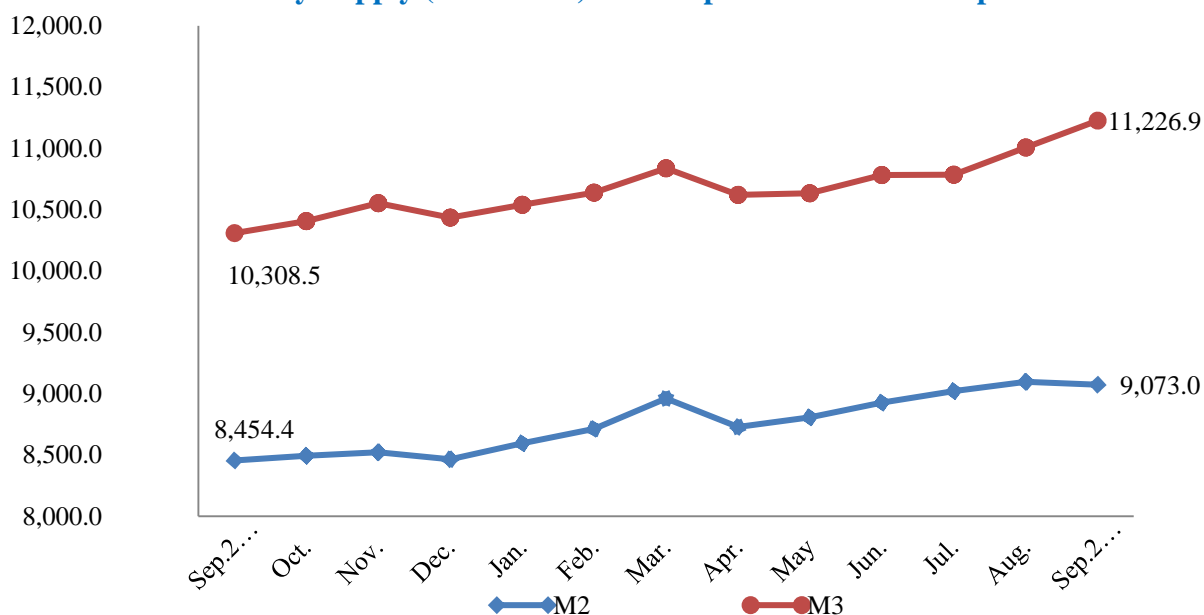


Source: Central Bank of Bahrain

d- Money Supply

Money supply has continued to grow since the third quarter of 2012. M2 stood at BD 11,226.9 million in September 2013, 9.0% higher than its value of September 2012. M3 was BD 9,073 million in September 2013, 7.3% higher than in September 2012 (Chart 1-22).

Chart 1-22: Money Supply (BD Billion) from September 2012 till September 2013



Source: Central Bank of Bahrain

In 2013, inflation in Bahrain was moderate. The inflation rate in consumer prices for the period January to November of 2013 was 3.2%. According to CIO (2013), The main upward contribution during November 2013 compared with November 2012 came from higher prices for the following groups; “Furnishing, household equipment and routine household maintenance” by 7.4%, “Housing, water, electricity, gas and other fuels” by 7.6%, “Education” group by 5%, “Food and Non-Alcoholic” by 4.9% and “Miscellaneous Goods and Services” group by 4.1%.

Chart 1-15: Monthly Inflation in 2013 (CPI%)



Source: CIO Bahrain.

1.3.2 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 since the beginning of 2013. Credit growth is expected to increase further in 2014. Overall funding conditions have improved and demand for loans has accelerated in Bahrain.

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 any negative effects of the Eurozone crisis on Bahrain's wholesale sector will have no major impact on Bahrain's economy. This is further supported by the fact that while the wholesale banking sector has been deleveraging since 2008, the retail banking sector has been expanding and credit to the private sector has been rising. Moreover, the exposure to Western Europe is mainly focused on the UK and France which are not the countries directly affected by the European crisis.

Bahrain's financial sector therefore is not expected to be significantly affected by any spill over effects of the Eurozone current problems. Other transmission mechanisms could be

through trade and tourism. However, once again, this is expected to be of minimal effect as Bahrain's trade is mostly with Asia and tourism in Bahrain is regional. 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.

Chapter

2

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

Key Points

Household debt ratio is stable

Business debt ratio decreased

Construction permits increase and commercial licenses drop

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.

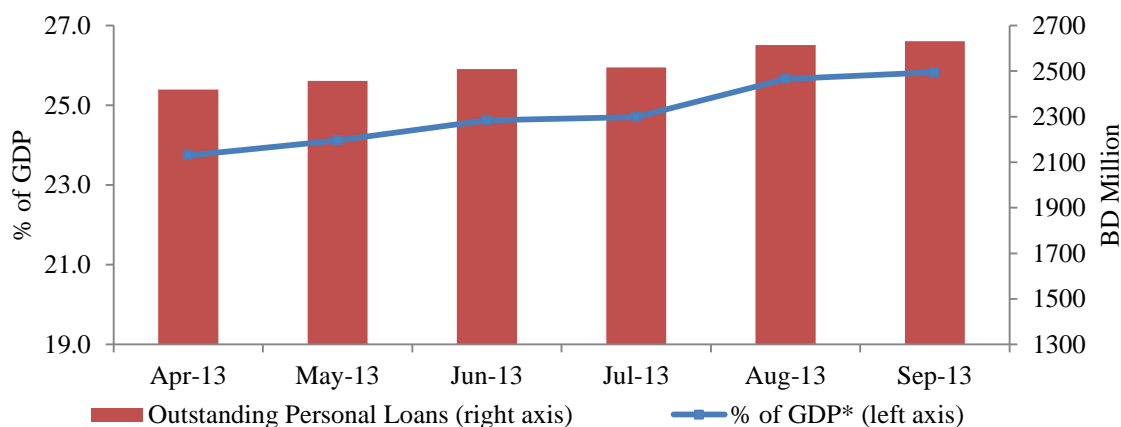
The construction and real estate sector receives special attention because this sector is usually highly sensitive to developments in macroeconomic conditions and financial institutions in Bahrain have direct and indirect exposures to the sector.

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 April 2013 to September 2013 (Chart 2-1).

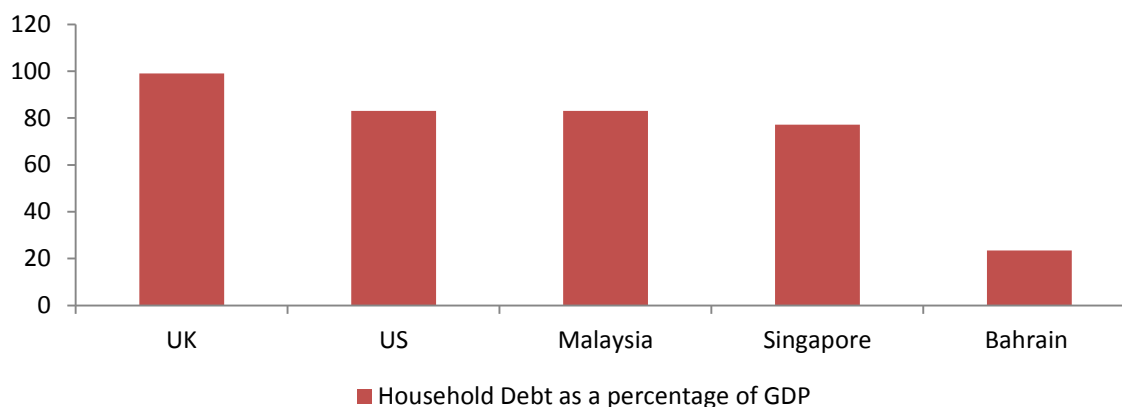
Chart 2-1: Personal Loans and Advances (Volume and % of GDP)



**Using 2012 GDP, provisional data*

Source: Central Bank of Bahrain

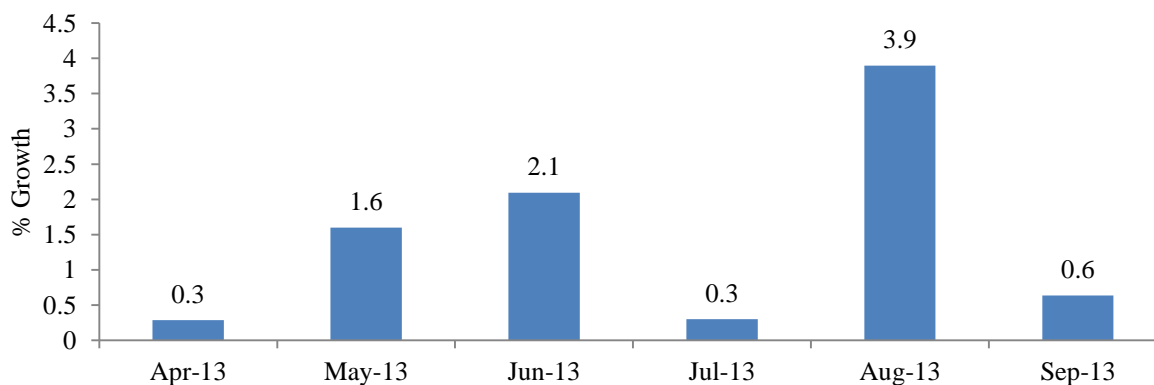
Personal loans remained steady at around 24.7% of GDP from April 2013 to September 2013 due to a fairly constant amount of outstanding personal loans throughout the six month period.

Chart 2-2: Household debt to GDP ratio

**Personal loans are used as a proxy measure of household debt for Bahrain.*

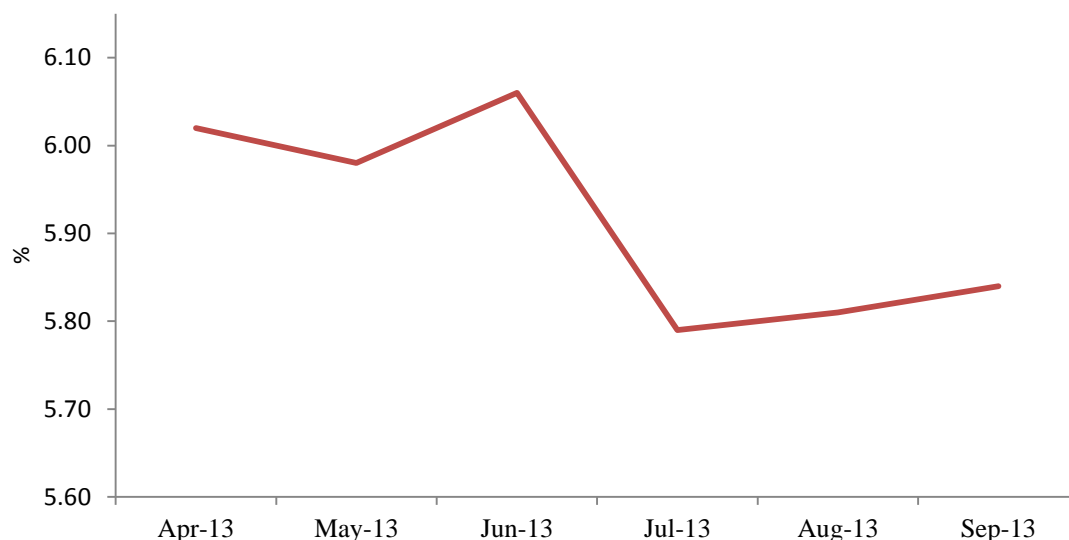
Sources: The Economist, The Telegraph, Business Times.

Bahrain has comparatively low household debt to GDP ratio in relation to the UK, US, Malaysia, and Singapore. This is consistent with the growth trends of consumer credit over the last few years.

Chart 2-3: Growth Rate of Total Personal Loans and Advances (%)

Source: Central Bank of Bahrain

Interest rate on personal loans reached its peak at 6.06% in June 2013 (Chart 2-3). Interest rates on secured and unsecured loans remained somewhat constant throughout this period.

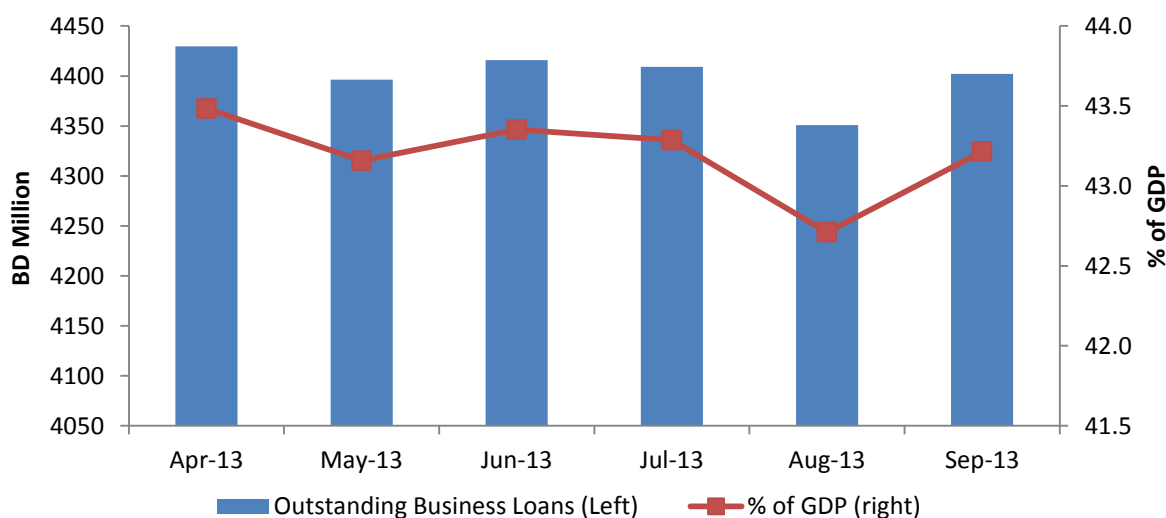
Chart 2-4: Retail Banks- Average Interest Rates on Personal Loans (%)

Source: Central Bank of Bahrain

2.3 The Bahraini Corporate Sector

Business Debt Ratio is Stable

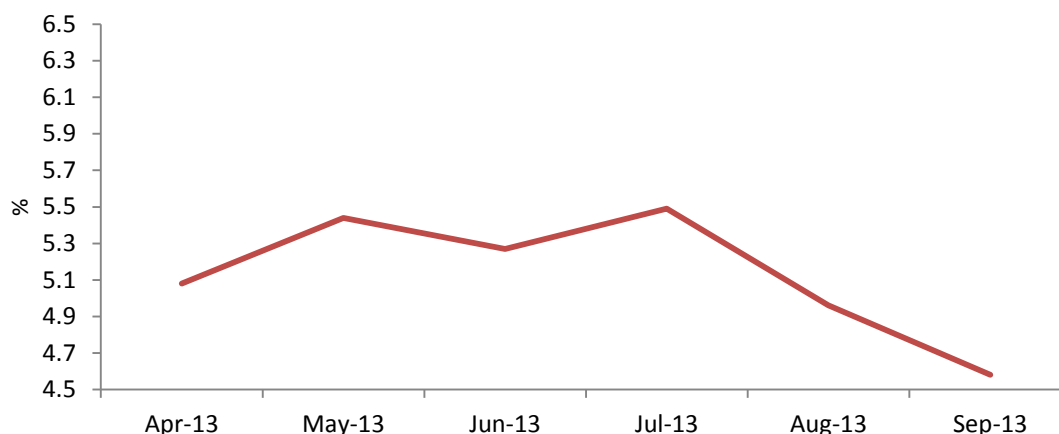
Business loans and advances remained constant from April 2013 to July 2013, and then decreased slightly in August and September 2013 (Chart 2-5). Outstanding business loans steadied at an average of 43.2% of GDP.

Chart 2-5: 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 July 2013 at 5.49% (Chart 2-6), and then reaching its lowest rate in September 2013. There was a decrease in interest rates on non-bank financial loans and a slight decrease in interest rates on transportation & communication loans during this period.

Chart 2-6: 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, while real estate has seen a drop from 445 licenses in Q1 2013 to 364 licenses issued in Q3 2013. In Q3 2013, a total of 610 new commercial licenses were issued for construction and real estate, rentals, and associated activities, a decrease from 666 in Q1 2013 (Table 2-1).

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

	2012:Q4	2013:Q1	2013:Q2	2013:Q3
Construction	190	221	237	246
Real Estate, Rentals and Associated Activities	229	445	375	364
Total	419	666	612	610

Source: Ministry of Industry and Commerce

The total number of construction permits issued by the Ministry of Municipalities Affairs and Agriculture has seen an increase throughout the year so far, ending with 593 permits in the three types, demolition and new construction, new construction and reclamation.

Table 2-2: Selected Construction Permits by Type

	2012:Q4	2013:Q1	2013:Q2	2013:Q3
Demolition and New Construction	9	17	12	14
New Construction	513	550	575	578
Reclamation	3	2	1	1
Total	525	569	588	593

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 been constant as interest rates remained fairly stable for personal loans, ranging from 5.8% to 6.02%. While the debt ratio for the business sector decreased as interest rates dropped in August and September.

For the *construction and real estate sector*, there has been a decrease in commercial licenses issued in the second and third quarters of 2013, whilst construction permits has increased during this period.

Part II:

Performance of the Banking Sector

Chapter
3

3. Conventional Banks

Key Points

Slight decrease in capital positions of conventional retail banks and conventional wholesale banks.

Non-performing loans (NPLs) increase for conventional retail banks and remain unchanged for conventional wholesale banks.

Loan portfolios in conventional retail and wholesale banks remain concentrated despite the decrease in some sectors.

Increase in earnings for conventional retail banks and conventional wholesale banks.

Liquidity decreases for conventional retail banks and for conventional wholesale banks.

3.1 Overview

This chapter analyzes 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 Soundness Indicators (FSIs). The Annex presents selected FSIs for conventional retail and conventional wholesale banks.

3.2 Conventional Retail Banks

Slight decrease in capital adequacy¹

Capital adequacy ratios for conventional retail banks slightly decreased from 19.0% in March 2013 to 18.5% in September 2013. The core capital ratio (ratio of Tier 1 capital to risk-weighted assets) showed also a decrease from 15.8% in March 2013 to 14.3% in September 2013. The leverage ratio (ratio of assets over capital) also showed a slight increase of 0.1% from 8.2% in March 2013 to 8.3% in September 2013. The ratio of non-performing loans (NPLs) net of provisions to capital decreased from 8.6% in March 2013 to 8.3% September 2013. This decline indicates that the capacity of local retail banks' capital to withstand NPL related losses has increased over this period.

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

Indicator	Mar. 2013	Sept. 2013
Capital Adequacy Ratio	19.0	18.5
Tier 1 Capital Adequacy Ratio	15.8	14.3
Leverage (assets/capital)(times)	8.2	8.3
NPFs net of provisions to capital	8.6	8.3

Source: Central Bank of Bahrain

Non-performing loans show slight increase

Loan delinquencies have shown a slight increase between the periods of March 2013 to September 2013 from 4.7% to 4.8%, respectively. The specific provisions as a proportion of NPLs showed a increase 52.9% in March 2013 to 54.4% in September 2013. The net NPLs of net loans increased from 1.9% in March 2013 to 2.0% in September 2013. For *local retail banks*, the NPLs remained unchanged at 5.6% in September 2013. For *overseas retail banks*, the NPLs increased to 2.6% at end- September 2013.

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.

Table 3-2: NPL Figures for Conventional Retail Banks

Indicator	Mar. 2013	Sept. 2013
NPL's (% Gross)	4.7	4.8
NPL's Local Banks (% Gross)	5.6	5.6
NPL's Overseas Banks (% Gross)	2.3	2.6
Specific provisions (% of NPLs) *	54.4	52.9
Net NPL's (% of net loans)	1.9	2.0

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 a mixed picture with sectors experiencing an increase in impairment, while some experience a decrease and others remaining unchanged (Table 3-3). The highest increase was in “agriculture, fishing, and forestry” and “construction” both with an increase of 3.1% followed by the “mining and quarrying sector” sector which increased by 2.9%. The “manufacturing” and “transport” sectors remained unchanged between the period of March 2013 and September 2013.

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

	Mar. 2013	Sept. 2013	Change %
Manufacturing	2.7	2.7	0.0
Mining and quarrying	0.0	2.9	2.9
Agriculture, fishing and forestry	19.3	22.4	3.1
Construction	9.3	12.4	3.1
Financial	10.6	12.4	1.8
Trade	4.5	4.0	(0.5)
Personal / Consumer finance	4.7	4.5	(0.2)
Commercial real estate financing	6.8	6.0	(0.8)
Residential mortgage	4.0	3.7	(0.3)
Government	0.0	0.0	0.0
Technology, media and telecommunications	2.6	2.3	(0.3)
Transport	0.4	0.4	0.0
Other sectors	1.4	2.1	0.7

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 16.8% of total loans in September 2013, an increase from the 16.5% in March 2013. The “personal/consumer finance” was the second recipients of loans at 12.3%, an increase from 12.1% over the same period. The top two recipient sectors “commercial real estate financing” and “other sectors”³ jointly represented 32.9% of loans in September 2013, an increase from the 32.1% in March 2013. Exposure to real estate/ construction was 33.9% of total lending in September 2013, an increase from the 32.9% in March 2013.

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.

³ The “other sectors” category includes sectors such as “private banking”, “services”, “tourism”, and “utilities”.

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

	Sept. 2012	Mar. 2013	Sept. 2013
Manufacturing	11.9	12.1	11.8
Mining and quarrying	0.2	0.2	0.3
Agriculture, fishing and forestry	0.3	0.3	0.3
Construction	6.1	6.4	5.8
Financial	8.7	8.8	7.6
Trade	9.5	9.3	9.9
Personal / Consumer finance	12.6	12.1	12.3
Commercial real estate financing	16.2	16.5	16.8
Residential mortgage	10.6	10.4	11.3
Government	3.5	3.2	3.0
Technology, media and telecommunications	2.3	2.6	2.7
Transport	2.7	2.5	2.1
Other sectors	15.4	15.6	16.1
Top two recipient sectors	31.6	32.1	32.9
Real Estate/ Construction Exposure**	32.9	33.2	33.9

Source: Central Bank of Bahrain

*Figures may not add to a hundred due to rounding

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

The numbers as of end-March 2013 continue to show high concentration of risk for *overseas retail banks* (Table 3-5). The top recipient of loans was the “manufacturing” sector with 14.5% of total loans in March 2013, a significant decrease from the 21.8% in March 2013.

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

	Sept. 2012	Mar. 2013	Sept. 2013
Manufacturing	26.7	21.8	14.5
Mining and quarrying	2.5	2.4	0.8
Agriculture, fishing and forestry	0.5	0.5	0.3
Construction	7.5	8.1	6.3
Financial	9.2	8.7	7.4
Trade	10.3	10.5	10.8
Personal / Consumer finance	13.1	13.6	12.8
Commercial real estate financing	6.3	6.1	13.6
Residential mortgage	1.6	1.5	8.5
Government	2.6	2.3	2.8
Technology, media and telecommunications	4.9	4.5	3.2
Transport	4.4	4.3	2.7
Other sectors	10.3	15.6	16.2
Top two recipient sectors	39.8	37.5	30.7
Real Estate/ Construction Exposure**	15.5	15.7	28.4

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.

The top two recipients of loans (“manufacturing” and “other sectors”) jointly accounted for 30.7% of total loans, also a significant decrease from the 37.5% in March 2013. Exposure to

real estate/ construction was 28.4% of total lending in September 2013, a jump from the 15.7% in March 2013.

Increase in retail bank profitability

As at end-September 2013, return-on-assets (ROA) increased to 1.4 from 0.7% in March 2013. ROA for *locally-incorporated banks* increased from 0.7% in March 2013 to 1.4% in September 2013. For *overseas banks*, ROA also increased from 0.6% to 1.3% over the same period. Return-on-equity (ROE)⁴ for *locally-incorporated banks* increased from 7.4% in March 2013 to 15.0 %.⁵ The increase in earnings can also be attributed to the increase in their net interest income as a proportion of gross income, which showed significant increase from 50.4% in March 2013 to 64.5% in September 2013. Similarly, net fees and commissions as a proportion of gross income increased from 12.0% in March 2013 to 14.5% in September 2013. Lastly, the operating expenses as a proportion of gross income increased from 32.5% in March 2013 to 42.3% in September 2013.

Liquidity position decreases

Between March 2013 and September 2013, bank deposits slightly decreased while non-bank deposits increased for retail banks. Bank deposits went from 22.2% in March 2013 to 21.9% in September 2013. Subsequently, non-bank deposits went from 77.8% to 78.1% over the same period.

The overall loan-deposit ratio for the segment decreased slightly from 62.9% in March 2013 to 62.8% in September 2013. Liquid assets as a proportion of total assets showed a decrease over the period of March 2013 to September 2013 from 29.6% to 26.5%, respectively. Similarly, liquid assets as a proportion of the short-term liabilities presented a decrease from 41.2% to 37.7% over this period.

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

⁵ ROA and ROE are compared on a year-to-year basis as earnings are cumulative and reflect the figures for the year to date.

3.3 Conventional Wholesale Banks

Decrease in capital adequacy⁶

As at end-September 2013, the regulatory capital adequacy ratio for locally-incorporated wholesale banks was 22.4%, a decrease from the 23.3% in March 2013. The core capital ratio (ratio of Tier 1 capital to risk-weighted assets) decreased to 19.4% in September 2013 from the 19.9% in March 2013. In addition, the leverage ratio (ratio of assets over capital) also showed a slight increase of 0.1% from 5.4% in March 2013 to 5.5% in September 2013. The ratio of non-performing loans (NPLs) net of provisions to capital decreased from 5.4% in to 5.0% over the same period.

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

Indicator	March 2013	Sept. 2013
Capital Adequacy Ratio	23.3	22.4
Tier 1 Capital Adequacy Ratio	19.9	19.4
Leverage (Assets/capital)(times)	5.4	5.5
NPL's net of prov. to capital	5.4	5.0

Source: Central Bank of Bahrain

No significant change in non-performing loans of wholesale banks

As at end-March 2013, loans classified as non-performing remained at 9.4%, an increase. *Locally-incorporated wholesale banks* experienced a decrease from 7.2 % in March 2013 to 6.9% of gross loans in September 2013. Alternatively, *overseas wholesale banks* witnessed an increase in NPLs from 11.0% to 11.3% over the same period.

The specific provisions as a proportion of NPLs showed a significant decrease from 64.4% in March 2013 to 62.8%. The net NPLs increased from 3.2% in March 2013 to 3.4% in September 2013.

Table 3-7: NPL Figures for Conventional Wholesale Banks

Indicator	March 2013	Sept. 2013
NPL's (% Gross)	9.4	9.4
<i>NPL's Local Banks</i>	7.2	6.9
<i>NPL's Overseas Banks</i>	11.0	11.3
Specific provisions (% of NPLs) *	64.4	62.8
Net NPLs (% of net loans)	3.2	3.4

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 shows that impairment in the "construction" was the highest between all sectors at 23.3% then followed by the

⁶ The capital adequacy ratio relates total capital to risk-weighted assets. The discussion excludes overseas wholesale banks, which do not have prescribed capital levels or ratios.

“commercial real estate financing” sector with an impairment of 22.9%. The highest increases were in the “trade” sector that increased by 10.5% followed by the “commercial real estate financing” sector which increased by 10.5%. The highest decreases in impairment were found in the “transport” sector which decreased by 0.8%.

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

	Mar. 2013	Sept. 2013	Change %
Manufacturing	3.3	4.8	1.5
Mining and quarrying	0.0	0.3	0.3
Agriculture, fishing and forestry	0.1	0.1	0.0
Construction	23.2	23.3	0.1
Financial	4.2	5.8	1.6
Trade	9.7	20.2	10.5
Personal / Consumer finance	2.0	1.9	(0.1)
Commercial real estate financing	15.9	22.9	7.0
Residential mortgage	0.1	0.2	0.1
Government	1.4	0.9	(0.5)
Technology, media and telecommunications	0.0	2.3	2.3
Transport	6.1	5.3	(0.8)
Other sectors	1.1	0.8	(0.3)

Source: Central Bank of Bahrain

Loan portfolios remain concentrated by sector despite decrease

An examination of lending patterns as at end-March 2013 shows that for *locally-incorporated wholesale banks*, the top recipient of loans remained the “manufacturing” sector, which accounted for 30.4% of total loans in September 2013 with a decrease from the 32.1% in March 2013 (Table 3-10). Also, the top two sectors (“manufacturing” and “financial”) accounted for 52.4% of total lending in September 2013, down from the 55.7% recorded for in March 2013.

Table 3-9: Distribution of Local Wholesale Banks’ Lending (% shares)*

	Sept. 2012	Mar. 2013	Sept. 2013
Manufacturing	31.7	32.1	30.4
Mining and quarrying	2.8	3.0	3.3
Agriculture, fishing and forestry	2.3	2.3	2.2
Construction	6.2	7.0	7.7
Financial	22.4	23.6	22.1
Trade	9.3	9.1	9.0
Personal / Consumer finance	2.2	2.3	2.3
Commercial real estate financing	1.5	1.3	2.0
Residential mortgage	0.5	0.5	0.6
Government	0.9	0.7	1.4
Technology, media and telecommunications	4.2	2.4	2.4
Transport	6.3	6.2	7.3
Other sectors	9.7	9.7	9.4
Top two recipient sectors	54.1	55.7	52.4
Real Estate/ Construction Exposure**	8.2	8.8	10.3

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.

In *overseas wholesale banks*, the top recipient of loans in September 2013 was the “financial” sector, with 39.9% of total loans (vs. 44.2% in March 2013) (Table 3-11). The top 2 sectors (financial and other sectors) jointly increased to 54.6% in September 2013 from 56.3% in March 2013.

Table 3-10: Distribution of Overseas Wholesale Banks’ Lending (% shares)*

	Sept. 2012	Mar. 2013	Sept. 2013
Manufacturing	14.3	11.2	11.3
Mining and quarrying	6.6	1.1	1.0
Agriculture, fishing and forestry	0.1	0.1	0.1
Construction	5.2	7.1	7.6
Financial	31.2	44.2	39.9
Trade	4.3	6.0	5.9
Personal / Consumer finance	0.3	0.5	0.4
Commercial real estate financing	2.0	2.8	1.5
Residential mortgage	0.0	0.0	0.0
Government	12.3	6.3	9.6
Technology, media and telecommunications	3.5	4.1	3.0
Transport	5.1	4.5	5.2
Other sectors	15.2	12.1	14.7
Top two recipient sectors	46.5	56.3	54.6
Real Estate/ Construction Exposure**	7.1	10.0	9.1

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.

Improved earnings and increase in profitability

ROA for the conventional wholesale banking sector was at 1.0% in September 2013, an increase from the 0.4% in March 2013. The ROA for *local wholesale banks* increased to 0.7% between March 2013 and September 2013. On the other hand, *overseas wholesale banks* also showed an increase from 0.5% to 1.2% over the same period. ROE for *local wholesale banks* nearly doubled from 2.2% to 4.3%. Net interest income as a proportion of gross income showed an increase from 46.0% in March 2013 to 49.1% in September 2013. Similarly, net fees and commissions as a proportion of gross income decreased to 22.1% in September 2013 from 43.2% in March 2013. Lastly, the operating expenses as a proportion of gross income decreased from 41.9% in March 2013 to 39.9% in September 2013.

Liquidity position decreases

As at end-September 2013, the overall loan-deposit ratio for conventional wholesale banks stood at 60.1%, an increase from the 59.4% in March 2013. The loan deposit ratio for *local wholesale banks* increased to 66.4% in September 2013 from 64.8% in March 2013. Over the same period, *overseas wholesale bank* decreased slightly from 55.8 to 55.7%.

Liquid assets for wholesale banks as a proportion of total assets decreased to 16.9% in September 2013 from 18.2% in March 2013. *Locally incorporated wholesale banks* had a liquid asset ratio of 31.5% in September 2013 a decrease from the 33.8% in March 2013.

Overseas wholesale banks had a lower ratio of 4.8%, also decrease from 5.3% over the same period.

Liquid assets as a proportion of short-term liabilities decreased to 28.9% in September 2013 from 31.4% in March 2013. Lastly, the deposits from non-bank sources as a proportion of total deposits increased to 42.2% from 40.0% while bank deposits decreased from 60.0% to 27.8% over the same period.

3.4 Overall Assessment of the Conventional Banking Sector

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 18.5% in September 2013. Capital adequacy ratio for locally-incorporated wholesale banks was 22.4%. Loan delinquencies have shown a slight increase between the periods of March 2013 to September 2013 from 4.7% to 4.8%, respectively for conventional retail banks. As for conventional wholesale banks, loans classified as non-performing remained at 9.4%. Loan concentration remains for conventional retail and wholesale banks despite some decrease in some sectors.

As at end-September 2013, return-on-assets (ROA) increased to 1.4 from 0.7% in March 2013. Return-on-equity (ROE) for *locally-incorporated banks* increased from 7.4% in March 2013 to 15.0 %. ROA for the conventional wholesale banking sector was at 1.0% in September 2013, an increase from the 0.4% in March 2013. ROE for *local wholesale banks* nearly doubled from 2.2% to 4.3%.

For conventional retail banks, liquid assets as a proportion of total assets showed a decrease over the period of March 2013 to September 2013 from 29.6% to 26.5%. Liquid assets for wholesale banks as a proportion of total assets decreased to 16.9% in September 2013 from 18.2% in March 2013.

Chapter

4

4. Islamic Banks

Key Points

Capital positions deteriorates for Islamic banks.

Drop in non-performing facilities (NPFs) for Islamic banks.

Increase in the concentration of facilities for both Islamic retail banks and Islamic Wholesale Banks.

Increased earnings for Islamic banks, with considerable variance among individual banks.

Improved liquidity position for Islamic retail banks, while it slightly worsens for Islamic wholesale banks.

4.1 Overview

This chapter analyzes the banking sector under the following categories: Islamic retail banks (section 4-2) and Islamic wholesale banks (section 4-3). Section 4.4 provides an overall assessment of the Islamic banking industry. Unless specified otherwise, the analysis in this chapter is based on consolidated financial data (Bahraini and non-Bahraini operations), as at end-September 2013 and compared with end-March 2013.

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

4.2 Islamic Retail Banks

Slight deterioration in Capital Provisions

The capital adequacy ratio of Islamic retail banks decreased from 18.2% in March 2013 to 17.5% in March 2013. Tier 1 capital also decreased from 15.7% in March 2013 to 14.9% in September 2013.

Table 4-1 Capital Provisions Ratios for Islamic Retail Banks

Indicator	Mar. 2013	Sept. 2013
Capital Adequacy Ratio	18.2	17.5
Tier 1 Capital Adequacy Ratio	15.7	14.9
Leverage (assets/capital)	7.4	7.8
NPFs net of provisions to capital	32.1	30.8

Source: Central Bank of Bahrain

The ratio of non-performing facilities (NPFs) net of provisions to capital decreased from 32.1% to 30.8% for the same period.

Decrease in non-performing facilities

Non-performing facilities (NPFs) dropped to 13.6% in September 2013, compared to 14.3% in March 2013.

Table4-2: NPF Figures for Islamic Retail Banks

Indicator	Mar. 2013	Sept. 2013
NPFs (% Gross)	14.3	13.6
Specific provisions (% of NPF's)*	36.6	39.1
Net NPF's (% of net loans)	8.1	8.0

Source: Central Bank of Bahrain

* Specific provisions as a percentage of NPF's are calculated as specific provisions divided by gross impaired facilities minus deferred profits.

Available data on sectorial breakdown shows that the majority of the sectors witnessed a decrease in non-performing facilities. The biggest decrease was in the "personal/consumer finance" sector with a decrease of 9.3% followed by "residential mortgages" with a decrease

of 8.9%. As for increases, the available data shows that the “construction” sector had the highest increase in NPF’s followed by the “trade” sector.

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

	Mar. 2013	Sept. 2013	Change %
Manufacturing	18.7	18.7	0.0
Mining and quarrying	2.0	0.1	(1.9)
Agriculture, fishing and forestry	14.9	17.1	2.2
Construction	16.2	32.6	16.4
Financial	7.7	5.5	(2.2)
Trade	15.5	28.6	13.1
Personal / Consumer finance	19.9	10.6	(9.3)
Commercial real estate financing	15.3	10.5	(4.8)
Residential mortgage	17.3	8.4	(8.9)
Government	0.0	0.0	0.0
Technology, media and telecommunications	7.0	2.1	(4.9)
Transport	4.9	7.9	3.0
Other sectors	8.7	6.5	(2.2)

Source: Central Bank of Bahrain

Slight improvement in asset concentration

Asset concentration might have improved slightly in some sectors over the past six months as Islamic retail banks have begun to slowly diversify their asset concentration.

Table 4-4: Distribution of Islamic Retail Banks’ Lending (% shares)*

	Mar. 2013	Sept. 2013
Manufacturing	18.7	15.9
Mining and quarrying	0.0	0.5
Agriculture, fishing and forestry	0.9	0.9
Construction	4.3	4.3
Financial	12.8	10.6
Trade	10.9	12.7
Personal / Consumer finance	20.7	17.8
Commercial real estate financing	13.9	18.2
Residential mortgage	4.8	5.0
Government	6.4	7.4
Technology, media and telecommunications	0.2	0.5
Transport	1.2	0.9
Other sectors	5.1	5.1
Top two recipient sectors	39.3	36.1
Real Estate/ Construction Exposure**	23.0	27.6

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.

At the end of September 2013, the top recipient of financing was “commercial real estate financing”, at 18.2% up from 13.9% in March 2013 followed by “personal/consumer finance” tht had a concentration of 17.8% in September 2013 down from 20.7% in March

2013. On the other hand, “commercial real estate financing” had the biggest increase from 13.9% in March 2013 to 18.2% in September 2013.

The top two recipients of financing (“Commercial real estate financing” and “Personal/Consumer Finance”) accounted for 36.1 % of total facilities extended. Real estate/construction exposure increased from 23.0% in March 2013 to 27.6% in September 2013, which can be attributed to the increase noticed in the “commercial real estate financing” sector.

Stable earnings

The return on assets (ROA) for Islamic retail banks remained constant at 0.1% in September 2013. Return on equity (ROE) increased from 0.5% in March 2013 to 1.1% in September 2013.

Increase in liquidity

The volume of liquid assets available to Islamic retail banks increased from 12.8% of total assets in March 2013 to 13.7% in September 2013. The ratio of total facilities to deposits declined from 78.9% in March 2013 to 78.2% in September 2013.

Table 4-5: Liquidity Measures for Islamic Retail Banks

Indicator	Mar. 2013	Sept. 2013
Liquid Assets (% of total assets)	12.8	13.7
Facilities – deposits ratio (%)	78.9	78.2

Source: Central Bank of Bahrain

4.3 Islamic Wholesale Banks

As of September 2013, there were 20 Islamic wholesale banks operating in Bahrain.

Decline in capital positions

As at end-September 2013, the CAR for Islamic wholesale banks declined to 25.0% against 26.1% in March 2013. In addition, Tier1 capital decreased from 25.2% in March 2013 to 23.6% in September 2013. The ratio of NPFs net of provisions to capital also decreased during this period from 7.0% to 4.3 % over the same period.

Table 4-6 Capital Provisions Ratios for Islamic Wholesale Banks

Indicator	Mar. 2013	Sept. 2013
Capital Adequacy Ratio	26.1	25.0
Tier 1 Capital Adequacy Ratio	25.2	23.6
NPFs net of provisions to capital	7.0	4.3

Source: Central Bank of Bahrain

Decrease in non-performing facilities (NPFs)

As at end-September 2013, NPFs for Islamic wholesale banks decreased to 5.4% from 9.3% in March 2013. The NPF's were concentrated in the "Construction" sector with 37.9% of NPF's in September 2013, up from 13.0% in March 2013. This was followed by the "trade", "Financial", and "Manufacturing" sectors.

Table4-7: NPF Figures for Islamic Wholesale Banks

Indicator	Mar. 2013	Sept. 2013
NPFs (% Gross)	9.3	5.4
Specific Provisioning (% of NPFs)*	63.9	72.8
Net NPF's (% of net loans)	3.4	1.5

Source: Central Bank of Bahrain

* Specific provisions as a percentage of NPF's are calculated as specific provisions divided by gross impaired facilities minus deferred profits.

Available data on the sectorial breakdown of non-performing facilities shows that the "construction" sector with an increase of 6.1% from 8.3% in March 2013 to 25.1% in March 2013 to 25.1% in September 2014. The biggest drop was in the "commercial real estate sector" sector with a decrease in non-performing facilities of 15.5% from March 2013 to September 2013 followed by the "financial" sector with a decrease of 4.1%.

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

	Mar 2013	Sept 2013	Change %
Manufacturing	4.1	4.4	0.3
Mining and quarrying	5.0	5.8	0.8
Agriculture, fishing and forestry	42.3	48.4	6.1
Construction	8.3	25.1	16.8
Financial	13.5	9.4	(4.1)
Trade	7.0	9.4	2.4
Personal / Consumer finance	3.8	4.1	0.3
Commercial real estate financing	23.3	7.8	(15.5)
Residential mortgage	1.5	10.7	9.2
Government	0.1	0.0	(0.1)
Technology, media and telecommunications	0.9	12.7	11.8
Transport	2.7	2.7	0.0
Other sectors	7.3	6.6	(0.7)

Source: Central Bank of Bahrain

Improvement in asset concentration (loans)

At end-September 2013, the “manufacturing” sector remained the top recipient of financing from Islamic wholesale banks, at 22.1%, surpassing “Financial” at 17.9%. The “Construction” sectors accounted for 13.4% of facilities concentration.

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

	Mar. 2013	Sep. 2013
Manufacturing	22.3	22.1
Mining and quarrying	0.6	0.5
Agriculture, fishing and forestry	0.3	0.3
Construction	10.9	13.4
Financial	12.2	17.9
Trade	13.4	12.0
Personal / Consumer finance	8.2	7.5
Commercial real estate financing	0.8	1.5
Residential mortgage	2.9	2.0
Government	1.0	7.3
Technology, media and telecommunications	0.2	0.2
Transport	2.2	3.9
Other sectors	24.8	11.3
Top two recipient sectors	47.1	40.0
Real Estate/ Construction Exposure**	14.6	16.9

Source: Central Bank of Bahrain

*Figures may not add to a hundred due to rounding

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

The top two recipient sectors in March 2013 (“manufacturing” and “financial”) jointly represented (40.0%) of total financing, down from 47.1% in March 2013. On the other hand, the real estate/ construction exposure increased from 14.6% in March 2013 to 16.9% in September 2013.

Positive earnings

The earnings performance of Islamic wholesale banks improved over the period from March 2013 to September 2013. Return on assets (ROA) increased from 0.3% in March 2013 to 0.6% in September 2013. Similarly, return on equity (ROE) improved considerably from -1.7% to 3.6% during the same period. The increase in earnings is due to the higher operating income.

It should be noted however that operating expenses (as % of operating income) increased from 55.8% in March 2013 to 56.7% in September 2013.

Liquidity position deteriorates slightly

As at end-September 2013, liquid assets of Islamic wholesale banks represented 21.1% of total assets, 0.7% lower than the 21.8% registered in March 2013. On the other hand, the facilities deposit ratio increased to 71.2% compared to the 67.6% registered in March 2013.

Table 4-10: Liquidity Measures for Islamic Wholesale Banks

Indicator	Mar. 2013	Sept. 2013
Liquid assets (% of total)	21.8	21.1
Facilities-deposit ratio	67.6	71.2

Source: Central Bank of Bahrain

4.4 Overall Assessment of the Islamic Banking Sector

The financial soundness indicators show that Islamic banks' (retail and wholesale) capital positions declined during the period. The earnings picture looks better. Since ROA and ROE witnessed growth. Capital adequacy decreased for Islamic retail and wholesale banks while NPFs have declined for Islamic wholesale and Islamic retail banks. Facilities concentration has decreased for retail Islamic banks and wholesale Islamic banks. Moreover, Islamic retail banks experienced a strengthened liquidity position as the liquid asset ratio increased while the facilities to deposit ratio decreased slightly. Wholesale Islamic liquidity positions weakened slightly while liquid assets reduced marginally and facilities to deposit ratio increased.

Part III:

Developments in the Equity Market and Payment Systems

Chapter

5

5. Performance of Equity Market

Key Points

Increase in the Bahrain All Share index

Year-on-year growth in market capitalization

Year-on-year growth in price-earning ratio

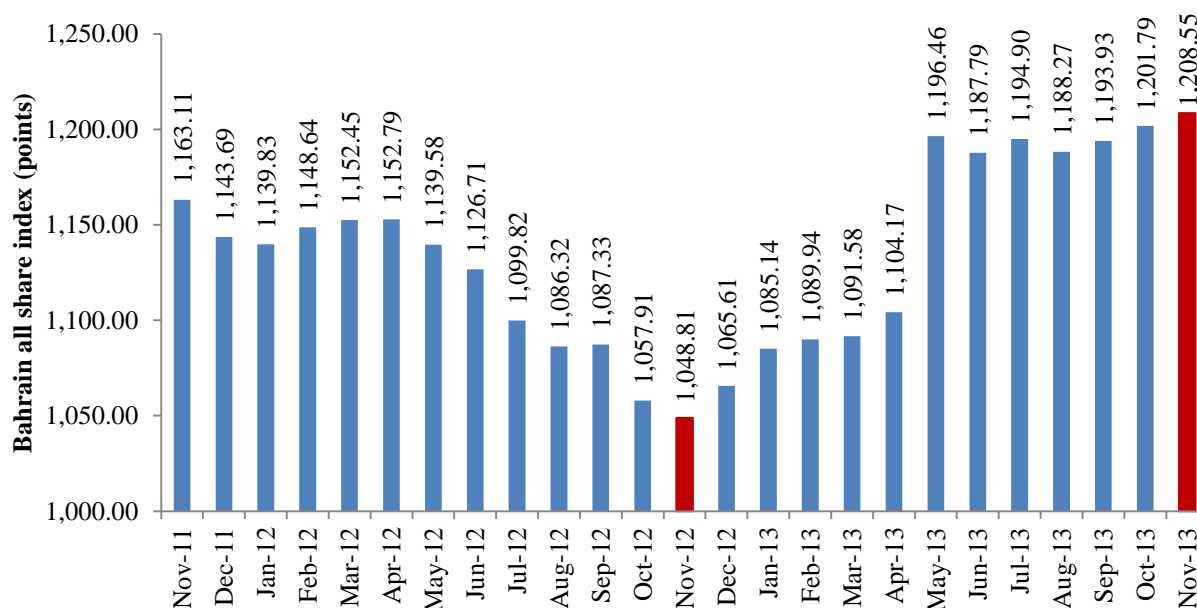
GCC markets have shown notable increases in their year-on-year performance

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 159.74 points (15.2%) between November 2012 and November 2013 (Chart 5-1). The index experienced decreases from April 2012 to November 2012. However, the index picked up in December 2012 and continued its upward trend for the sixth consecutive month until May 2013, before experiencing a minor decrease in June 2013. The index performed well afterwards and closed at its highest point in the past two years at 1,208.55 in November 2013.

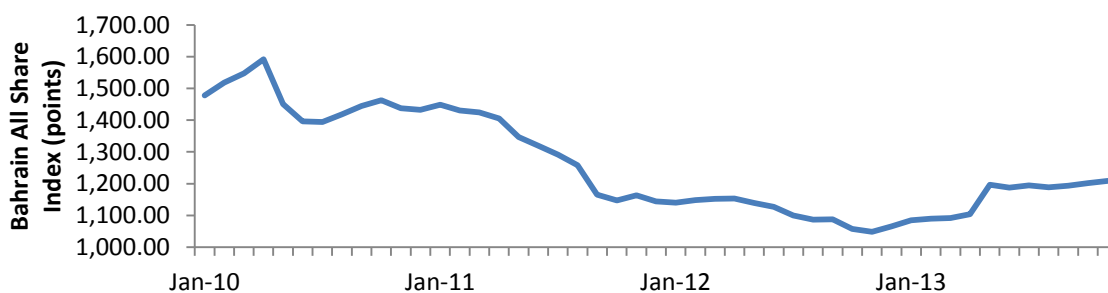
Chart 5-1: Recent Trends in the Bahrain All-Share Index, November 2012-November 2013.



Source of Data: Bahrain Bourse

Looking at the overall performance of the Bahrain All Share index since 2011 (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 May 2013 and November 2013, reflecting growing confidence in the Bahraini stock market.

Chart 5-2: Bahrain All-Share Index, January 2010-November 2013



Source of Data: Bahrain Bourse

Increase in market capitalization

As at end-November 2013, market capitalization of the Bahrain Bourse stood at BD 6.7 billion (Table 5-1). This level of market capitalization is 13.6% higher than the level as at end-June 2013 and 17.0% higher *year-on-year*.

Table 5-1: Market Capitalization on the Bahrain Bourse

(BD)

Sector	November 2012	June 2013	November 2013	Nov. 2012- June 2013 (%)	Nov. 2012- Nov. 2013 (%)
Commercial banks	2,215,216,668	2,975,221,461	3,120,146,120	34.3%	40.9%
Investment	1,582,822,074	1,513,479,458	1,613,434,727	-4.4%	1.9%
Insurance	153,038,690	144,213,624	165,858,591	-5.8%	8.4%
Services	929,536,840	971,899,295	923,069,854	4.6%	-0.7%
Industrial	694,693,276	761,246,021	740,244,011	9.6%	6.6%
Hotel and Tourism	185,925,416	180,773,416	175,800,031	-2.8%	-5.4%
TOTAL	5,761,232,964	6,546,833,275	6,738,553,334	13.6%	17.0%

Source: Bahrain Bourse

A breakdown of market capitalization by sector indicates that the “Commercial Banks” recorded the highest *year-on-year* increase in market capitalization (40.9%) followed by Insurance (8.4%). The “Hotel and Tourism” sector witnessed a *year-on-year* decrease of 5.4%.

The turnover ratio (value of trading as a share of market capitalization) was around 0.32% in November 2013, an increase from the 0.26% in June 2013 and 0.09 in November 2012.

Increase in price-earnings ratios

As at November 2013, the price-earnings ratio (P-E ratio) for the stock market stood at 9.72, an increase from the 9.38 attained in June 2013 and the 7.47 in November 2012. The “Industrial” sector witnessed the highest *year-on-year* increase in the P-E ratio between November 2012 and November 2013. The biggest *year-on-year* declines were in the “Hotel and Tourism” sector where the PE ratio decreased from 15.21 in November 2012 to 11.92 in November 2013.

Table 5-2: Price-Earning Multiples

Sector	November 2012	June 2013	November 2013
Commercial banks	10.06	11.27	12.00
Investment	8.59	7.19	7.76
Insurance	14.32	10.91	12.49
Services	8.18	10.09	9.57
Industrial	3.23	7.69	7.47
Hotel and Tourism	15.21	12.28	11.92
Total Market	7.47	9.38	9.72

Source: Bahrain Bourse

The bulk of the value of shares traded in November 2013 was the “Investment” sector whose traded shares (by value) represented 79.8% of total shares traded. However, commercial banks shares represented 16.4% of the total shares traded in November 2013, down from 80.3% in June 2013.

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

Sector	November 2012	June 2013	November 2013
Commercial banks	90.4	80.3	16.4
Investment	4.4	11.4	79.8
Insurance	0.1	0.6	0.03
Services	4.2	6.3	3.1
Industrial	0.4	0.7	0.2
Hotel and Tourism	0.2	0.3	0.2

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

Source: Bahrain Bourse

During November 2013, the three most active stocks in terms of volume traded were: GFH's stock (217,448,334) followed by Ithmaar Bank's stock (19,897,078) and Al Salam Bank's stock (14,372,469). The highest closing prices of the most active stocks in November 2013 were AUB's at BD 0.270 and Nass's at BD 0.153.

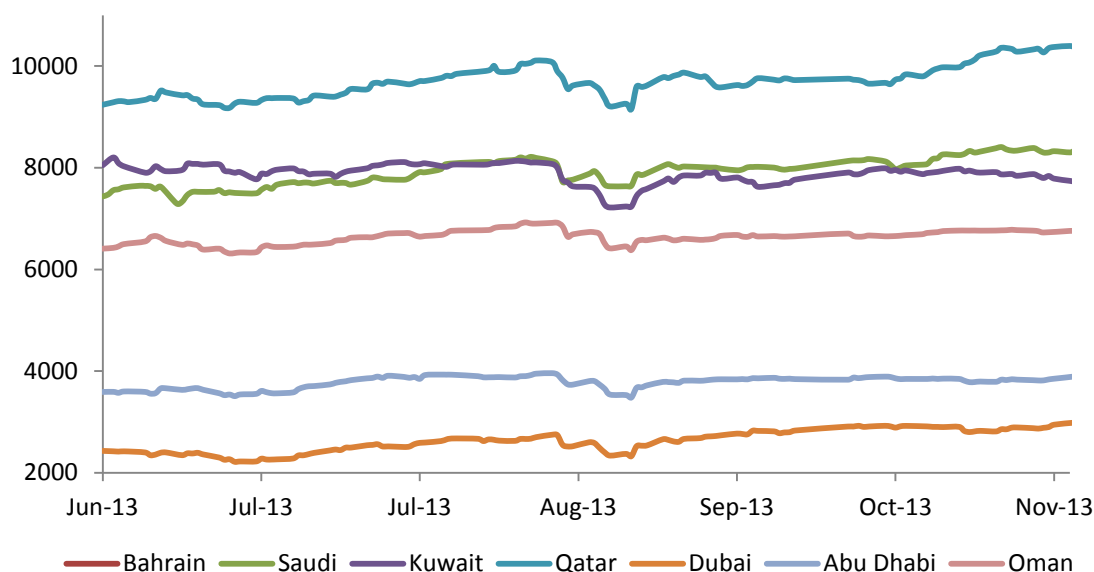
Table 5-4: Most Active Stocks in November 2013 in terms of volume

	Volume	Value	Closing price (BHD)
Gulf Finance House	217,448,334	13,110,256	0.056
Ithmaar Bank	19,897,078	1,713,206	0.084
Al Salam Bank	14,372,469	1,429,151	0.100
Ahli United Bank	8,495,511	2,228,492	0.270
Nass Corporation	3,873,540	582,622	0.153

Source: Bahrain Bourse

5.2 GCC Market Trends

Chart 5-5: GCC Indices June 2013 – November 2013



Sources: Bloomberg

The year 2013 witnessed several key developments that shaped GCC equity markets performance including the continuous recovery of the real estate sector in Dubai and the announcement from the Saudi Capital Market Authority in 2012 that it would allow listing by foreign companies that already have their shares listed on other regulated exchanges. The GCC is becoming a mainstream investment destination for international investors, with equity index compilers MSCI and S&P Dow Jones indices due to upgrade Qatar and UAE status to emerging markets next year. The upgrade is going to attract an inflow of investment funds from international markets.

The robust performance of macroeconomic indicators in the GCC countries in 2013 led to a positive overall performance of the GCC markets. Strong economic growth fueled by solid energy prices, strong fiscal positions that were translated to major investment projects in infrastructure, and the recovery of the real estate market had a positive impact on equities in the GCC markets. The GCC markets outlook for next year is poised for continuous growth and positive performance.

Table 5-6: Stock Market Indices in GCC counties

Index	December 2012	June 2013	December * 2013	Dec. 2012- June 2013 (%)	Dec. 2012- Dec. 2013 (%)
Bahrain All Share Index	1,065.61	1,187.79	1,204.4	11.5%	13.0%
Tadawul All Share Index	6,801.22	7,404.12	8,561.8	8.9%	25.9%
Kuwait Market Index	5,934.28	8,300.51	7,592.24	39.9%	27.9%
Qatar Exchange Index	8,358.94	9,238.00	10,453.2	10.5%	25.1%
Dubai Financial Market Index	1,622.53	2,366.79	3,237.2	45.9%	99.5%
Abu Dhabi Index	2,630.86	3,562.88	4,149.6	35.4%	57.7%
Muscat Securities Market Index 30	5,760.84	6,417.83	6,793.4	11.4%	17.9%

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

*December 23rd. or latest available.

Gulf stock markets soared in 2013, with all index recording double-digit year on year growth. The biggest year-on-year growth was in the Dubai Financial Market Index (99.5%) followed by Abu Dhabi Index (57.7%). The two indices benefited from expansionary fiscal policy carried on by the emirates to develop the infrastructure and real estate sector. The Kuwait Market Index recorded a year on year growth of 27.9%. On the period between December 2012 and June 2013, all GCC market indices experienced varying degrees of increases. The Dubai Financial Market Index and Kuwait Market Index experienced the most increases of 45.9% and 39.9% respectively, while Bahrain All Share Index increased by 11.5%.

5.3 Overall assessment of the equity market

The performance of the Bahrain All Share Index has been upwardly trending with a 13.0% year-on-year growth in the Index and a 17.0% year-on-year increase in market capitalization. Bahrain Bourse posted four consecutive months of positive growth. Signs of a recovery in the market after the downward trend between May 2011 and October 2012 materialized as the situation improved in Bahrain and investors' confidence was restored. Despite the developments, the Bahrain Bourse continues to make efforts to strengthen its ties with other regional stock markets.

Throughout the recent two years of political uncertainty in the MENA region, GCC states were resilient during 2013 and delivered strong and sustainable growth in their economies supported by robust oil prices, government backup of key economic sectors and the attractive investment opportunities driven by the favorable demographic profile and solid stocks that reached to attractive levels along with steady growth in corporate earnings.

Overall, the GCC stock markets are set to experience continuous positive growth in 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 boost the performance of the stock markets.

Chapter

6

6. Payment and Settlement Systems

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. Wholesale payments refer to the real time gross settlement system to process inter-bank payments.

Decrease in volume and value of cheques processed through the ACS.

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. The number of ATM's in Bahrain grew in 2012 by a total of 33 ATM's reaching a total 483 compared to 450 ATM's in 2011.

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.

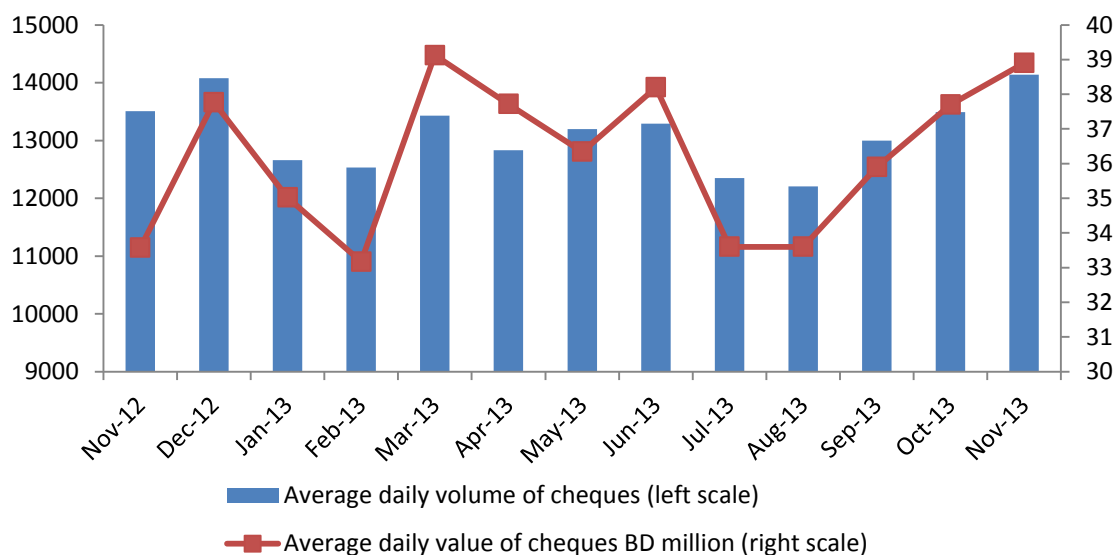
Increase in average daily volume and value of cheques through ACS

In the period between June 2013 and November 2013, the average daily volume of cheques processed through the Automated Cheque Clearing System (ACS) increased by 6.4% from 13293 to 14141 (year-on year increase of 4.7%) (Chart 6-1). The average daily value of cheques increased by 1.8% from BD 38.2 million in June 2013 to BD 38.9 million in November 2013 (year-on-year increase of 15.8%).

The average daily volume kept fluctuating through June 2013 until Nov 2013; however the biggest increase was by the high 6.5% in September 2013 followed by a 3.8% increase in October 2013. The average daily volume reached its peak in November 2013 of 14141 average daily transactions. The average daily volume had a dip in June and July 2013 by 7.1% and 1.1% respectively.

The average daily value of cheques was steady between June 2013 and November 2013. The highest value of cheques cleared was seen in November 2013 by BD 38.9 million whereas the lowest value of cleared cheques occurred in July 2013 and August 2013 both by BD 33.6 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 2012-2013



Source: Central Bank of Bahrain

6.2.2 E-Payment systems

ATM and EFTPOS

The availability of cash has increased over the past decade, thanks to the growing number of ATMs. The table above reveals that the number of ATM's in Bahrain grew in 2012 by a total of 33 ATM's reaching a total 483 compared to 450 ATM's in 2011. ATMs (with a credit transfer function) increased marginally by 1 ATM reaching 325 at 2012. These ATMs accept any type of credit or debit card and households can make withdrawals at any branch of any bank or at any ATM, regardless of which bank holds their account. Several banks in Bahrain operate their own proprietary ATM networks. These ATM networks are interconnected through the BENEFIT network, which is the national switch of Bahrain that allows the bank customers to share all of the ATMs located in the Kingdom. The BENEFIT Company is also a member of the GCC-wide cross boarder ATM sharing arrangement known as GCC Net, thus allowing all GCC issued cards to be used in all ATMs across the GCC. BENEFIT also enables AMEX card holders to use Benefit switch to withdraw cash using any of the ATMs in Bahrain, Qatar, Oman, Kuwait and UAE.

Table 6-1: Evolution of the number of ATMs in Bahrain

Terminals located in the country	2008	2009	2010	2011	2012
ATMs	241	376	386	450	483
ATMs with a cash withdrawal function	241	376	386	450	483
ATMs with a credit transfer function	164	299	308	324	325

Source: CBB

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](#)).

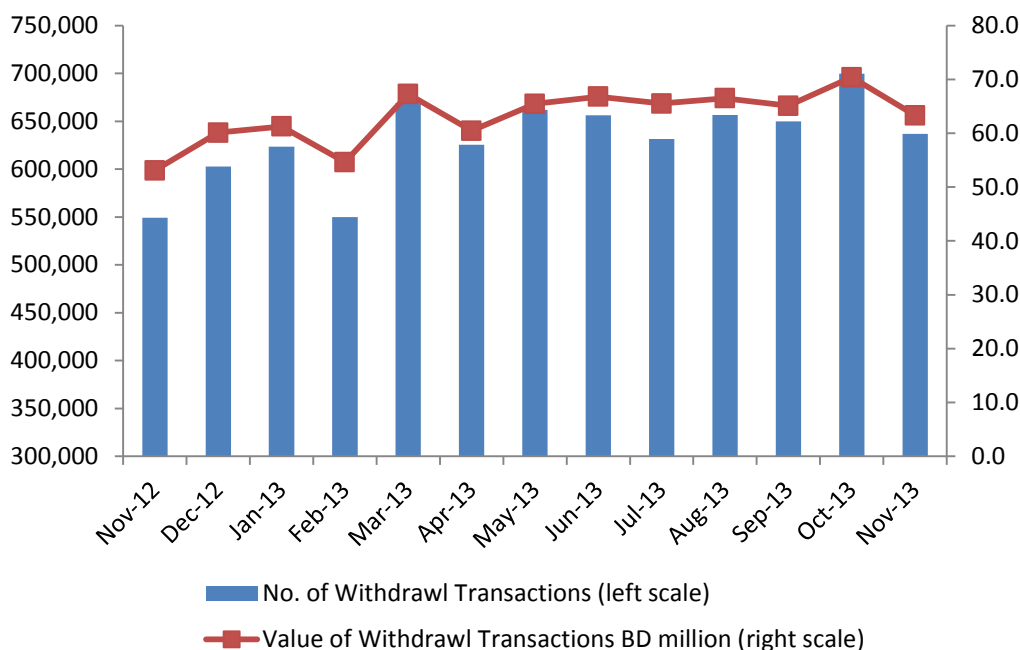
Year on year growth in number and value of ATM withdrawals

Between May 2013 and November 2013, the number of withdrawal transactions processed through the ATM Clearing System⁷ decreased by 3.8% from 662,078 to 636,866 (year-on-year growth was 15.9%)(Chart 6-2). Similarly, in value terms, total withdrawals processed decreased by 2.1% from BD 65.4 million to BD 63.3 (year-on-year growth was 10.2% growth).f

⁷ The ATM statistical data is provided by the BENEFIT Company and consists of ATM withdrawals related to customers who use ATMs of other banks only.

There have been fluctuations in both the value and volume of transactions between November 2012 and November 2013. October 2013 witnessed the highest number of ATM withdrawals with an increase of 7.7% whereas the biggest decrease in the number of withdrawals took place in the month of November 2013 by almost 9.0%. This corresponds with the value of withdrawals as well where the highest value of withdrawals was witnessed in October 2013 by BD 70.4 million and the lowest value of withdrawals in November 2013 by BD 63.3 million.

Chart 6-2: Number and Value of ATM Transactions, Nov 2012- Nov 2013



Source: The Benefit Company

Regarding Point of sales, BENEFIT connects all of the Point of Sale (POS) terminals available in the major retail shops and outlets in the Kingdom. Through the national network of The BENEFIT Company, all banks customers are able to pay for their purchases in Bahrain using their debit cards (ATM) without the need for them to carry cash in their pockets. Table below shows that EFTPOS terminals (electronic fund transfer at point of sale) increased by 871 terminal (6.6%) reaching 14,068 in 2012.

Table 6-2: Evolution of the number of POS and EFTOPOS in Bahrain

Terminals located in the country	2008	2009	2010	2011	2012
POS terminals	9,429	11,194	12,404	13,197	14,068
EFTPOS terminals	9,429	11,194	12,404	13,197	14,068

Source : CBB

Card Payments

During the past few years, the use of payment with cards in Bahrain has increased remarkably. All retail banks propose these cards to their customers as an alternative of cash and cheques. The main cards issuers in Bahrain are Visa and MasterCard but other providers like American Express and Diner Club are also present in the Bahraini banking system.

Basically, there are two types of cards in payments in Bahrain: Debit Cards and Credit Cards. Debit cards are used as a means of payment for retail and wholesale transactions at EFTPOS as well as for cash withdrawal at ATMs. Broadly, transactions are achieved via an online transfer of funds from the cardholder's bank or debit card account. Debit cards in Bahrain are PIN based cards only.

The use of credit cards has become increasingly popular in recent years. All major credit card brands, such as American Express, JCB, MasterCard and Visa, are issued and accepted in Bahrain. The most widely credit card used in Bahrain is Visa provided CrediMax. CrediMax was the first card acquirer that introduced state-of-the-art Point of sales (POS) machines that are well equipped to accept Smart Card including Visa, MasterCard, JCB products, Benefits, and GCC Net.

The issuance of credit cards is subject to Central Bank of Bahrain guidelines and to regulations on, for example, income eligibility criteria and credit card marketing. Credit card payment involves credit provision by the card issuers to the cardholders. In a credit card transaction, the card issuer pays for the goods and services on behalf of the consumer, after charging the retailer a merchant discount fee. If cardholders settle their accounts within the payment grace period offered by the card issuers (usually at least 30 days), the provision of credit is interest-free. This buy-now-pay-later benefit is strikingly different from other means of retail payment, and explains why credit cards have become so popular in Bahrain.

Table 6-3: Classification and Number of cards issued in Bahrain

Cards issued in the country	2008	2009	2010	2011	2012
<i>Cards with a cash function</i>	810,309	913,088	861,229	1,007,330	1,108,507
<i>Cards with a debit function</i>	754,412	838,764	793,602	917,729	1,018,006
<i>Cards with a delayed debit function</i>	9,386	8,097	6,877	8,508	7,666
<i>Cards with a credit function</i>	151,870	173,403	161,605	181,058	171,232
<i>Cards with an e-money function</i>	3,884	5,608	9,413	13,509	24,237
<i>of which: cards with an e-money function which have been loaded at least once</i>	2,719	4,038	6,155	8,533	11,246
<i>Total number of cards (irrespective of the number of functions on the card)</i>	883,356	989,599	942,089	1,093,013	1,192,414
<i>of which: cards with a combined debit, cash and e-money function</i>	139,337	154,743	139,555	169,655	192,715

Source: CBB

According to Table 6-3 above, the total number of cards (irrespective of the number of functions on the card) increased by 99,401 cards or (9.1%). Cards with cash function increased by 101,107 reaching 1,108,507 cards in 2012. Cards with a debit function increased by 100,277 reaching 1,018,006 cards in 2012. Cards with an e-money function increased by 10,728 reaching 24,237.

On the other hand, Cards with a delayed debit function decreased by 842 cards reaching a total of 7666 cards in 2012. Cards with a credit function surprisingly dropped in in 2012 by 9,826 cards to reach 171,232 cards in the same year.

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. The central bank of Bahrain is actively working in the implementation of mobile payment at point of sale in the next few months.

Box 1: Recent Innovation in E-payment System: The case of virtual money Bitcoin

Over the past few months, the emergence of virtual currencies in internet has raised a serious concern for central bankers, governments and policymakers. Nevertheless, the debate is not new. In reality, it was initially discussed in the mid-nineties following the ICT revolution and the emergence of new means of payments. Since that date, we have observed the development of a variety of innovating payment methods in the real world and on the web (regional money like the German regional currency Chiemgauer, virtual money like LinkedEL of the second life, M-payment, contactless payment, Litecoin (LTC), Peer-to-peer Coin (PPC), etc.). These innovations have started to be progressively more popular and some of them have even taken over traditional means of payments such as cheques, paper and coin money. In some European countries the moved towards a “checkless society” has been achieved by some nations.

The new form of “money” that has received the most attention around the world is called “e-money products”. It is actually an evolution of the monetary form in parallel with coins, fiduciary and scriptural money systems. E-money products can be used to carry out micro-transactions both in the traditional market via an e-wallet which has a specific monetary value and on the virtual market by means of a storage device of currency units located on the hard disk of a personal computer. The e-money card is a new means of payment which makes it possible to transfer value from card to terminal or card to electronic wallet, both in the real world and via networks. This monetary innovation is seen as a fundamental achievement; it

carries a preloaded monetary value and can be used as a means of payment for multiple small value purchases.

Recently, another new virtual currency, named “Bitcoins”, has emerged. Bitcoins is a new generation of decentralized, peer-to-peer virtual currencies and was considered as the first implementation of a concept called “crypto-currency”. Bitcoins were introduced as open source software in 2009. An e-currency user can get Bitcoins by converting conventional currency at an exchange platform (Bit Floor), and then Bitcoins will be stored at an e-wallet to be exchanged for sending electronic units (currency) between participants (miners) to exchange for products and services (The total number of Bitcoins is not supposed to exceed 21 million). One of the advantages of Bitcoins is its convertibility. In fact, Bitcoin’s holder can redeem e-currency into conventional fiat money or real *life* money whenever he wants.

Bitcoins are controlled by all Bitcoins users across the world. Unlike fiat money, a monetary system under Bitcoins does not need a central bank or government. The Bitcoin’s supply is determined by an algorithm that allows computers around the world to set its value and its exchange rate against the other currencies. The reel value of Bitcoins is determined by the supply and demand. Demand for bitcoins has been widening based on measures such as the number of bitcoin wallets downloaded and the number of participants (miners) joining the digital currency universe.

Unlike the other existing virtual currencies such as Litecoin (LTC) and Peer-to-peer Coin (PPC), Bitcoin has received a considerable deal of attention by central bankers and regulators. This is because central banks did not have the power or the right authority to directly supervise or regulate these private currencies or the issuers that manage them. Therefore, e-private currency such as Bitcoins may raise new risks related to law enforcement and supervisory issues.

During the past few months, the exchange rate of Bitcoins against the US\$ has been very volatile. According to Figure below we have seen various steps. In the first step (the first quarter of 2013), the cryptocurrency increased progressively to reach US\$200 in mid-April 2013. Few days later, (second step) Bitcoins declined considerably to stood below US\$100. In the third phase, Bitcoins fluctuate around US\$ 150 until end-October 2013. In the fourth step, Betcoins have experienced a boom to reach an unprecedented level of US\$1200 on Mt. Gox, in early December 2013; this is the first time this level has been reached in a US dollar denominated exchange rate.

In less than a year, Bitcoins moved from \$13.50 to US\$1,200, thus a historical appreciation of 5,000%. To conclude, the virtual currency has become a very lucrative investment. Federal Reserve Chairman Ben Bernanke states that Bitcoin “*may hold long-term promise, particularly if the innovations promote a faster, more secure and more efficient payment system.*”



Source: <http://bitcoincharts.com/charts/>

Central banks around the world have different reactions and viewpoints regarding the emergence of Bitcoins. In reality, they cannot do anything to stop e-money development become e-money issuers not under their regulation and supervision. Ben Bernanke said that: “the Federal Reserve generally monitors developments in virtual currencies and other payments system innovations; it does not necessarily have authority to directly supervise or regulate these innovations or the entities that provide them to the market. In general, the Federal Reserve would only have authority to regulate a virtual currency product if it is issued by, or cleared or settled through, a banking organization that we supervise.” However, to limit the risks related to virtual currencies, some countries have quickly banned banks from handling Bitcoin transactions. For example, China forbidden any use of currency without a ledger tender status and restricted the exchange of Bitcoins against the Chinese Yuan, (also known as Renminbi). In Europe, the European Banking Authority has warned that Bitcoin lacks consumer protections. In the US, it seems that Bitcoin system is not a serious concern. The Federal Reserve is currently working on how improving the supervision on the suspicious transactions to avoid money laundering and to keep the financial sector sound and safe.

Source: FSD Working paper N25

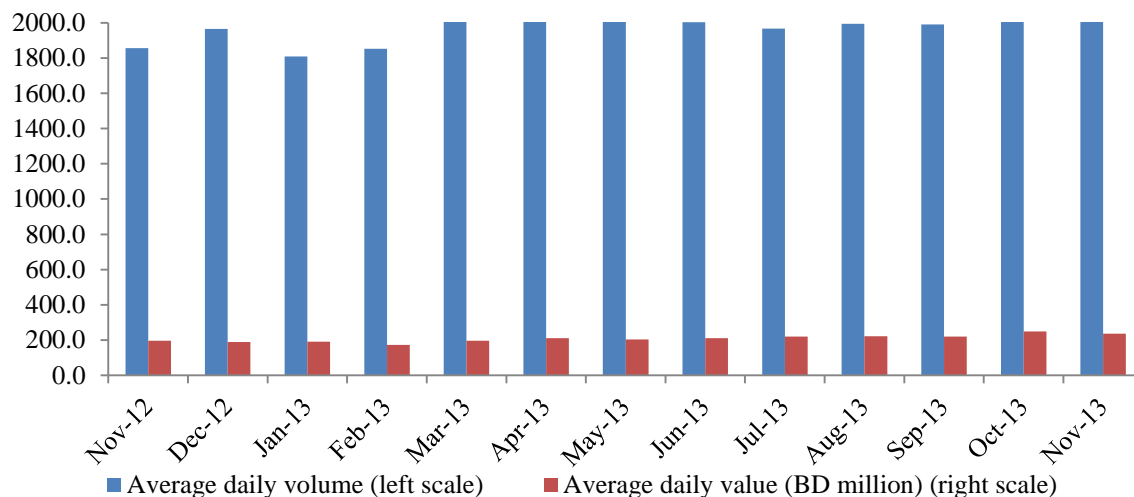
6.3 Wholesale Payments

Increase in volume and value of payments through RTGS

In Bahrain, wholesale transaction are made through 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 November 2012 and November 2013 is seen in Chart 6-4 below.

Chart 6-4: RTGS System- Average Daily Volume and Value of Payments Processed, Nov 2012 – Nov 2013



Source: Central Bank of Bahrain

Between June 2013 and November 2013, the *average daily volume of transfers* increased by 13.6% from 2003.1 to 2276.5 (22.6% year-on-year increase). In addition, the value of these transfers is increasing. In value terms, the *average daily value of transfers* witnessed a 11.5% increase from BD 211.5 million in June 2013 to BD 235.8 million in November 2013 (20.3% year-on-year increase).

6.4 Payment system and the degree of the financial inclusion in Bahrain

According to the table below, we can conclude that the Bahraini financial sector is inclusive. Access to finance measured by the number of Branches and ATM machines per 100,000 people is large. In terms of Bank branches per 100,000 people Bahrain stands at 13. When looking at number of ATM machines per 100,000, Bahrain records 30 ATM Machines per 100,000.

Table 6-4: Financial Inclusion Indicators Bahrain

	Bank branches per 100,000	ATM Machines per 100,000	% of Adults with Bank Accounts
Bahrain	13	30	64.5

Source: Global Findex 2012, World Bank.

Looking at the table below it can be seen that the number of bank accounts increase remarkably, moving from 931,961 to 1377,858 accounts in 2008 and 2012 respectively. This confirms the higher inclusion of the financial sector in Bahrain and reveals the easy access to financial services. Here, it is worth mentioning that while most of the emerging countries apply high commissions and fees to all the financial services and operations, in Bahrain, most of the services are free.

Table 6-5: Number of customer accounts*

	2008	2009	2010	2011	2012
Total no. of bank customer accounts	931,961	1,099,586	1,251,964	1,359,375	1,377,858

*BD & foreign currency demand & savings) at the end of the year. Source: CBB

Box 3: What's financial inclusion?

Financial Inclusion refers to the accessibility of financial services to the different socioeconomic classes of a society, including banking and saving accounts, transfer and payment services, insurance services, and financing and credit services. If such financial services were unavailable or underprovided, some people might resort to unofficial channels, which are usually untrusted, unregulated, and solicit higher interest rates.

The widespread use of informal-savings mechanisms suggests a missed opportunity for the market to provide safe, affordable financial products to the unbanked. For example, adults who don't use banks or other formal financial institutions often turn to fairly sophisticated methods to manage their finances, such as rotating-savings clubs or credit associations. Therefore, financial inclusion is an integral part of the development of economies and it is vital for sustainable economic growth.

When people have access to credit, new opportunities surge. On the macro level, the advantage is far more visible. Financial inclusion will be channeling savings of the poor into the financial system. Moreover, the expansion in low cost deposits will aid in the risk of diversification of the banks making them more dependent on low cost deposits rather than depending on the large deposits, hence, improving liquidity of the system.

In the recent years, policy-makers across the world have shown an increased interest in Financial Inclusion. The interest arises from the substantial importance of Financial Inclusion in facilitating access to financial services, creating jobs, and improving the standards of living and economic growth.

The recent World Bank financial inclusion data base reveals that 2.5 billion of the global adult population has no means of accessing regulated financial services. The account holders in developing countries represent 41% of the adult population while its 89% in the developing world (WBGFD 2013). Such absence of financial services results in the poor to rely on illegitimate money lenders at high rates of interest where they might be forced to pledge their gold or life stock.

Illegitimate lenders might also intimidate borrowers with unrealistic interest rates, consequently, borrowers will default which might result in borrowers dealing in drugs or prostitution on the lenders behalf. Furthermore people who save in an unfashion way and (i.e. not in banks) will not benefit from interest rates on savings. In addition poor countries where people are forced to save at home are most likely more exposed to theft.

Annex: Financial Soundness Indicators

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

	Sept. 2012	Mar. 2013	Sept. 2013
Capital Adequacy			
Total capital adequacy ratio (%) *	18.9	19.0	18.5
Tier 1 capital adequacy ratio (%) *	15.6	15.8	14.3
Leverage (assets/capital)(times)*	7.9	8.2	8.3
Non-performing loans net provisions to capital ratio (%)*	10.5	8.6	9.2
Non-performing loans (% of gross loans)	4.8	4.7	4.8
Specific provisions (% of NPLs)	62.7	54.4	52.9
Net non-performing loans (% of net loans)	2.4	1.9	2.0
Loan concentration (share of top-2 sectors) (%)	29.8	30.4	30.7
Real Estate/ Construction exposure (%) **	28.3	28.5	28.4
Earnings			
ROA Retail banks (%)	0.7		1.4
<i>ROA Local retail banks (%)</i>	<i>0.7</i>		<i>1.4</i>
<i>ROA Overseas retail banks (%)</i>	<i>0.6</i>		<i>1.3</i>
ROE Local retail banks (%)***	7.4		15.0
Net interest income (% of gross income)	50.4		64.5
Net fees & commissions (% of gross income)	12.0		14.5
Operating expenses (% of gross income)	32.5		42.3
Liquidity			
Liquid assets (% of total assets)	27.6	29.6	26.5
Liquid assets (% of short-term liabilities)	38.3	41.2	37.7
Loan-deposit ratio (%)	66.9	62.9	62.8
Deposits from non-bank sources (% of total deposits)	75.4	77.8	78.1

* Locally-incorporated banks only

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

	Sept. 2012	Mar. 2013	Sept. 2013
Capital Adequacy			
Total capital adequacy ratio (%) *	23.4	23.3	22.4
Tier 1 capital adequacy ratio (%)*	19.7	19.9	19.1
Leverage (assets/capital)(times)*	5.2	5.4	5.5
Non-performing loans net provisions to capital ratio (%)*	5.5	5.4	5.3
Asset Quality			
Non-performing loans (% of gross loans)	9.2	9.4	9.4
Specific provisions (% of NPLs)	65.5	64.4	62.8
Net non-performing loans (% of net loans)	4.1	3.2	3.4
Loan concentration (share of top-2 sectors) (%)	48.4	55.5	51.7
Real Estate/ Construction exposure (%) **	7.5	9.5	9.6
Earnings			
ROA Wholesale Banks (%)	0.4		1.0
<i>ROA Local wholesale banks (%)</i>	<i>0.3</i>		<i>0.7</i>
<i>ROA Overseas wholesale banks (%)</i>	<i>0.5</i>		<i>1.2</i>
ROE Local wholesale banks (%) ***	2.2		4.3
Net interest income (% of gross income)	46.0		49.1
Net fees & commissions (% of gross income)	43.2		22.1
Operating expenses (% of gross income)	41.9		39.9
Liquidity			
Liquid assets (% of total assets)	17.4	18.2	16.9
Liquid assets (% of short-term liabilities)	27.2	31.4	28.9
Loan-deposit ratio (%)	78.3	59.4	60.1
Deposits from non-bank sources (% of total deposits)	36.2	40.0	42.2

* Locally-incorporated banks only

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

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

Source: Central Bank of Bahrain

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

	Sept. 2012	Mar. 2013	Sept. 2013
Capital Adequacy			
Total capital adequacy ratio (%) *	18.1	18.2	17.5
Tier 1 capital adequacy ratio (%) *	15.4	15.7	14.9
Leverage (assets/capital)(times)*	7.4	7.4	7.8
Non-performing facilities net provisions to capital ratio (%)*	58.9	32.1	30.8
Asset Quality			
Non-performing facilities (% of gross facilities)	22.6	14.3	13.6
Specific provisions (% of NPFs)	36.6	38.3	39.1
Net non-performing facilities (% of net facilities)	16.8	8.7	8.0
Concentration of facilities (share of top-2 sectors) (%)	34.8	39.3	36.1
Real Estate/ Construction exposure (%) **	29.7	23.0	27.6
Earnings			
ROA (%)			0.1
ROE (%) ***			1.1
Net income from own funds, current accounts and other banking activities (% of operating income)			63.2
Net income from jointly financed accounts and Mudarib fees (% of operating income)			27.4
Operating expenses (% of operating income)			87.1
Liquidity			
Liquid assets (% of total assets)	10.7	12.8	13.7
Facilities-deposit ratio (%)	82.1	78.9	78.2
Current accounts from non-banks (% of non-capital liabilities, excl. URIA)	21.2	21.3	22.6

* 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
Financial Soundness Indicators—Islamic Wholesale Banks (End of period)

	Mar. 2012	Sept. 2012	Mar. 2013
Capital Adequacy			
Total capital adequacy ratio (%) *	26.1	25.2	25.0
Tier 1 capital adequacy ratio (%) *	25.2	23.8	23.6
Leverage (assets/capital)(times)*	5.8	5.8	5.8
Non-performing facilities net provisions to capital ratio (%)*	9.5	4.3	4.3
Asset Quality			
Non-performing facilities (% of gross facilities)	9.3	5.4	5.4
Specific provisions (% of NPFs)	63.9	73.1	72.8
Net non-performing facilities (% of net facilities)**	3.4	1.5	1.5
Concentration of facilities (share of top-2 sectors) (%)	47.1	40.7	40.0
Real Estate/ Construction exposure (%) **	14.6	16.8	16.9
Earnings			
ROA (%)	0.3		0.6
ROE (%) ***	1.7		3.6
Net income from own funds, current accounts and other banking activities (% of operating income)	68.2		65.6
Net income from jointly financed accounts and Mudarib fees (% of operating income)	31.4		32.9
Operating expenses (% of operating income)	55.8		56.7
Liquidity			
Liquid assets (% of total assets)	21.8	20.7	21.1
Facilities-deposit ratio (%)	67.6	71.5	71.2
Current accounts from non-banks (% of non-capital liabilities, excl. URIA)	44.0	43.2	43.1

* Locally-incorporated banks only

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

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

Source: Central Bank of Bahrain

END