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Preface

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

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

This objective is the primary responsibility of CBB's Financial Stability Directorate, which conducts regular surveillance of the financial system to identify areas of concern and undertakes research and analysis on issues relating to financial stability. In pursuit of its objective of promoting financial stability, the CBB conducts regular financial sector surveillance, keeping a close watch on developments in individual institutions as well as in the system as a whole.

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

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

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

- Part I: Looks at national and international developments:
  - Chapter 1: Reviews recent international financial developments.
  - Chapter 2: Examines the recent developments in Bahrain's financial sector and the household sector.
- Part II: Looks at the developments in the banking sector:
  - Chapter 3: Evaluates the financial condition and performance of the entire banking Sector of the Kingdom.
  - Chapeter 4: Evaluates the financial condition and performance of conventinoal banks
  - Chapter 5: Evaluates the financial condition and performance of Islamic banks.
- Part III: Looks at the developments in equity market and payment and settlement systems.

- Chapter 6: Reviews recent trends on the equity market.
- Chapter 7: Focuses on stability issues relating to the payment and settlement systems.

Unless indicated otherwise, Chapter 3, 4 and 5 of the report analyzes data covering the period between end-March 2016 and end-Septem ber 2016.

Executive Summary

Global Macro Financial Environment Overview

The global economic and financial conditions faced new challenges in the second half of 2016. The exit of the UK from the EU followed by the US election also added uncertainty to the global financial markets. The United States growth slowed down in the first half of 2016 before gaining some momentum in the second half. In the Euro Area, economic activity showed some improvement after the first quarter of the year. Growth for the BRIICS countries (Brazil, Russia, India, Indonesia, China and South Africa), was the weakest in emerging markets. The Australian, Canadian and UK economies had shown modest signs of recovery.

Recent geo-political concerns have weighed on the power of the Euro. The economic performance of the Eurozone economy along with the uncertainty on the future of the UK within the Euro Area added some pressure on the Euro. The Euro continued to fall against the US Dollar reaching USD 1.039 on the interbank market in December 20th 2016. Since our June report, the British pound (GBP) depreciated against the US dollar. The exit from the Eurozone was the principle reason of this sharp depreciation.

Financial and Non-Financial Sector Overview

Bahrain's banking sector represented 6.2 times of GDP in Q3 2016. Total retail banking assets continued growing reaching BD 31.5 billion in November 2016. Retail bank's assets in the GCC represented 21.6% of total assets. The amount of credit provided by them reached BD 8,076 million in November 2016. Total deposits reached BD 16,473.2 million in November 2016, where 56.3% of them are domestic deposits.

Money supply continued to grow were M2 stood at BD 10,286.1 million in end-November 2016. M3 was BD 12271.7 million in end-November 2016, 3.7% higher than in November 2015. The inflation rate in consumer prices has always been stable in Bahrain.

The household sector plays an important role in financial stability and the overall economy. The construction and real estate sector plays a huge importance on economic developments and is a good indicator of macroeconomic conditions in the country.

Banking Sector

The Capital Adequacy Ratio (CAR) for the banking sector stood at 19.2% in September 2016. Non-performing loans (NPL) ratio increased to 5.5% in September 2016. Specific provisions showed a decrease to 54.1% in September 2016.

Return-on-assets (ROA) reached 1.3% in September 2016. Return-on-equity (ROE) increased to 6.0% in September 2016. By September 2016, the overall loan-deposit ratio was 67.9% and Liquid assets stood at to 22.8%.

Conventional Banks

For Conventional Retail Banks, CAR increased to 19.6% in September 2016. Non-performing loans (NPL) ratio increased to 4.7% in September 2016 and the loan portfolio of retail banks remains concentrated. As at end-September 2016, return-on-assets (ROA) was at 1.1%. Return-on-equity (ROE) for *locally-incorporated banks* stood at 11.4% in September 2016.

For Conventional Wholesale Banks, the CAR for locally-incorporated wholesale banks increased to 19.8% by September 2016. Loans classified as non-performing increased to 5.5% of total loans. ROA for the conventional wholesale banking sector was at 0.6% in September 2016. ROE for *local wholesale banks* increased from 2.5% to 3.6%. Liquid assets for wholesale banks as a proportion of total assets increased to 24.6% in September 2016 from 22.7% in March 2015.

Islamic Banks

The CAR of Islamic retail banks increased to 17.1% in September 2016. Non-performing facilities (NPF) ratio decreased to 12.1% and Specific Provisoining also decreased to 34.1%. The return on assets (ROA) for Islamic retail banks remained positive but decreased to reach 0.2% in September 2016 compared to Sept 2015. Return on equity (ROE) decreased to 1.6% for the same period. Liquid asset ratio increased to 12.3% in September 2016. The ratio of total facilities to deposits decreased to 82.9% in September 2016.

The CAR for Islamic wholesale banks increased from 19.1% in March 2016 to 19.3% in September 2016. As of end-September 2016, NPF ratio for Islamic wholesale banks decreased to 2.9% and provisioning increased to 82.4% over the same period. Return on assets (ROA) increased to 0.2% in September 2016. Return on equity (ROE) increased as well to 1.6% in September 2016. As of end-September 2016, liquid assets of Islamic wholesale banks represented 18.9% of total assets and the facilities deposit ratio decreased from 62.1% to 61.6% in September 2016.

Performance of Equity Markets

As at December 2016, Bahrain Bourse recorded a total listing of 44 Companies, 19 Mutual funds and 14 Bonds and Sukuks. *Year-on-year* data demonstrates that the Bahrain All Share Index increased by 4.56 points (0.4%) between Dec 2015 and Dec 2016 closing at 1220.45 points by Dec 2016.

Market capitalization of the Bahrain Bourse stood at BD 3.7 billion. As Dec 2016, the price-earnings ratio (P-E ratio) stood at 8.9, an increase from the 8.42 attained in June 2016 and the 8.85 in Dec 2015.

The bulk of the value and the volume of shares traded in Dec 2016 was in the “Commercial Banks” sector whose traded shares by value represented 54.9% of total shares and by volume of shares represented 79.1%. The majority of the number of transactions in December 2016 (1,163 transactions and a 33.2% increase compared to June 2016) was also attained by the “Commercial Banks”.

Payments and Settlement System

Payment and Settlement Systems are central to the smooth operations of the financial sector and the efficient functioning of the overall economy. The RTGS System provides for Payment and Settlement of Customer transactions as a value addition. The daily average volume of Bank transfers for the second half of 2016 decreased by 21.2% to 227 transfers. The value of those transfers have increased in the second half of 2016 was BD259.3 million.

The CBB operates and oversees The Scripless Securities Settlement System (SSSS). The volume of issues in the second half of 2016 was 43. The average value of issues for the second half of 2016 was BD3.06 billion.

As for ATM transactions, the daily average volume of ATM transactions for the second half of 2016 was 39,242 transactions per day. The daily average value of ATM transactions stood at BD3.8 million. With regards to use of cheques, the daily average volume of cheques for the second half of 2016 was 266,400 with a daily average value of BD793.7 million.

Part I:

Developments in the International and Domestic Financial Markets

1. Developments in the International Financial Markets

Chapter 1

Key Points

- Since the last Financial Stability Report (FSR), the global economy has faced new challenges following the Brexit and the US election.
- Persistence of low inflation in many economies, low global demand and low interest rates have stopped the global path of recovery.
- The ECB expressed its willingness to add more quantitative easing program to address concerns about low inflation and to support growth in the Eurozone.
- The U.S. dollar continued to appreciate against many major and emerging market currencies amid divergent monetary policy expectations.

1.1 Overview

Since lasts edition of the Financial Stability Report (FSR), the global economic and financial conditions have faced new challenges in the second half of 2016. Continuing low inflation in many economies, low global demand and low interest rates have added more uncertainty and stopped the global recovery. The exit of the UK from the EU followed by the US election also added uncertainty to the global financial markets. The overall environment showed some signs of resilience by the end of the year.

During the second half of 2016, the global economy had some important events in advanced countries and emerging market economies, summarized as follows:

- The United States growth was slow in the first half of year 2016, averaging just above 1%. The economy gained momentum in the third and fourth quarter growing by 3.5% and 1.4% respectively (source: the US Bureau of Economic Analysis). The US performance was mainly supported the retail sector, strong US dollar and increased export activities.
- In the Euro Area, economic activity was improving since the first quarter of the year supported by stronger private consumption, low inflation rate and monetary policy

by the European Central Bank. Furthermore, labor market improved slightly in many countries.

- In Japan, economic activity in the second half of 2016 was supported by higher industrial production and strong exports activity. The weakness of the Japanese Yen along with lower commodity and energy prices and financial conditions have helped the recovery of foreign trade balance and improved economic growth in the third and fourth quarters. The government continues supporting the local economy by various fiscal stimulus and quantitative easing programs. Employment and wages are continuing to improve.
- In the BRIICS countries (Brazil, Russia, India, Indonesia, China and South Africa), growth was the weakest marking the fifth consecutive decrease and the worst year since the global credit crisis. Falling global commodity prices have affected these emerging markets which rely heavily on export led growth. In 2016, China's economic growth was slowing causing a decline in various equity and commodity markets. Increasing non-financial sector debt is also another issue that threats the Chinese economy. In the third quarter of 2016 net capital outflows from China increased to near-record levels and the Chinese currency has lost almost 3% of its value against the US dollar. The IMF expects a significant slowdown in China's growth in the coming years.
- The overall situation in the Middle East and North Africa (MENA) seems to have taken a turn for the worse since the beginning of 2016 by situations in Libya, Syria, Yemen and Iraq. Oil prices are still and affecting hurting oil-producing countries reserves. Geopolitical risks, subdued global demand and challenging domestic conditions are affecting the MENA's growth.
- GCC countries have recorded economic growth from large infrastructure projects and improvement in non-oil sector growth. GCC banks remain well capitalized and profitable. The challenge for GCC countries faced to find more channels to well manage their public finances and to diversify their economy with persistent low oil prices traded in the end of 2016 at around USD 50 a barrel.
- In Bahrain, banks remain profitable and well capitalized. However, the recent sharp drop in the prices of oil and some other commodities, should it become persistent, will weigh on the economy.

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

1.2 Global Macro-financial Environment

Overall, 2016 was a year where the global economic and financial conditions were weak and risks associated to this environment increased drastically in the second half of the year. The Brexit and the US election were the main reason of the deterioration of the global economy and the increase of market uncertainty.

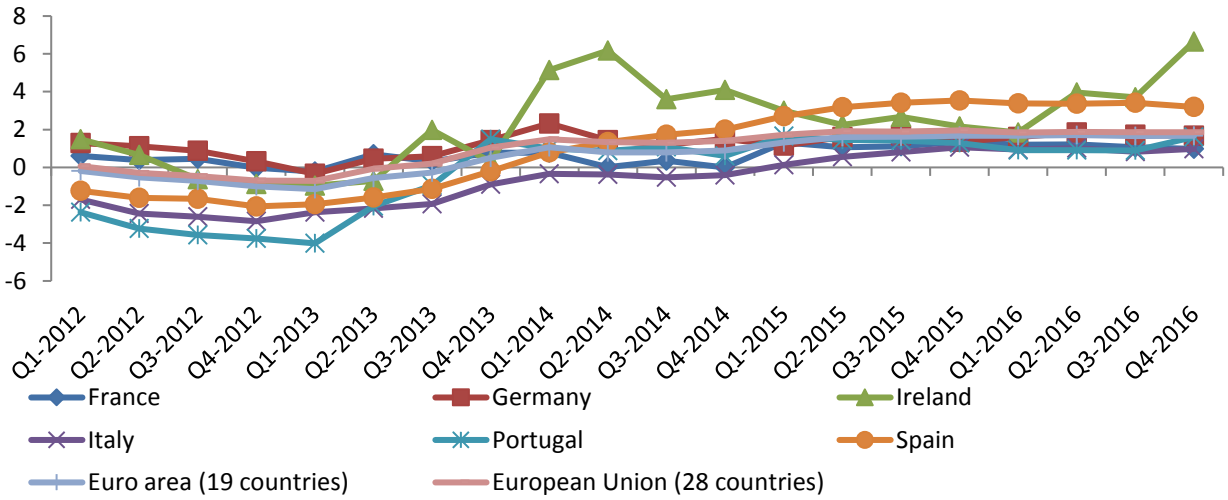
1.3 Recent Trends in the Global Economy

A. Economic Performance

The global economic activity had slow growth mainly due to: slow growth in advanced economies notably in the United States, sharp decline in commodity and energy prices, decreasing trade flows, and diminishing capital flow.

At its last monetary policy meeting of 2016, the Fed announced its decision to raise interest rates, while the accompanying projection materials included an increase in the median estimate for rate hikes for 2017. Recovery in Europe remains slow following the Brexit which amplified volatility and raised new concerns in the global financial markets. Recent OECD's data shows that since 2013, the Euro Area (19 countries) have experienced positive growth. In the fourth quarter of 2016, Euro Area has achieved a growth by 1.7%. Similarly, the Eurozone (28 countries) had achieved 1.8% of growth in the same period a bit lower than the previous quarter where the growth rate was 2.0%.

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



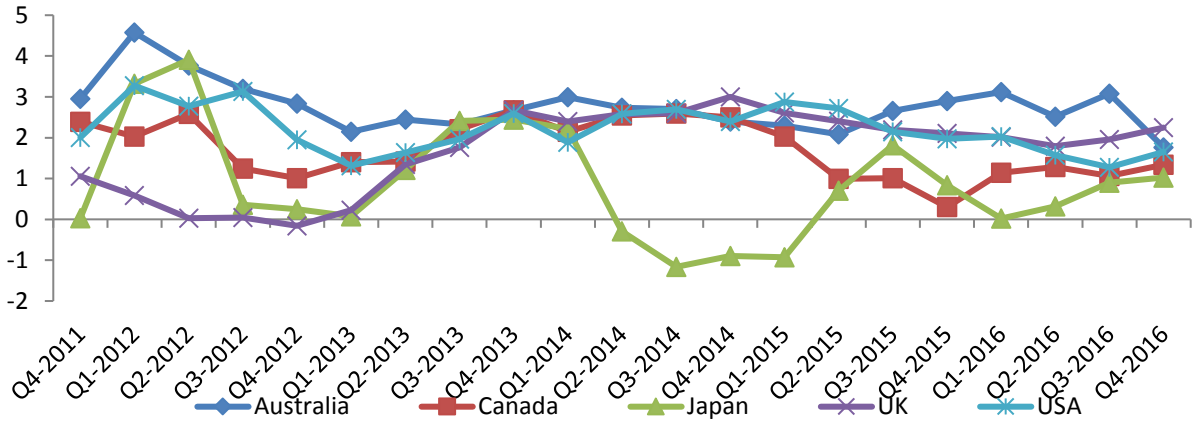
Growth rate compared to the same quarter of previous year, seasonally adjusted
Source: OECD Quarterly National Accounts

At a country level, Ireland achieved the highest best performance as GDP growth reached 6.6% in the fourth quarter of 2016. Spain achieved a high economic growth throughout 2016 and growth was 3.2% in the fourth quarter of 2016. Italy and France showed economic growth. Germany; the largest economy in the Eurozone has experienced better economic activities in the second half of 2016 where GDP growth was 1.6 % in the first quarter of 2016 and 1.7% in the last quarter of 2016.

Regarding non-European countries (Chart 1-2), Australia recorded a slowing GDP growth from 3.1% in the first quarter of 2016 to 1.8% in the fourth quarter of 2016. In the UK, GDP grew

by 2.0% in the first quarter of 2016, supported by The Bank of England quantitative easing programs and despite the exit from the European monetary union (EuroZone), growth rate of the GDP remained stable and its level of the beginning of the year. For Japan, the country's economic performance was weak in the beginning of the year but economic growth improved during the remaining quarters moving from 0% in Q1/2016 to 1% in Q4/2016.

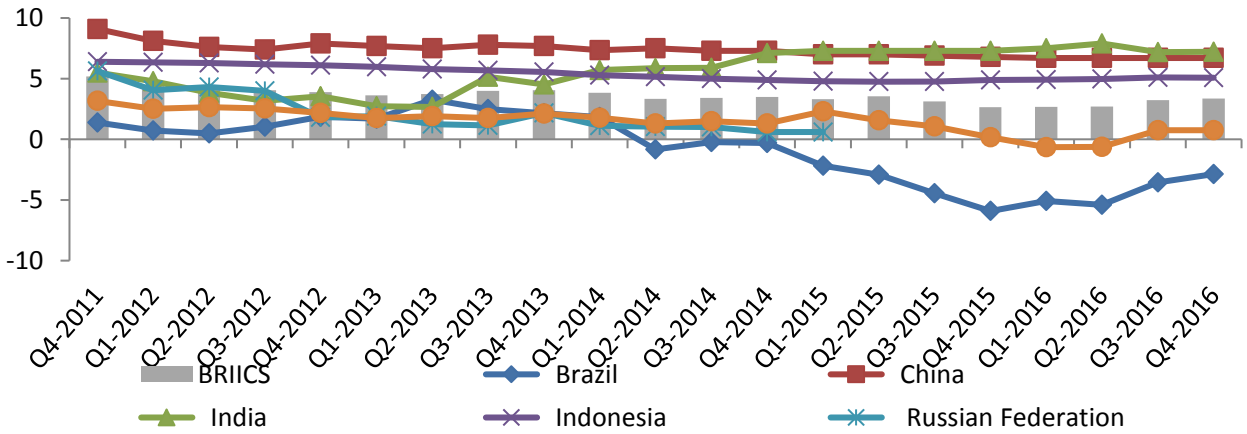
Chart 1-2: Real GDP Growth in Advanced Economies (Quaterly%)*



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

As for emerging economies, Chart 1-3 shows that in the fourth quarter of 2016, the BRICS countries' growth was positive (3.37%- excluding Russia). While India's economy continues to perform well, Brazil's economic performance slowed since the second quarter of 2014 and the country fell into recession for the eleventh consecutive quarter. In China, economic growth increased in the fourth quarter of 2016 (+6.7%). Indonesia has also shown very encouraging economic performance and the country kept a growth rate above 5% during the four quarters of 2016.

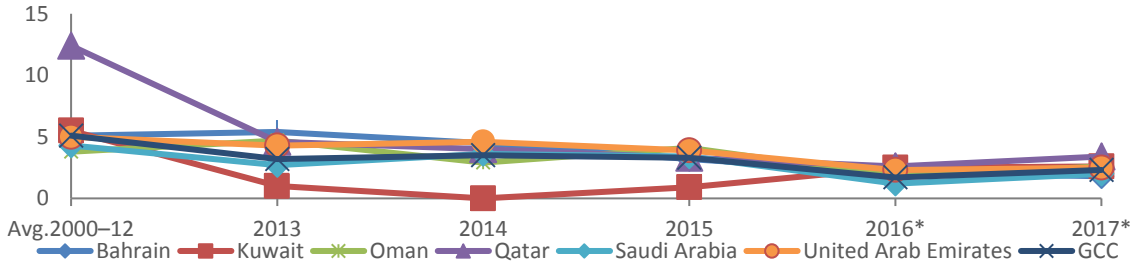
Chart 1-3: Quaterly Real GDP Growth in BRIICS (Quaterly%)*



**Growth rate compared to the same quarter of previous year, seasonally adjusted. *Data on Russia is not available since the 4th quarter of 2015. Source: OECD Quarterly National Accounts.*

The drop of energy prices followed by the continuing uncertainty in the global economy have affected the growth of GCC economies in 2016 as their growth rate moved from 3.3% in 2015 to 1.8% in 2016. Projections for 2017 show that the regional economy will grow at a moderate rate of growth of 2.3%.

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

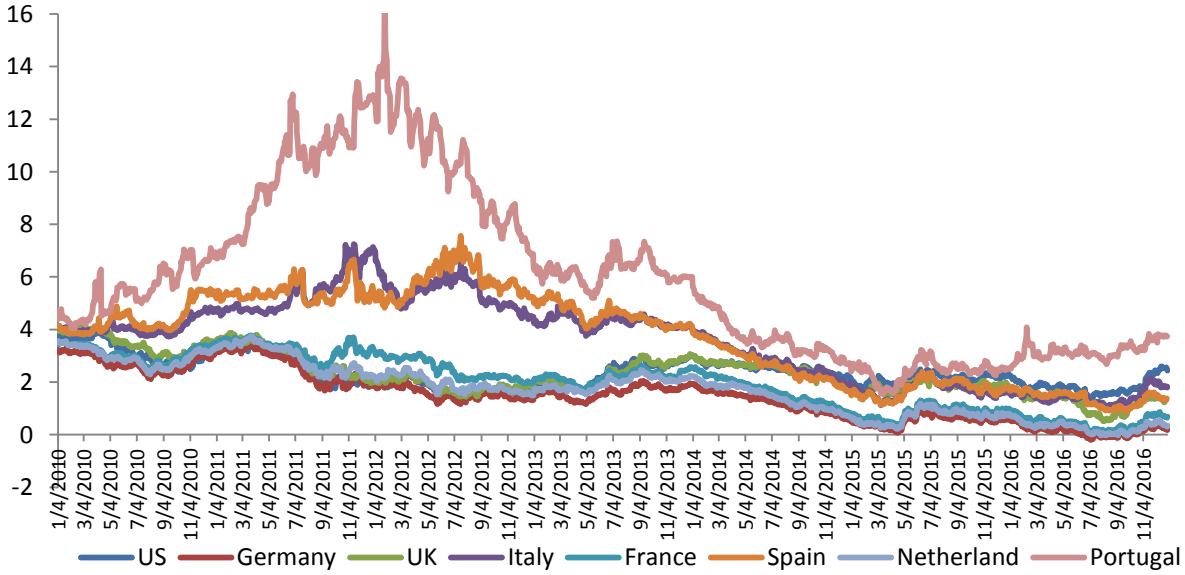


Denotes forecast.
Source: IMF MENAP Regional Economic Outlook, October 2016

B. Financial Markets

Chart 1-5 highlights the change in Yields on ten-year sovereign bonds in some European countries and the US. The graph shows volatility of the sovereign bond yields during the past six months which in turn has triggered market volatility and caused depreciation of some currencies. After a decrease of ten-year maturity, yields on many European bonds increased slightly in 2016. Similarly, the yield on the 10-year bonds in the US increased in the last quarter of 2016, as expectations that the new US administration's plans for tax cuts and causing inflation worries for bond investors. However, the yield on the 10-year benchmark German bond fell into negative zone for the first time in June 2016 and the beginning of October 216 following fears of the Brexit.

Chart 1-5: Yields on 10 Year Sovereign Bonds

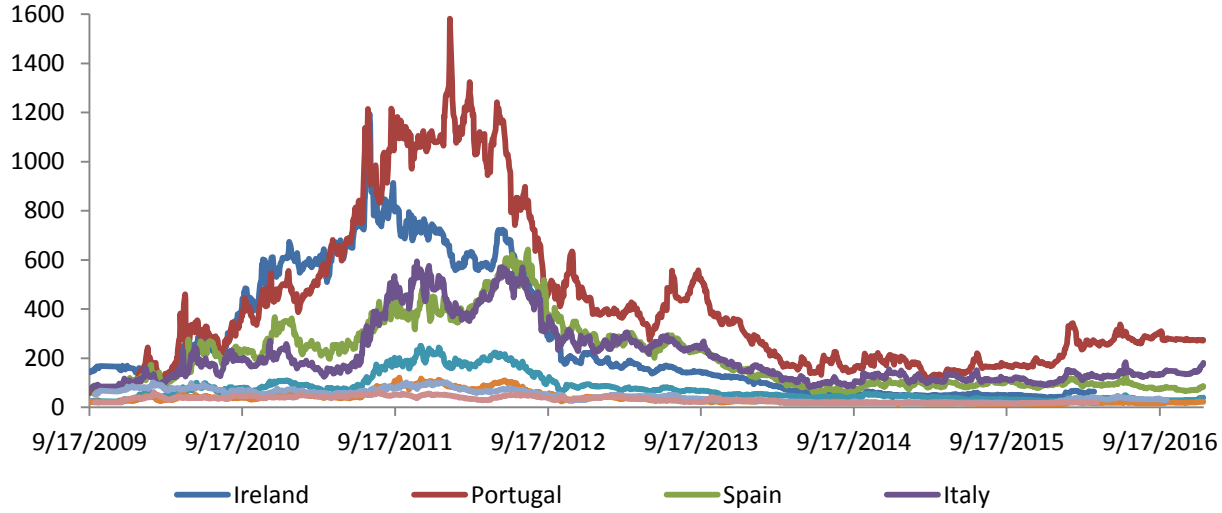


Source: Bloomberg

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.

In the second half of 2016, the average five-years CDS spreads declined (Chart 1-6) in most advanced economies. In the US, UK, Germany and France spreads on Credit Default Swaps remained low since 2009 despite public debt levels that are comparable to or above those of southern Euro area member states. However, during the last quarter of 2016, CDS spread default swaps increased slightly in Portugal and Italy reflecting growing investor anxiety about the health of both countries' banking sectors. Currently, the CDS market is also suffering from a pro-cyclical effect. As bank debt comes under pressure, investors seek to protect positions by buying CDS.

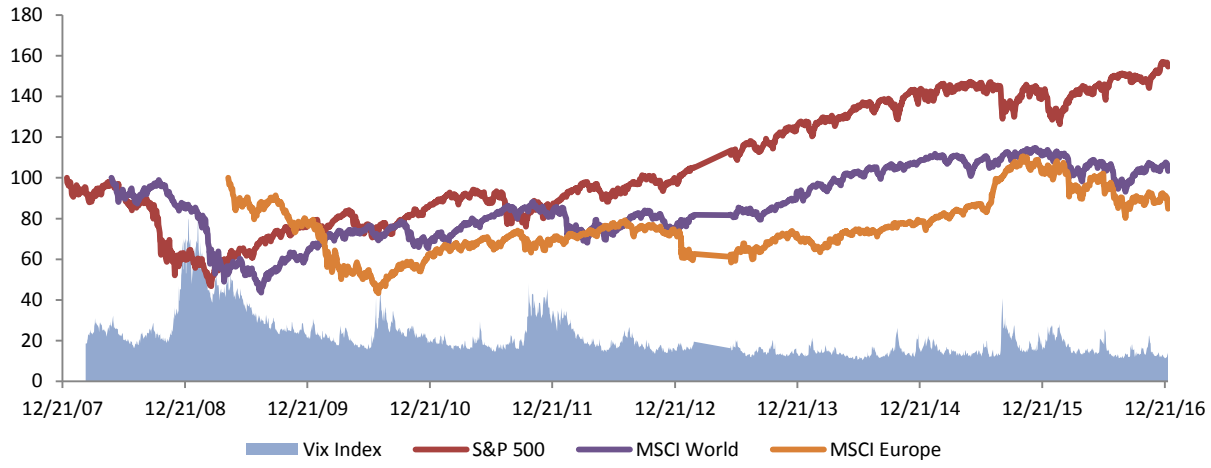
Chart 1-6: Five Year Spreads on Credit Default Swaps



Source: Bloomberg

Regarding global equity markets, following a period of uncertain sentiments during the summer 2013; optimism returned to global equity markets. This was due to policy measures and quantitative easing programs undertaken in some advanced economies that had an immediate impact on equity markets (chart 1-7). Since the last FSR, equity prices have risen across a range of advanced economies. As chart 1-7 shows, equity prices in the Euro area have increased by 5.5% after volatility in the beginning of 2016. Similarly, the S&P 500 has risen by 4.1%, reaching a high record since 2007.

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



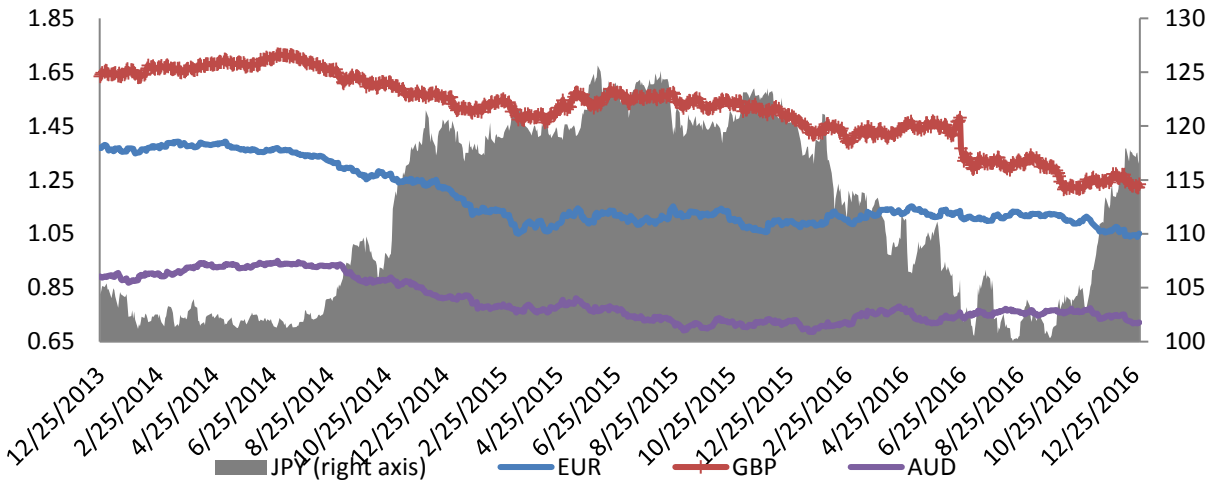
Source: Bloomberg

C. Volatility of the major currencies

The modest economic performance of the Eurozone economy and continued uncertainty on the future of the UK within the Euro Area have added some pressure on the European single currency. Furthermore, the recent geo-political concerns have also weighed on the power of the Euro. As a result, all these factors have devaluated the value of the single currency against its most important competitor. The Euro (EUR) continued to fall reaching its lowest level against the US Dollar (USD) at USD 1.039 on the interbank market on December 20th 2016.

In the second half of 2016, the British pound (GBP) depreciated against the US dollar. The exit from the Eurozone was the principle reason of this sharp depreciation of the UK money. In the beginning of June 2016, the GBP was traded 1.47 against the US dollar and its value moved to 1.234 in the end of December 2016. In the second half of 2016, the Japanese yen (JPY, right axis of Chart 1-8) depreciated sharply against the US dollar as a consequence of the Shinzo Abe's promise to loosen monetary policy and weaken the currency in a bid to reflate the economy. As a result the US dollar was traded against Yen 0.85 in the beginning of the year is now worth to yen 120 by end of December 2016. The Australian dollar depreciated slightly during the past six months, it was traded at 0.74US$ in June 2016, and it is at 0.72US$ in mid-December 2016.

Chart 1-8: Various Currencies Against US dollar



Source: Bloomberg

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

Chapter 2

Key Points

- The retail banking sector assets and wholesale banking sector assets stood at BD 31.5 billion USD 109.1 billion respectively as of end November 2016.
- The volume of credit regains momentum and reached BD 8,076 million in November 2016
- Household debt ratio increased.
- Business debt ratio stable.
- Construction permits increased and commercial licenses dropped.

2.1 Overview

This chapter assesses the recent developments of the Bahraini financial and non-financial sectors and to whether the local banking and financial sectors remain resilient since the last FSR. The financial condition and performance of financial institutions 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 assessment also 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.

2.2 Bahrain's Banking sector

In November 2016, the banking sector in Bahrain was made up of 105 banks, categorized as follows:

- 29 retail banks (including 7 Islamic retail banks); 14 locally incorporated and 15 branches of foreign banks
- 76 wholesale banks (including 19 Islamic wholesale banks)

There are also 302 non-banking financial institutions operating in Bahrain, including investment business firms, insurance companies (including Takaful and Re-Takaful firms), and specialized licenses. The insurance industry has progressed effectively during the past few years, which has grown into a regional hub. Insurance contribution increased to 5.1% of GDP by end of 2015. Particularly strong growth over the last five years has been in medical insurance (which now accounts for 20% of total premiums). The insurance market in Bahrain now comprises 25 locally-incorporated firms and 11 overseas firms carrying out insurance, reinsurance, takaful and retakaful. These institutions offer all basic and modern insurance services such as medical and health insurance, long-term insurance (life and savings products). The expansion in the takaful sector (Sharia compliant insurance) has been particularly impressive, with gross contributions rising from $5 million in 2001 to more $168 million in 2015.

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

2.2.1 The size of the banking sector

Bahrain's banking sector represented 6.2 times GDP by the end of the third quarter of 2016. The banking sector started as 13.4 times GDP in 2007 and despite the global financial turmoil, the size remained at 11.5 times of GDP from 2008 until 2010. In 2013, the size of the banking sector fell become 5.9 times of GDP due to drop in the wholesale banking sector in Q3 2013 and reaching 3.5 times by Q3 2016. The size of the retail banking sector is at 2.7 times the GDP by Q3/2016.

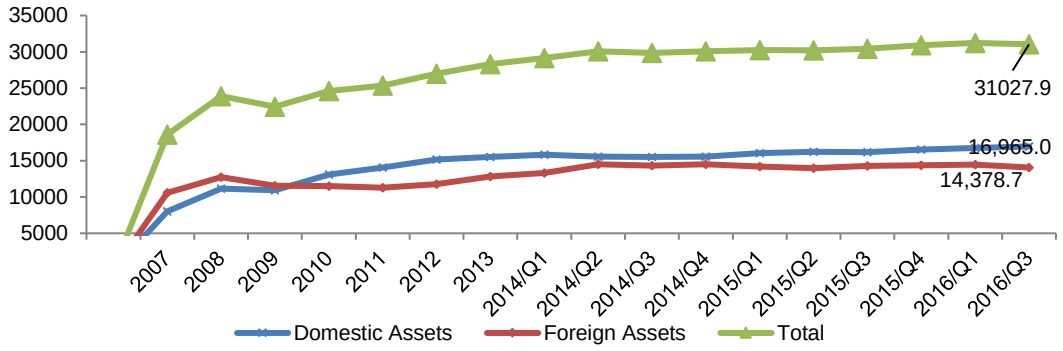
Despite the contraction in the banking size, the Bahraini financial and banking sector performed well and represented 16.3% of GDP in 2015 and the first half of 2016 and remains to be the largest non-oil contributor to GDP. Bahrain's financial sector has faced a number of shocks over the past eight years and managed to perform well despite these financial, social and economic shocks.

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

	2007	2010	2013/Q4	2014/Q4	2015/Q3	2016/Q1	2016/Q3
Size of the Banking sector (times GDP)	13.4	11.5	5.9	5.6	6.1	6.2	6.2
Consolidated Balance Sheet of Retail Sector (USD billion)	49.5	65.4	75.3	80.0	80.9	83.0	82.5
times of GDP	2.7	3.4	2.3	2.4	2.6	2.7	2.7
Consolidated Balance Sheet of Wholesale Sector(USD billion)	196.3	157.7	116.7	109.3	109.5	109.1	110.2
times of GDP	10.7	8.1	3.6	3.2	3.5	3.5	3.5

Source: CBB Statistical Bulletin

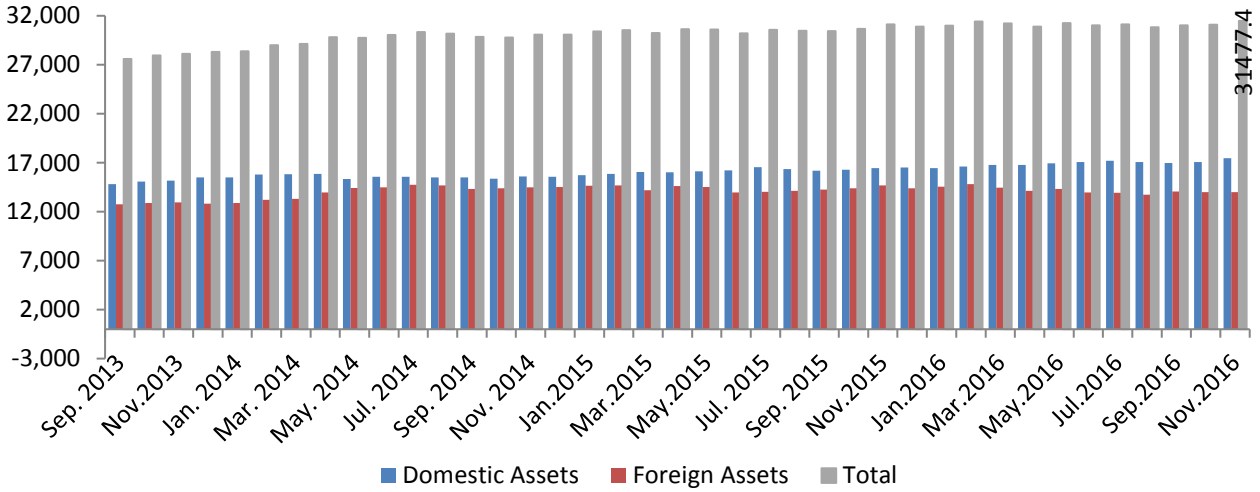
Chart 2-1: Retail Banks' Assets (BD million)



Source: Central Bank of Bahrain

Despite the global uncertainty and the troubles in MENA region, retail banking total assets continued growing since December 2012 to reach BD 31.5 billion in November 2016 (see Chart 2-2).

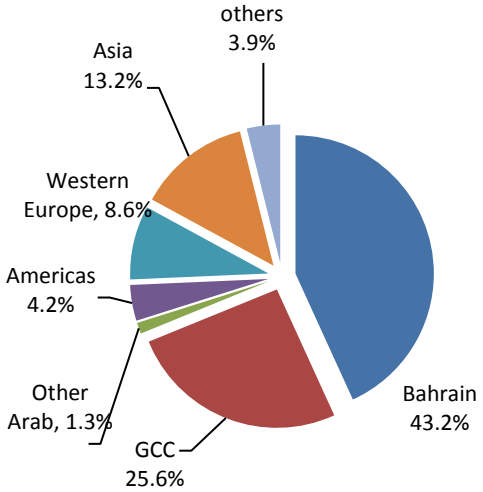
Chart 2-2: Categorization of Retail Banks' Assets (BD million)



Source: Central Bank of Bahrain.

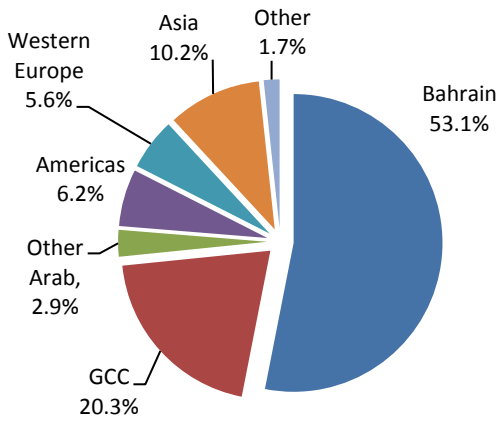
The share of GCC assets of total of total retail banking assets was 21.6%. The level of Europe and American contribution in retail banking showed a slight decline (9.8%). This shows that the retail-banking sector in Bahrain is lightly exposed to foreign risk from U.S and Europe.

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



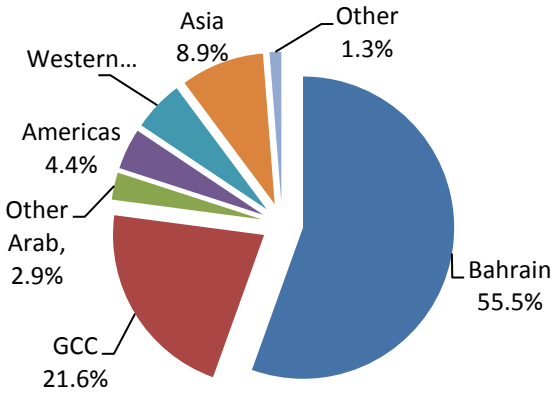
** For conventional and Islamic retail banks*
Source: Central Bank of Bahrain

Chart 2-4: Retail Banks' Assets (%) by Geographical Classification (Nov2015)*



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

Chart 2-5: Retail Banks' Assets (%) by Geographical Classification (November 2016)*

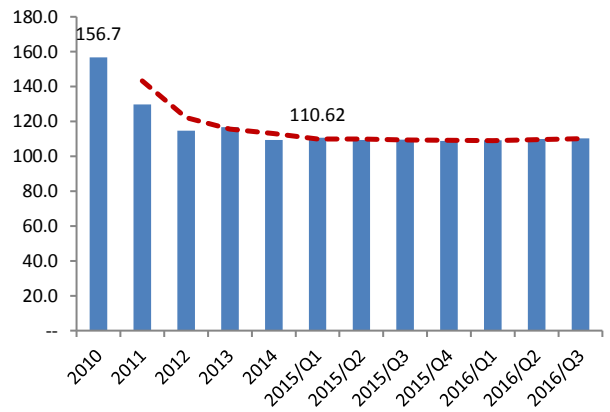


** For conventional and Islamic retail banks*
Source: Central Bank of Bahrain

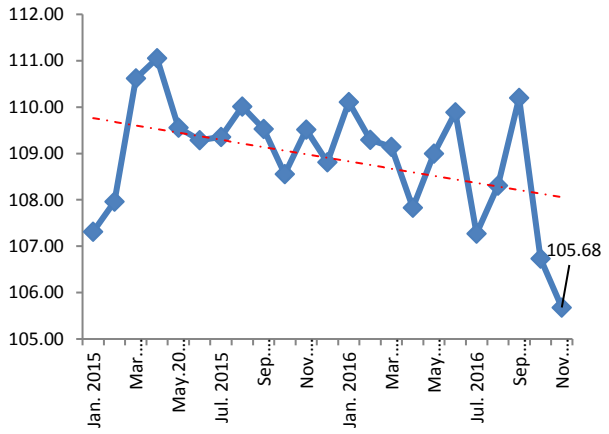
On the other hand, the wholesale banking sector reached USD 105.7 billion by end of November 2016 (See Charts 2-6 and 2-7).

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

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



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

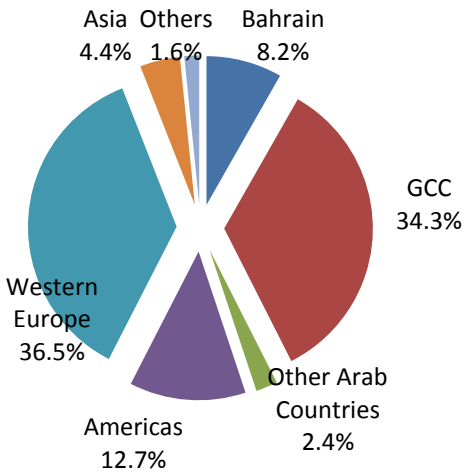


--- *Linear Trendline*
** For conventional and Islamic wholesale banks*
Source: Central Bank of Bahrain

According to the geographical classification of wholesale banks' assets:

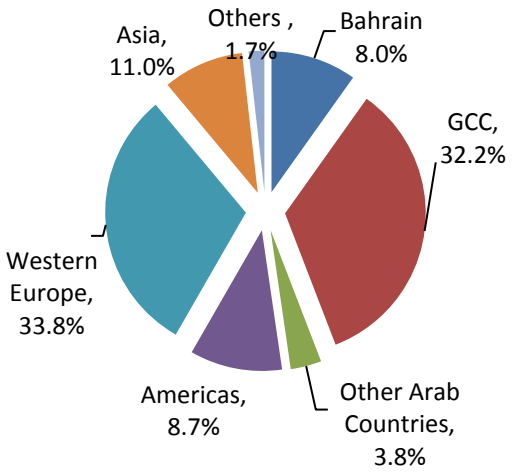
- The share of America's total assets decreased considerably since 2007 but it recently improved slightly to 10.6% in November 2016.
- The share of Europe's total assets remained over the past eight years and is at 30.6%.
- Asian assets which moved from 4.4% from 2007 to 9.3% in November 2016.
- GCC total assets dropped during the past few years, but they still represent almost the third of the wholesale banking sector at 34.3% in November 2016.

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



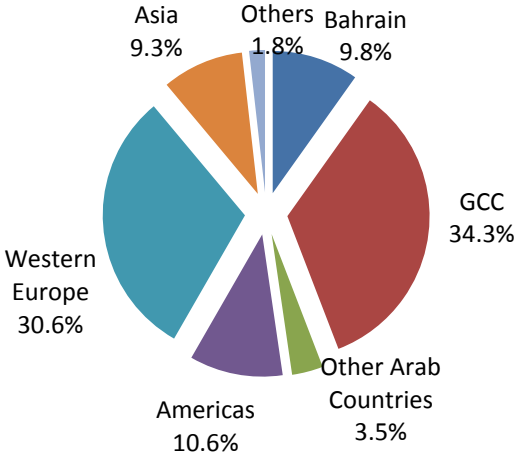
** For conventional and Islamic retail banks*
Source: Central Bank of Bahrain

Chart 2-9: Wholesale Banks Assets by: Geographical Classification (Oct.2015)*



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

Chart 2-10: Wholesale Banks Assets by Geographical Classification (November 2016)*

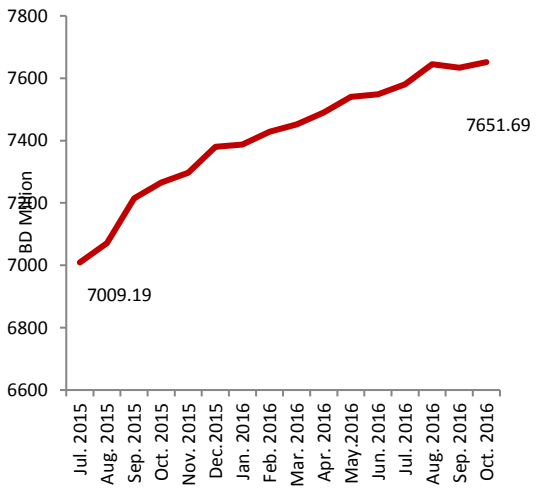


** For conventional and Islamic retail banks*
Source: Central Bank of Bahrain

2.2.2 Credit Developments

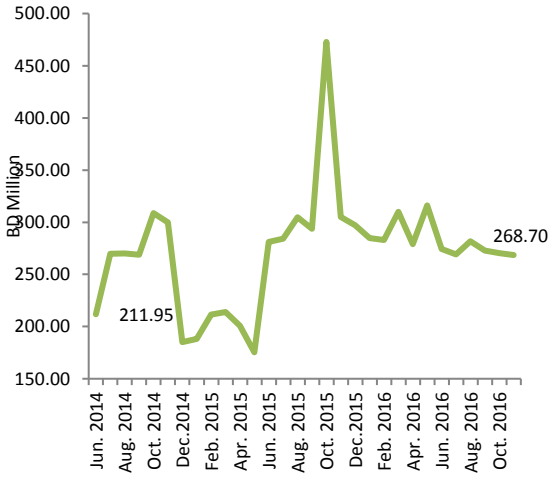
The total amount of credit given by the retail sector witnessed a slight increase since last June moving from BD 7,998 million to BD 8,076 million in November 2016 (Chart 2-11). The high credit growth reveals the recovery of the economic activities and the restore of confidence in the kingdom of Bahrain. Regarding banks' lending to the general government, it decreased to BD268.7 million at end-November 2016 after reaching BD 472.78 million at end-October 2015.

Chart 2-11.: Loans to the Private Sector (BD Million)*



Source: Central Bank of Bahrain

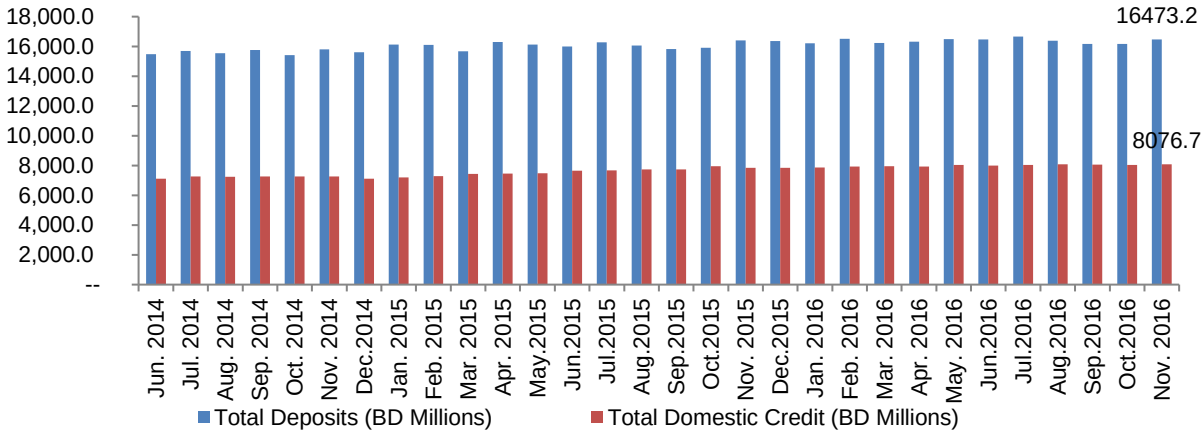
Chart 2-12: Loans to General Government (BD Million)*



Source: Central Bank of Bahrain
**Excluding securities*

As for total deposits, they reached BD16473.2 million in November 2016, where 56.3% of them are domestic deposits. Interestingly, this was followed by an increase in total domestic credits which moved from around BD 7845.4million at end-November 2015 to 8076.7 in November 2016 (chart 2-13). Despite the high availability of liquidity, total domestic credit remains moderate in Bahrain representing only 68.8 % of GDP as of the third quarter of 2016.

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

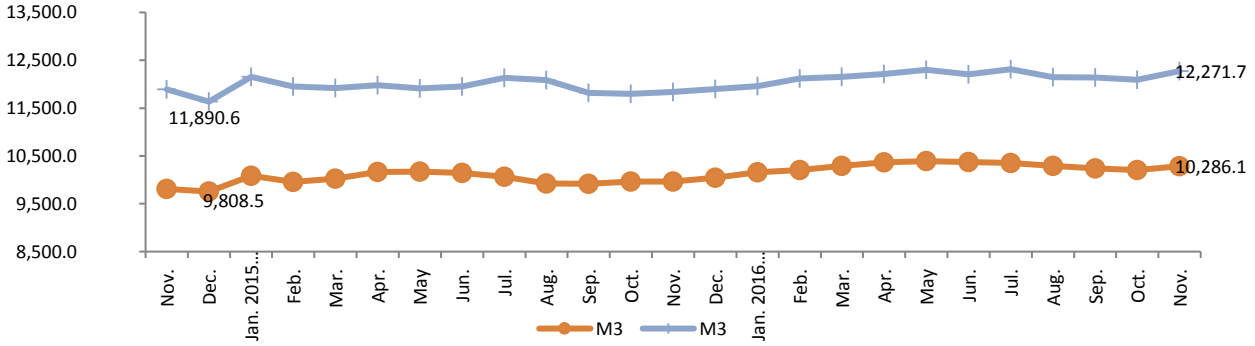


Source: Central Bank of Bahrain

2.3 Monetary indictors

Money supply continued to grow. M2 stood at BD 10,286.1 million in end-November 2016, 3.2% higher than its value of November 2015. M3 was BD 12271.7 million in end-November 2016, 3.7% higher than in November 2015(Chart 2-14).

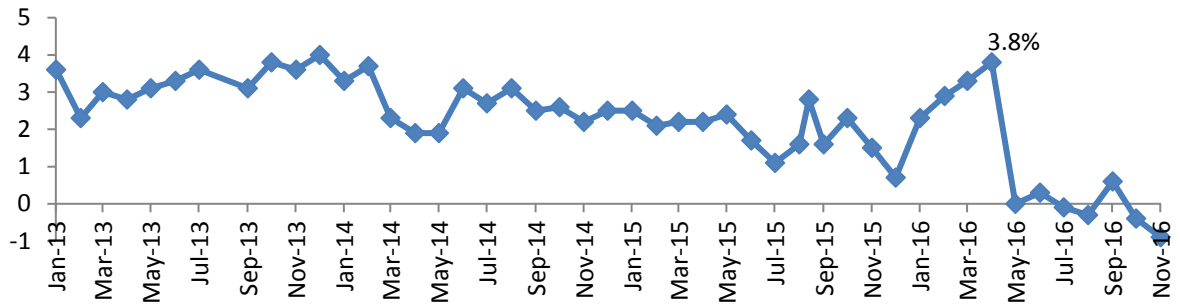
Chart 2-14: Money Supply (BD Billion) from July 2015 to November 2016



Source: Central Bank of Bahrain

Generally speaking, the inflation rate in consumer prices has always been stable in Bahrain. According to CIO (2016), inflation moved from 2.3% in January 2016 to -0.9% in November 2016. The most important decreases come from the "food and beverage", "transport", and "miscellaneous goods and services" which decreased by 1.3%, 1.2%, and 0.7% respectively.

Chart 2-15: Monthly Inflation in 2013-2016 (CPI%*)



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

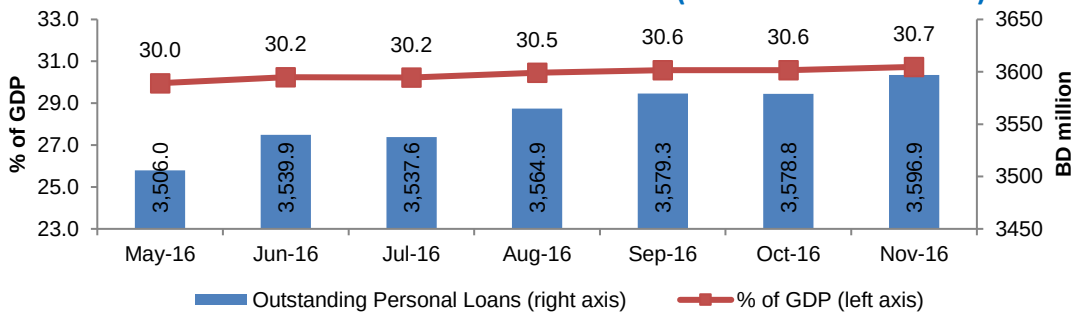
2.4 The Bahraini Households Sector

The household sector plays an important role in financial stability and the overall economy. The household sector can allocate funds to financial assets through bank deposits and securities, and to non financial assets from land and other fixed assets. It can also receive funds from financial and non financial institutions. The construction and real estate sector plays a huge importance on economic developments and is a good indicator of macroeconomic conditions in the country.

2.4.1 Household Debt Ratio

Outstanding personal loans, used as a proxy for household borrowing, for the period shows that the household debt saw an increase throughout the period between May 2016 and November 2016 (Chart 2-16).

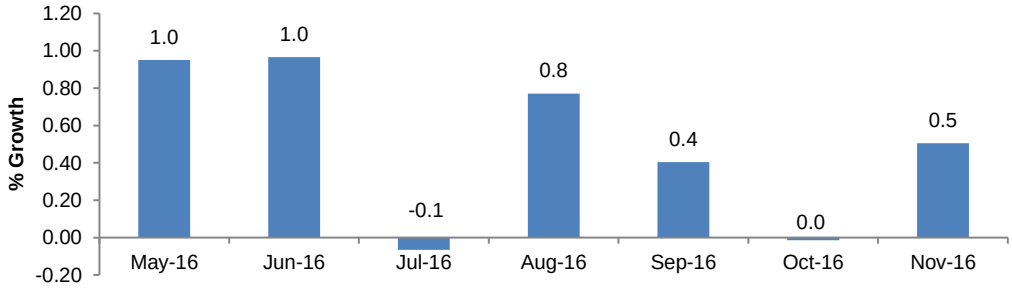
Chart 2-16: Personal Loans and Advances (Volume and % of GDP)



**Using 2015 GDP*
Source: Central Bank of Bahrain

Personal loans as a percentage of GDP remained stable from May 2016 to November 2016. Starting at 30.0% (BD 3,506.0 million) in May 2015 and capping at 30.7% in November 2016 (BD 3,596.9 million). There was a 2.6% increase in outstanding personal loans during the same period.

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



**Using 2015 GDP*
Source: Central Bank of Bahrain

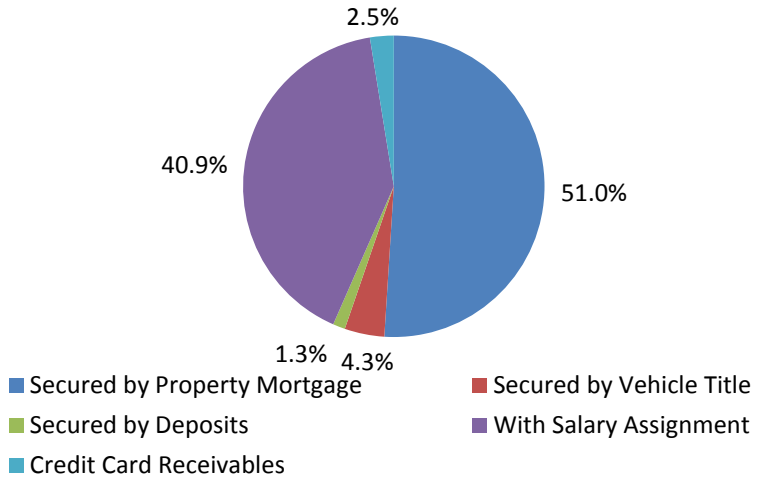
The growth in personal loans were mainly due to an increase in personal loans secued by property mortgage as seen in Table 2-2. The two main contributors to personal loans as seen in chart 2-18 were personal loans secured by property mortgages which make around 51.0% of the total personal loans followed by personal loans secured with salary assignments which make around 40.9% of total personal loans as of end of November 2016.

Table 2-2: Personal Loans Breakdown

BD million	2016						
	May	Jun	July	Aug	Sep	Oct	Nov
Total	**3,506.0**	**3,539.9**	**3,537.6**	**3,564.9**	**3,579.3**	**3,578.8**	**3,596.9**
Secured by Property Mortgage	1,453.4	1,467.8	1,467.4	1,473.8	1,498.3	1,502.0	1,509.2
Secured by Vehicle Title	121.9	124.6	127.8	128.2	127.2	126.4	126.3
Secured by Deposits	94.1	54.2	56.9	52.8	53.5	52.4	38.9
With Salary Assignment	1,143.0	1,190.4	1,191.7	1,202.3	1,201.3	1,204.4	1,209.2
Credit Card Receivables	70.9	78.1	72.3	72.0	73.4	73.3	75.4

Source: Central Bank of Bahrain

Chart 2-18: Personal Loans Breakdown (November 2016)

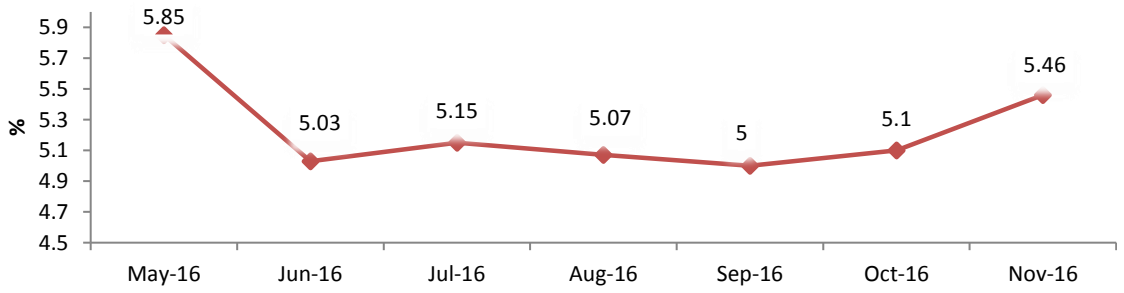


Source: Central Bank of Bahrain

Interest rates on personal loans started off at its highest of 5.8% in May 2016 and then dropped to 5.0% in the next month. A sharp increase was seen in November 2016, reaching

5.5% from 5.1% the previous month (Chart 2-19). Interest rates on secured and unsecured loans were constant during this period.

Chart 2-19: Retail Banks- Average Interest Rates on Personal Loans (%)

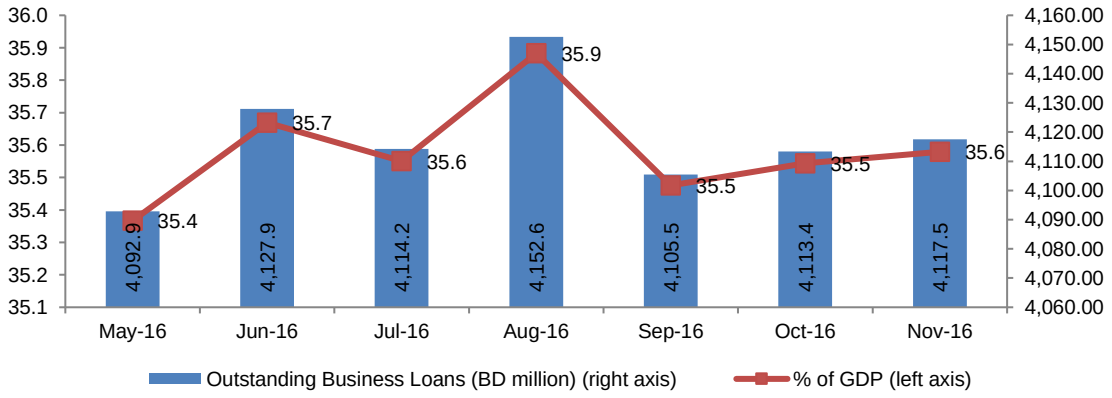


Source: Central Bank of Bahrain

2.4.2 The Bahraini Corporate Sector

Business loans and advances were fairly even from May 2016 to November 2016, reaching its peak at BD 4,152.6 million in August (Chart 2-20). Outstanding business loans remained steady ending at 35.6% in November 2016.

Chart 2-20: Business Loans and Advances (Volume and % of GDP)



Source: Central Bank of Bahrain

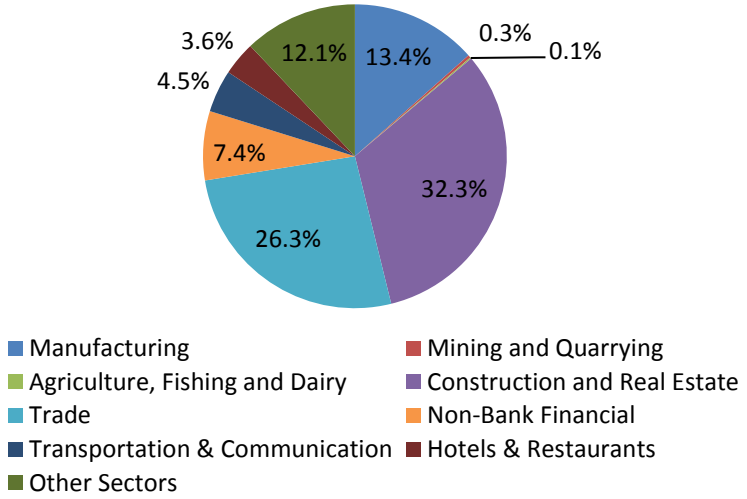
For the past seven months, the main contributor to the increase in business loans was the loans to the construction and real estate sector. The trade sector also contributed to some of the increases in business loans that happened this year (Table 2-3). The biggest contributors to business loans are the construction and real estate sector (32.3%) followed by trade (26.3%) and then manufacturing (13.4%) (Chart 2-21).

Table 2-3: Business Loans By Sector

Sectors	2016						
	May	Jun	Jul	Aug	Sep	Oct	Nov
Total	**4,217.9**	**4,183.5**	**4,222.6**	**4,242.4**	**4,198.0**	**4,195.4**	**4,211.1**
Manufacturing	611.5	585.0	583.8	580.5	576.0	558.1	565.9
Mining and Quarrying	4.2	4.8	13.8	11.9	13.6	12.1	12.5
Agriculture, Fishing and Dairy	7.4	7.4	6.7	6.0	6.1	6.0	5.8
Construction and Real Estate	1,325.5	1,339.9	1,320.8	1,336.3	1,353.9	1,341.6	1,359.6
Trade	1,155.2	1,163.6	1,151.3	1,159.0	1,118.9	1,123.7	1,107.2
Non-Bank Financial	307.3	300.2	300.0	301.6	295.3	296.1	309.8
Transportation & Communication	187.3	168.3	170.1	166.2	168.2	189.5	190.5
Hotels & Restaurants	159.7	159.2	157.7	153.5	154.9	154.3	151.3
Other Sectors	459.8	455.5	518.4	527.4	511.1	514.0	508.7

Source: Central Bank of Bahrain

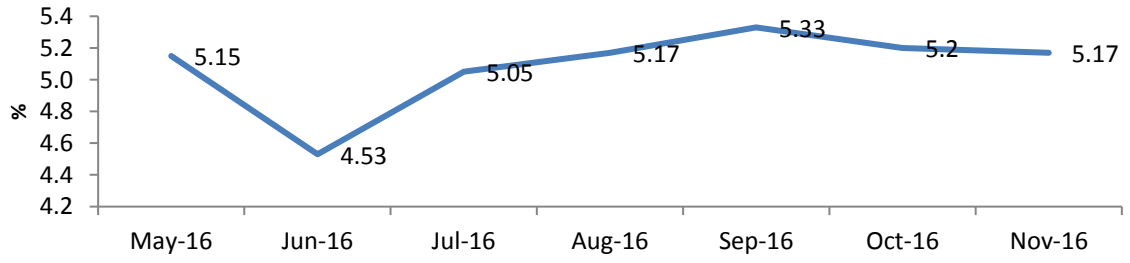
Chart 2-21: Business Loans by Sector November 2016



Source: Central Bank of Bahrain

Average interest rates on business loans fluctuated throughout the period. It was at its lowest in June 2016 at 4.53% and at its peak in September 2016 at 5.33% (Chart 2-22).

Chart 2-22: Retail Banks- Average Interest Rates on Business Loans (%)



Source: Central Bank of Bahrain

2.4.3 Construction and Real Estate

The total number of construction permits issued by the Ministry of Municipality & Agricultural Affairs has seen a decrease from Q1 2016 to Q3 2016, with a total of 859 permits at the end of the third quarter.

Table 2-4: Selected Construction Permits by Type

	2016:Q1	2016:Q2	2016:Q3
Demolition and New Construction	14	11	6
New Construction	887	928	851
Reclamation	58	4	2
Total	**959**	**943**	**859**

Sources: Ministry of Municipality Affairs and Agriculture

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

Despite the global uncertainty and weak economic condition in emerging markets, all the indicators presented and analyzed above reveal that the Bahraini banking sector is performing efficiently during the year 2016. Bank loans continue their growth with mortgage loans growing steadily during the year so far. Overall funding conditions have improved and demand for loans has accelerated in Bahrain. Banks operating in Bahrain are well capitalized, funding and liquidity buffers are well above minimum required standards, and non-performing loans continue to drop. Regulatory changes in recent years have helped to improve prudential standards for retail and wholesale banks (conventional and Islamic). All these changes have been beneficial for financial stability and will further strengthen the position of Bahrain as a financial center.

Part II:

Performance of the Banking Sector

3. Overall Banking Sector

Chapter 3

Key Points

- An increase in capital positions.
- Non-performing loans (NPLs) increased slightly.
- Loan portfolios remain concentrated in some sectors despite the decrease in some sectors, but no significant change from previous quarter
- Stable positive earnings for banks.
- Increase in liquidity position.

3.1 Overview

In this new chapter to the Financial Stability Report, the performance of the overall banking sector in the Kingdom of Bahrain is analysed and assessed (all the segments of the banking sector combined). Unless specified otherwise, the analysis in this chapter is based on consolidated financial data (Bahraini and non-Bahraini operations), as at end-September 2016 and compared with end-March 2016.

This chapter offers macroprudential analysis of the entire banking sector based on a set of selected Financial Soundness Indicators (FSIs).[1] **Annex 1 presents selected *Financial Soundness Indicators* (FSIs) for the different banking segments. Annex 2 presents selected graphs showing the development of selected indicators over time.**

3.2 Overall Banking Sector Performance

Increase in Capital Adequacy Ratio [2]

The Capital adequacy ratio (CAR) for the banking sector stood at 19.2% in September 2016. The ratio has increased from 18.4% in March 2016. The core capital ratio (ratio of Tier 1 capital to risk-weighted assets) showed an increase from 16.8% in March 2016 to 17.6% in

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

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

September 2016, whereas the leverage ratio (ratio of assets over capital) increased from 6.9% to 7.8 during the same period.

Table 3-1 Capital Provisions Ratios

Indicator	March 2016	Sep. 2016
Capital Adequacy Ratio	18.4	19.2
Tier 1 Capital Adequacy Ratio	16.8	17.6
Leverage (assets/capital)(times)	6.9	7.8

Source: Central Bank of Bahrain

Increase in NPL's

Non-performing loans (NPL) ratio increased from 5.2% in March 2016 to 5.5% in September 2016. The specific provisions as a proportion of NPLs showed a decrease reaching 54.1% in September 2016 from 59.1% in March 2016.

Table 3-2: NPL Figures

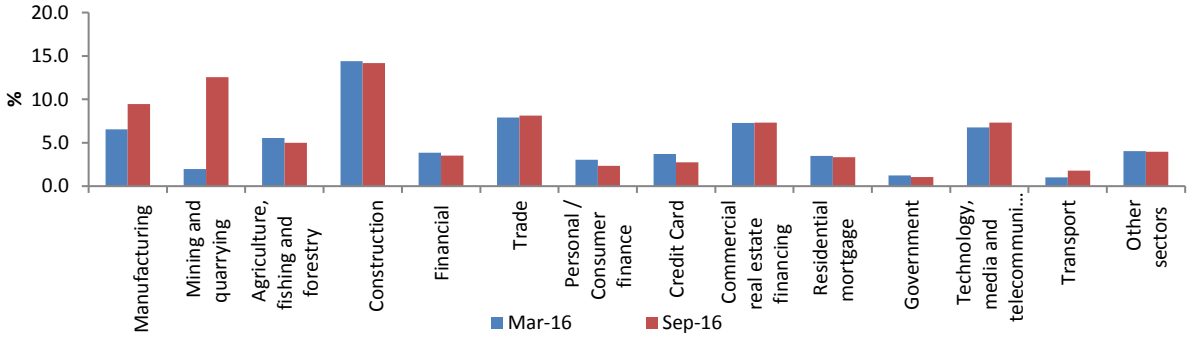
Indicator	March 2016	Sep. 2016
NPL's (% Gross)	5.2	5.5
Specific provisions (% of NPLs) *	59.1	54.1

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.*

Data on the sectoral breakdown of impaired loans[3] as a percentage loans in each sector shows some sectors experiencing an increase in impairment, while some experience a decrease and others remaining unchanged (Table 3-3 and Chart 3-1). The highest increase was in "Mining and Quarrying" by 10.6% followed by "Manufacturing" by 3.0% and the highest decrease was in "Credit Cards" by 0.9% followed by "Agriculture, fishing and forestry" and "Personal/Consumer Finance" both by 0.6%.

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



Source: Central Bank of Bahrain

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

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

	March 2016	Sep. 2016	Change
Manufacturing	6.5	9.5	3.0
Mining and quarrying	2.0	12.6	10.6
Agriculture, fishing and forestry	5.6	5.0	(0.6)
Construction	14.4	14.2	(0.2)
Financial	3.8	3.5	(0.3)
Trade	7.9	8.1	0.2
Personal / Consumer finance	3.0	2.4	(0.6)
Credit Card	3.7	2.8	(0.9)
Commercial real estate financing	7.3	7.3	0.0
Residential mortgage	3.5	3.3	(0.2)
Government	1.2	1.0	(0.2)
Technology, media and telecommunications	6.8	7.3	0.5
Transport	1.0	1.8	0.8
Other sectors	4.0	4.0	0.0

Source: Central Bank of Bahrain

Loan portfolios concentrated in some sectors

The loan portfolio of *the banking system* shows concentrations in four sectors. "Manufacturing" represented 15.5% of total loans in September 2016, a decrease from the 16.3% in March 2016. The "Financial" sector represented 13.8% of total loans down from 14.5% over the same period. The "Other" [4] sector stood at 13.6% of total loans down from 14.4% over the same period. "Personal/Consumer Finance as percentage of total finance" increased from 9.6% in March 2016 to 11.1% in September 2016.

Table 3-4: Distribution Lending (% total loans)*

	March 2016	Sep. 2016	Change
Manufacturing	16.3	15.5	(0.80)
Mining and quarrying	2.0	1.9	(0.10)
Agriculture, fishing and forestry	0.7	0.8	0.10
Construction	8.8	8.5	(0.30)
Financial	14.5	13.8	(0.70)
Trade	10.0	9.6	(0.40)
Personal / Consumer finance	9.6	11.1	1.50
Credit Card	0.3	0.3	0.00
Commercial real estate financing	8.7	8.7	0.00
Residential mortgage	4.1	5.0	0.90
Government	4.8	5.2	0.40
Technology, media and telecommunications	2.0	1.8	(0.20)
Transport	3.8	4.1	0.30
Other sectors	14.4	13.6	(0.80)
Top two recipient sectors	30.8	29.3	(1.50)
Real Estate/ Construction Exposure**	21.6	22.2	0.60

Source: Central Bank of Bahrain

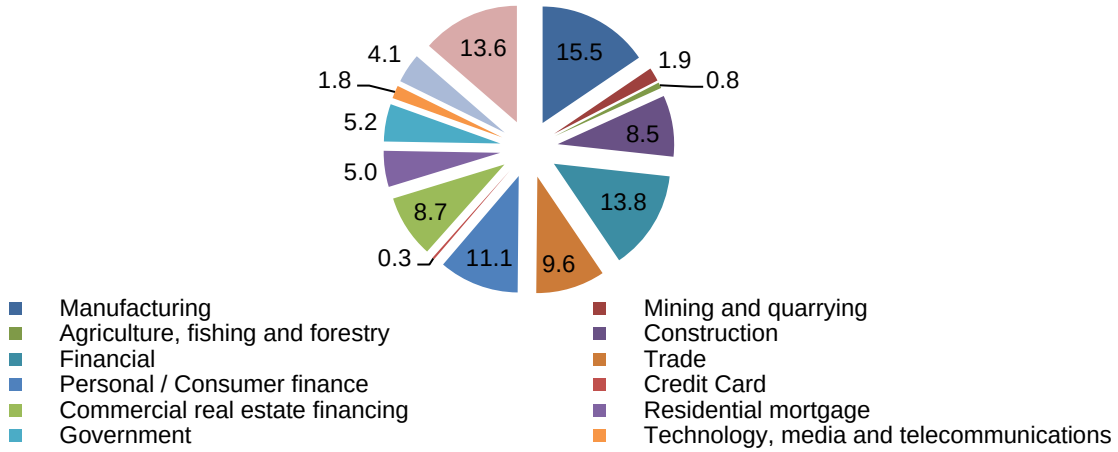
**Figures may not add to a hundred due to rounding*

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

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

The top two recipient sectors "Manufacturing" and "Financial" jointly represented 29.3% of loans in September 2016, decrease from 30.8% in March 2016. Exposure to real estate/ construction was 22.2% of total lending in September 2016, a slight increase from 21.6% registered in March 2016.

Chart 3-2: Distribution Lending (% of total loans)



Source: Central Bank of Bahrain

Increase in profitability

As at end-September 2016, return-on-assets (ROA) increased to reach 1.3% from 0.9% in September 2015. Return-on-equity (ROE)[5] increased from 3.9% in September 2015 to 6.0% in September 2016. Net interest income (as a % of total income) stood at 67.8% % in September 2016 a decrease from 75.6% in September 2015. In addition, operating expenses as a proportion of total income was 55.8% in September 2015 a slight decrease from the 56.3% registered in September 2015.

Table 3-5: Profitability of Retail Banks (%)

	Sep. 2015	Sep. 2016
ROA *	0.9	1.3
ROE**	3.9	6.0
Net interest income (% total income)***	75.6	67.8
Operating expenses (% total income)	56.3	55.8

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

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

Liquidity position stays resilient

Between March 2016 and September 2016, the overall loan-deposit ratio decreased from 69.5% in March 2016 to 67.9% in September 2016. Liquid assets as a proportion of total assets increased to reach 22.8%, over the same period.

Table 3-6: Retail Banks' Liquidity Profile (%)

	March 2016	Sep. 2016
Liquid Asset Ratio	22.0	22.8
Loan-Deposit Ratio	69.5	67.9

Source: Central Bank of Bahrain.

3.4 Overall Assessment of the Banking Sector

The financial soundness indicators show that the Banking Sector witnessed an increase in capital adequacy ratio. Capital adequacy ratios for the banking sector increased from 18.4% in March 2016 to 19.2% in September 2016. Non-performing loans have shown a slight increase between periods of March 2016 to September 2016 from 5.2% to 5.5% yet remain stable within the same range. Profitability has increased with ROA being at 1.3% and ROE at 6.0%. Liquidity has increased between March 2016 and September 2016.

In the following two chapters (chapters 4 and 5) of the Financial Stability Report, the FSI's of the four banking sectors (Conventional Retail, Conventional Wholesale, Islamic Retail, and Islamic Wholesale) are analysed to assess the performance of the sectors in the banking system in Bahrain.

4. Conventional Banks

Chapter 4

Key Points

- An increase in capital positions of conventional retail banks and conventional wholesale banks.
- Non-performing loans (NPLs) for conventional banks increased
- Loan portfolios in conventional retail and wholesale banks remain concentrated despite the decrease in some sectors.
- Stable earnings for conventional retail banks and a decrease for conventional wholesale banks.
- Slight decrease in liquidity for conventional retail banks increase for conventional wholesale banks.

4.1 Overview

This chapter analyses the banking sector under the following categories: conventional retail banks (section 4.2), conventional wholesale banks (section 4.3). Section 4.4 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-March 2016 and compared with end-September 2016.

This chapter offers macroprudential analysis of the conventional banking sector based on a set of selected Financial Soundness Indicators (FSIs).[6] **Annex 1 presents selected *Financial Soundness Indicators* (FSIs) for the different banking segments. Annex 2 presents selected graphs showing the development of selected indicators over time.**

4.2 Conventional Retail Banks

Increase in capital adequacy [7]

The CAR for conventional retail banks increased from 18.1% in March 2016 to 19.6% in September 2016. The core capital ratio (ratio of Tier 1 capital to risk-weighted assets) showed

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

[7] 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.

an increase from 16.3% in March 2016 to 17.8% in September 2016, whereas the leverage ratio (ratio of assets over capital) remained at 7.7 during the same period. The ratio of non-performing loans (NPLs) net provisions to capital decreased to reach 6.1% in September 2016 from 7.4% in March 2016.

Table 4-1 Capital Provisions Ratios for Local Conventional Retail Banks

Indicator	Mar. 2016	Sep. 2016
Capital Adequacy Ratio	18.1	19.6
Tier 1 Capital Adequacy Ratio	16.3	17.8
Leverage (assets/capital)(times)	7.7	7.7
NPLs net of provisions to capital	7.4	6.1

Source: Central Bank of Bahrain

Increases in non-performing loans

NPL ratio increased from 4.0% in March 2016 to 4.7% in September 2016. The specific provisions as a proportion of NPLs showed a decrease to 49.9% in September 2016 from 55.5% in March 2016. The net NPLs of net loans increased from 1.9% in March 2016 to 2.4% in September 2016. For *local retail banks*, the NPLs decreased to 3.9% in September 2016. For *overseas retail banks*, the NPLs increased to 6.3% in September 2016.

Table 4-2: NPL Figures for Conventional Retail Banks

Indicator	Mar. 2016	Sep. 2016
NPL's (% Gross)	4.0	4.7
NPL's Local Banks (% Gross)	4.1	3.9
NPL's Overseas Banks (% Gross)	3.6	6.3
Specific provisions (% of NPLs) *	55.5	49.9
Net NPL's (% of net loans)	1.9	2.4

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 [8] shows some sectors experiencing an increase in impairment, while some experience a decrease and others remaining unchanged (Table 4-3 and Chart 4-1). The highest increase was in "Mining and Quarrying" by 44.7%, and the highest decrease was in "Construction" by 2.0%.

Table 4-3: Conventional Retail Banks' Impaired Loan Ratios by Sector (% of gross loans per sector)

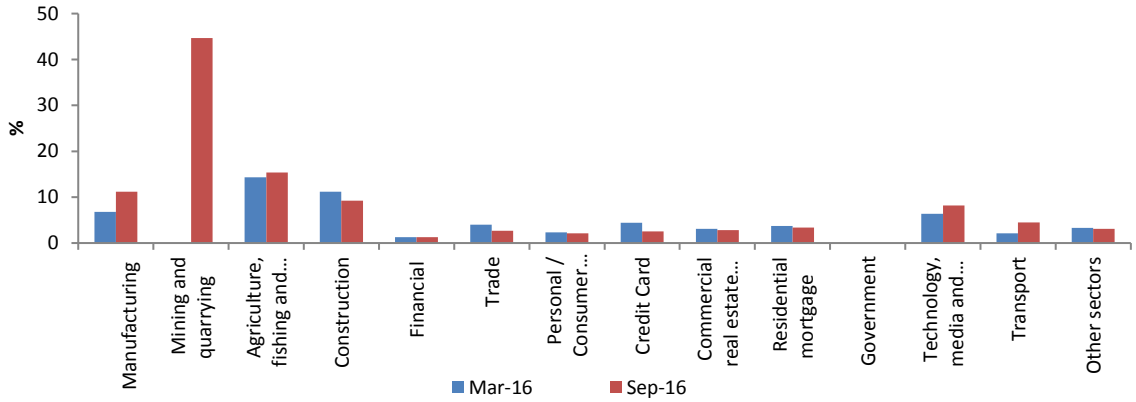
	Mar. 2016	Sep. 2016	Change
Manufacturing	6.8	11.2	4.4
Mining and quarrying	0.0	44.7	44.7
Agriculture, fishing and forestry	14.3	15.4	1.1
Construction	11.2	9.2	(2.0)
Financial	1.3	1.3	0.0

[8] 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.

Trade	4.0	2.7	(1.3)
Personal / Consumer finance	2.3	2.1	(0.2)
Credit Card	4.4	2.5	(1.9)
Commercial real estate financing	3.1	2.8	(0.3)
Residential mortgage	3.7	3.4	(0.3)
Government	0.0	0.0	0.0
Technology, media and telecommunications	6.4	8.2	1.8
Transport	2.1	4.5	2.4
Other sectors	3.3	3.1	(0.2)

Source: Central Bank of Bahrain

Chart 4-1: Conventinoal Retail Banks' Impaired Loans by Sector (% of gross loans per sector)



Source: Central Bank of Bahrain

Loan portfolios remain concentrated

The loan portfolio of *retail banks* remains concentrated with the top recipient of loans being the "Commercial real estate financing" sector accounting for 17.9% of total loans in September 2016, compared with 17.4% in March 2016. The "Manufacturing" sector represented 13.9% of total loans followed by the "Personal/Consumer finance" and "Other" sectors at 13.7% of total loans over the same period.

The top two recipient sectors "Commercial real estate financing" and "Manufacturing" jointly represented 31.7% of loans in September 2016. Exposure to real estate/ construction was 29.8% of total lending in September 2016, a decrease from the 30% registered in March 2016.

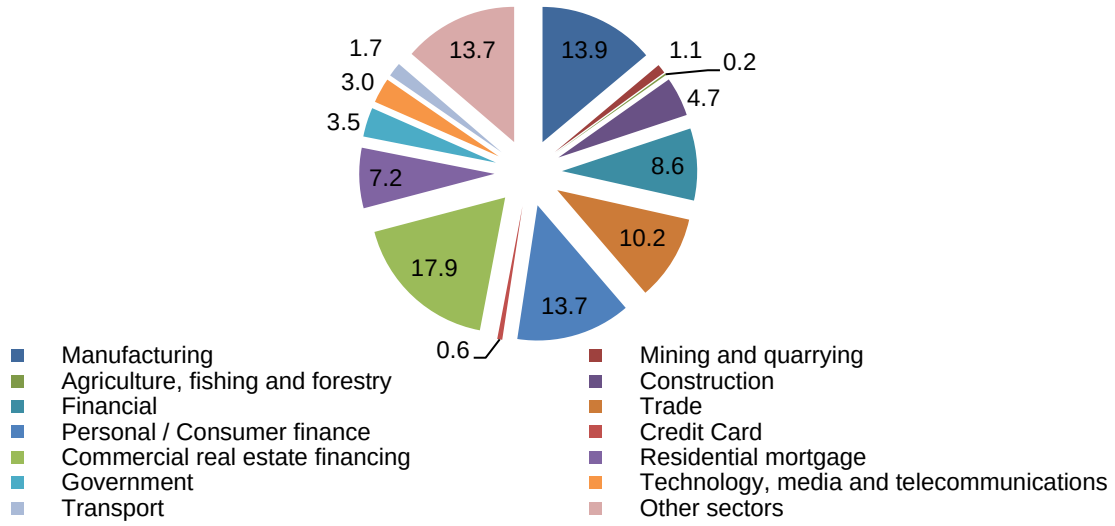
Table 4-4: Distribution of Conventional Retail Banks' Lending (% total loans)*

	Mar. 2016	Sep. 2016	Change
Manufacturing	14.2	13.9	(0.3)
Mining and quarrying	1.0	1.1	0.1
Agriculture, fishing and forestry	0.2	0.2	0.0
Construction	5.3	4.7	(0.6)
Financial	9.1	8.6	(0.5)
Trade	10.7	10.2	(0.5)
Personal / Consumer finance	13.5	13.7	0.2
Credit Card	0.6	0.6	0.0
Commercial real estate financing	17.4	17.9	0.5
Residential mortgage	7.3	7.2	(0.1)
Government	2.8	3.5	0.7
Technology, media and telecommunications	3.2	3.0	(0.2)

Transport	1.7	1.7	0.0
Other sectors	13.0	13.7	0.7
Top two recipient sectors	**31.6**	**31.7**	**0.1**
Real Estate/ Construction Exposure**	**30.0**	**29.8**	**(0.2)**

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

Chart 4-2: Distribution of Conventional Retail Banks' Lending (% of total loans)



Source: Central Bank of Bahrain

The loan portfolio of *locally incorporated retail banks* remains concentrated with the top recipient of loans being the "Commercial real estate financing" sector accounting for 20.1% of total loans in September 2016, an increase from the 19.5% in March 2016. The "Other sectors" represented 15.1% of total loans up from 13.7% followed by the "Personal/Consumer Finance" sector at 12.9% of total loans over the same period. The top two recipient sectors "Commercial real estate financing" and "Others"[9] jointly represented 35.2% of loans in September 2016, an increase from the 33.2% in March 2016. Exposure to real estate/construction was 35.2% of total lending in September 2016, a slight decrease from the 35.3% registered in March 2016.

Table 4-5: Distribution of Local Conventional Retail Banks' Lending (% total loans)*

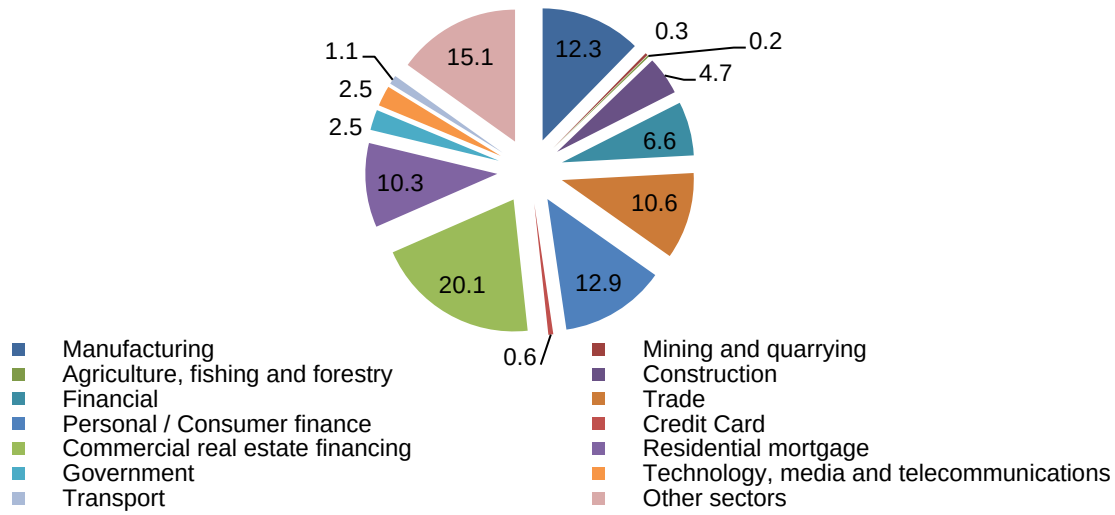
	Mar. 2016	Sep. 2016	Change
Manufacturing	12.4	12.3	(0.1)
Mining and quarrying	0.2	0.3	0.1
Agriculture, fishing and forestry	0.2	0.2	0
Construction	5.4	4.7	(0.7)
Financial	7.8	6.6	(1.2)
Trade	11.1	10.6	(0.5)
Personal / Consumer finance	12.5	12.9	0.4
Credit Card	0.6	0.6	0

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

Commercial real estate financing	19.5	20.1	0.6
Residential mortgage	10.3	10.3	0
Government	2.9	2.5	(0.4)
Technology, media and telecommunications	2.5	2.5	0
Transport	1.1	1.1	0
Other sectors	13.7	15.1	1.4
Top two recipient sectors	**33.2**	**35.2**	**2**
Real Estate/ Construction Exposure**	**35.3**	**35.2**	**(0.1)**

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

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



Source: Central Bank of Bahrain

The numbers as of end-September 2016 continue to show high concentration of risk for *overseas retail banks* (Table 4-6 and Chart 4-4). The top recipient of loans was the "Manufacturing" sector with 16.9% of total loans in September 2016, a decrease from the 18.0% in March 2016.

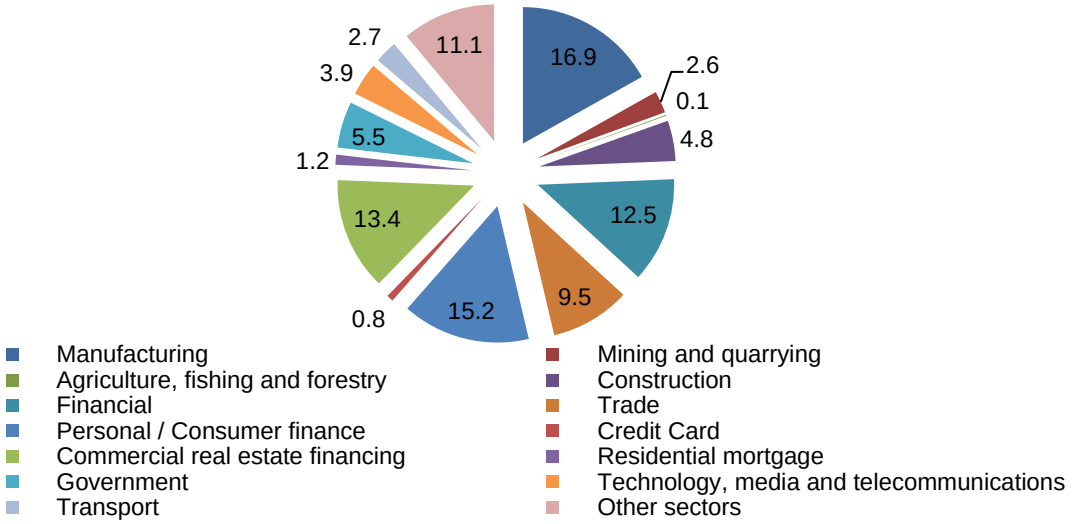
Table 4-6: Distribution of Overseas Conventional Retail Banks' Lending (% total loans)*

	Mar. 2016	Sep. 2016	Change
Manufacturing	18.0	16.9	(1.1)
Mining and quarrying	2.6	2.6	0.0
Agriculture, fishing and forestry	0.1	0.1	0.0
Construction	5.1	4.8	(0.3)
Financial	12.0	12.5	0.5
Trade	9.9	9.5	(0.4)
Personal / Consumer finance	15.5	15.2	(0.3)
Credit Card	0.7	0.8	0.1
Commercial real estate financing	13.0	13.4	0.4
Residential mortgage	1.2	1.2	0.0
Government	2.7	5.5	2.8
Technology, media and telecommunications	4.6	3.9	(0.7)

Transport	2.9	2.7	(0.2)
Other sectors	11.5	11.1	(0.4)
Top two recipient sectors	**33.5**	**32.1**	**(1.4)**
Real Estate/ Construction Exposure**	**19.3**	**19.3**	**0.0**

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

Chart 4-4: Distribution of Conventional Overseas Retail Bank's Lending (% of toal loans)



Source: Central Bank of Bahrain

The top two recipients of loans ("Manufacturing" and "Personnel/Consumer finance") jointly accounted for 32.1% of total loans. Exposure to real estate/ construction was 19.3% of total lending in September 2016, unchanged since March 2016.

Increase in local retail bank profitability

As at end-September 2016, return-on-assets (ROA) slightly decreased to reach 1.1%. ROA for *locally-incorporated banks* remained at 1.3% from September 2015 to September 2016. For *overseas banks*, ROA decreased from 1.1% in September 2015 to 0.6% in September 2016. Return-on-equity (ROE)[10] for *locally-incorporated banks* increased from 10.5% in September 2015 to 11.4% in September 2016.

Net interest income (as a % of total income) increased from 71.9% in September 2015 to 73.9% in September 2016. In addition, operating expenses as a proportion of total income increased from 42.9% in September 2015 to 47.5% in September 2016.

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

Table 4-7: Profitability of Retail Banks (%)

	Sep. 2015	Sep. 2016
ROA *	1.2	1.1
ROA Locally Incorporated Banks	1.3	1.3
ROA Overseas Banks	1.1	0.6
ROE**	10.5	11.4
Net interest income (% total income)	71.9	73.9
Operating expenses (% total income)	42.9	47.5

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

Liquidity position slightly decreased

Between March 2016 and September 2016, bank deposits decreased while non-bank deposits increased for retail banks. Bank deposits decreased to 20.1% in September 2016. Non-bank deposits increased to 79.9% over the same period. The overall loan-deposit ratio for the segment decreased from 70.8% in March 2016 to 70.0% in September 2016. Liquid assets as a proportion of total assets decreased over the period of March 2016 to September 2016 to reach 24.4%, respectively. Similarly, liquid assets as a proportion of the short-term liabilities presented a decrease from 38.1% to 37.1% over this period.

Table 4-8: Retail Banks' Liquidity Profile (%)

	Mar. 2016	Sep. 2016
Liquid Asset Ratio	25.3	24.4
Loan-Deposit Ratio	70.8	70.0
Non-Bank Deposits as a % of total deposits	79.1	79.9

Source: Central Bank of Bahrain.

4.3 Conventional Wholesale Banks

Increase in capital adequacy[11]

As at end-September 2016, the regulatory capital adequacy ratio for locally-incorporated wholesale banks was 19.8%, an increase from the 19.4% registered in March 2016. The core capital ratio (ratio of Tier 1 capital to risk-weighted assets) increased to 18.4% in September 2016 from the 17.8% recorded in March 2016. Furthermore, the leverage ratio (ratio of assets over capital) increased from the 6.6% in March 2016 to 9.4% in September 2016. The ratio of non-performing loans (NPLs) net of provisions to capital increased from 3.8% in March 2016 to 7.2% over the same period.

[11] 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.

Table 4-9: Capital Provisions Ratios for Local Conventional Wholesale Banks

Indicator	Mar. 2016	Sep. 2016
Capital Adequacy Ratio (%)	19.4	19.8
Tier 1 Capital Adequacy Ratio (%)	17.8	18.4
Leverage (assets/capital)(times)	6.6	9.4
NPLs net of provisions to capital (%)	3.8	7.2

Source: Central Bank of Bahrain

Increase in non-performing loans of wholesale banks

As at end-September 2016, loans classified as non-performing increased to 5.5% of total loans. The NPL ratio of *Locally-incorporated wholesale banks* increased to 4.2%. Similarly, *overseas wholesale* banks witnessed an increase in its NPL ratio from 6.6% to 6.9% over the same period. Specific provisions as a proportion of NPLs however witnessed a decrease from 66.3% in March 2016 to 63.0% in September 2016. The net NPLs as of total loans increased from 1.8% in March 2016 to 2.1% in September 2016.

Table 4-10: NPL Figures for Conventional Wholesale Banks

Indicator	Mar. 2016	Sep. 2016
NPL's (% Gross)	5.1	5.5
NPL's Local Banks	3.6	4.2
NPL's Overseas Banks	6.6	6.9
Specific provisions (% of NPLs) *	66.3	63.0
Net NPLs (% of net loans)	1.8	2.1

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.*

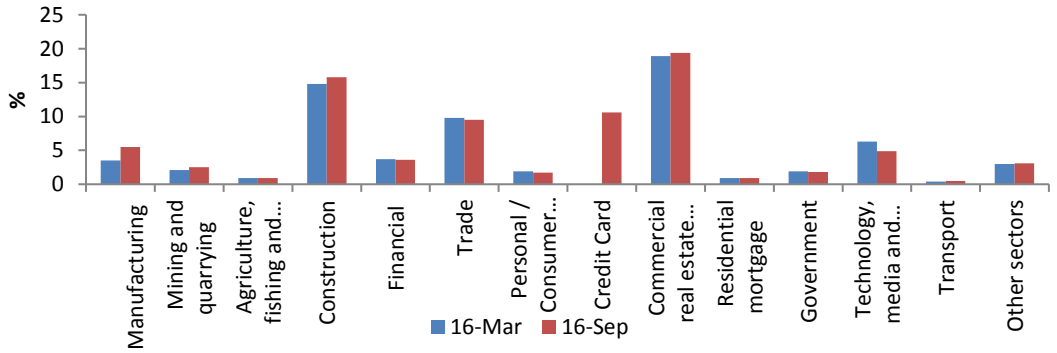
Table 4-12 depicts data on the sectoral breakdown of impaired loans, it demonstrates that impairment in the "Commercial real estate financing" was the highest between all sectors at 19.4% followed by the "Construction" sector with an impairment of 15.8%. The biggest increases were in the "Credit Card" sector which increased by 10.6% followed by "Manufacturing" and "Construction" which increased by 2% and 1% respectively. The greatest decrease in impairment was found in the "Technology, media and telecommunications" sector which decreased by 1.4%.

Table 4-11: Conventional Wholesale Banks' Impaired Loan Ratios by Sector (% of gross loans to sector)

	Mar. 2016	Sep. 2016	Change %
Manufacturing	3.5	5.5	2.0
Mining and quarrying	2.1	2.5	0.4
Agriculture, fishing and forestry	0.9	0.9	0.0
Construction	14.8	15.8	1.0
Financial	3.7	3.6	(0.1)
Trade	9.8	9.5	(0.3)
Personal / Consumer finance	1.9	1.7	(0.2)
Credit Card	0.0	10.6	10.6
Commercial real estate financing	18.9	19.4	0.5
Residential mortgage	0.9	0.9	0.0
Government	1.9	1.8	(0.1)
Technology, media and telecommunications	6.3	4.9	(1.4)
Transport	0.4	0.5	0.1
Other sectors	3.0	3.1	0.1

Source: Central Bank of Bahrain

Chart 4-5: Conventional Wholesale Banks' Impaired Loans by Sector (% of gross loans to sector)



Source: Central Bank of Bahrain

Loan portfolios remains concentrated despite decreases in some sectors

An examination of lending patterns as at end-September 2016 shows that, for conventional wholesale banks, the top recipient of loans remains to be the "Financial" sector, which accounted for 21.0% of total loans in September 2016 representing a decrease of merely 0.4% compared to March 2016 (Table 4-13 and Chart 4-6).

Table 4-12: Distribution of Conventional Wholesale Banks' Lending (% total Loans)*

	Mar. 2016	Sep. 2016	Change
Manufacturing	16.6	16.5	(0.1)
Mining and quarrying	3.6	3.1	(0.5)
Agriculture, fishing and forestry	1.3	1.4	0.1
Construction	10.3	10.7	0.4
Financial	21.4	21.0	(0.4)
Trade	9.2	9.6	0.4
Personal / Consumer finance	3.3	3.4	0.1
Credit Card	0.0	0.0	0.0
Commercial real estate financing	1.9	1.7	(0.2)

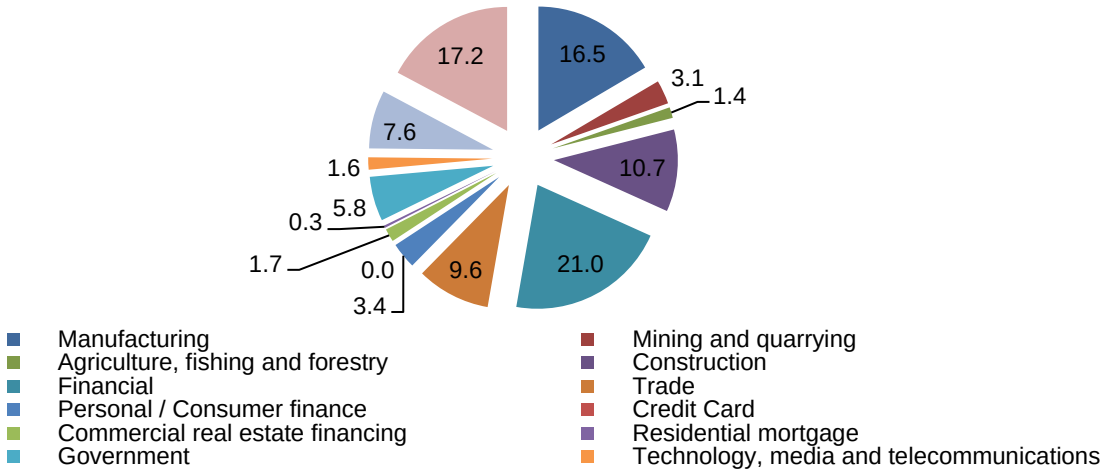
Residential mortgage	0.4	0.3	(0.1)
Government	5.4	5.8	0.4
Technology, media and telecommunications	1.7	1.6	(0.1)
Transport	7.0	7.6	0.6
Other sectors	17.8	17.2	(0.6)
Top two recipient sectors	**39.2**	**38.2**	**(1.0)**
Real Estate/ Construction Exposure**	**12.6**	**12.7**	**0.1**

Source: Central Bank of Bahrain

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

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

Chart 4-6: Distribution of Conventional Wholesale Banks' Lending (% of total loans)



Source: Central Bank of Bahrain

Also, the top two sectors remain to be ("financial" and "other"), they jointly account for 38.2% of total lending in September 2016, while real estate/ construction exposure slightly increased to 12.7% from 12.6%.

Nevertheless, for *locally-incorporated wholesale banks,* the top recipient of loans is the "Manufacturing" sector, which accounted for 25.0% of total loans in September 2016, representing an increase from the 24.6% in March 2016 (Table 4-14 and Chart 4-7).

Table 4-13: Distribution of Conventional Local Wholesale Banks' Lending (% total Loans)*

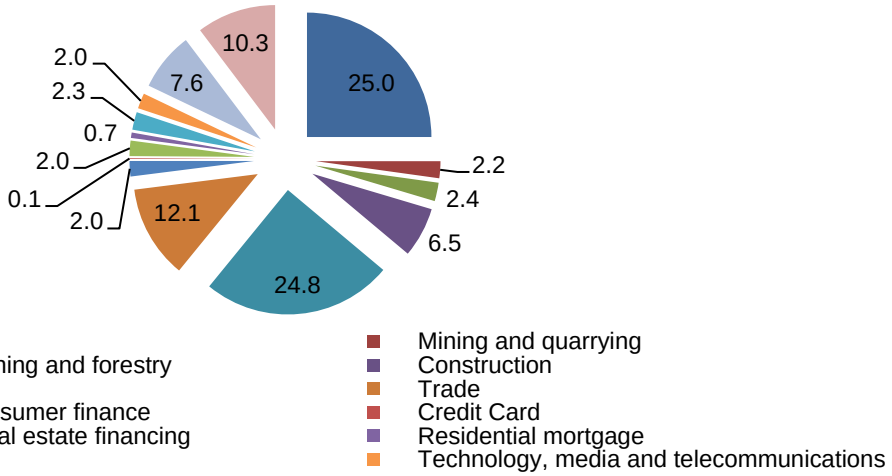
	Mar. 2016	Sep. 2016	Change
Manufacturing	24.6	25.0	0.4
Mining and quarrying	2.3	2.2	(0.1)
Agriculture, fishing and forestry	2.0	2.4	0.4
Construction	6.6	6.5	(0.1)
Financial	26.0	24.8	(1.2)
Trade	12.0	12.1	0.1
Personal / Consumer finance	1.9	2.0	0.1
Credit Card	0.1	0.1	0.0
Commercial real estate financing	2.5	2.0	(0.5)
Residential mortgage	0.8	0.7	(0.1)
Government	2.4	2.3	(0.1)
Technology, media and telecommunications	2.0	2.0	0.0
Transport	7.3	7.6	0.3

Other sectors	9.7	10.3	0.6
Top two recipient sectors	**50.5**	**49.9**	**(0.6)**
Real Estate/ Construction Exposure**	**9.8**	**9.2**	**(0.6)**

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 highest two sectors continue to be the ("financial" and "manufacturing") when compared to March 2016, together accounting for 49.9% of total lending in September 2016 while real estate/ construction exposure decreased to 9.2% from 9.8%.

Chart 4-7: Distribution of Conventional Local Wholesale Banks' Lending (% of total loans)



Source: Central Bank of Bahrain

While observing *overseas wholesale banks*, the top recipient of loans in September 2016 remained the "Other" sector, with 24.3% of total loans, regardless of the slight decrease from 25.9% in March 2016, followed by the "financial" sector, with an increase from 16.9% to 17.1% and the "construction" sector with an increase to 15.0% from 14.0% (Table 3-14 and Chart 3-8). The top 2 sectors (financial and other) jointly represented 41.4% in September 2016. Real estate/construction exposure increased from 15.3% in March 2016 to 16.3% in September 2016.

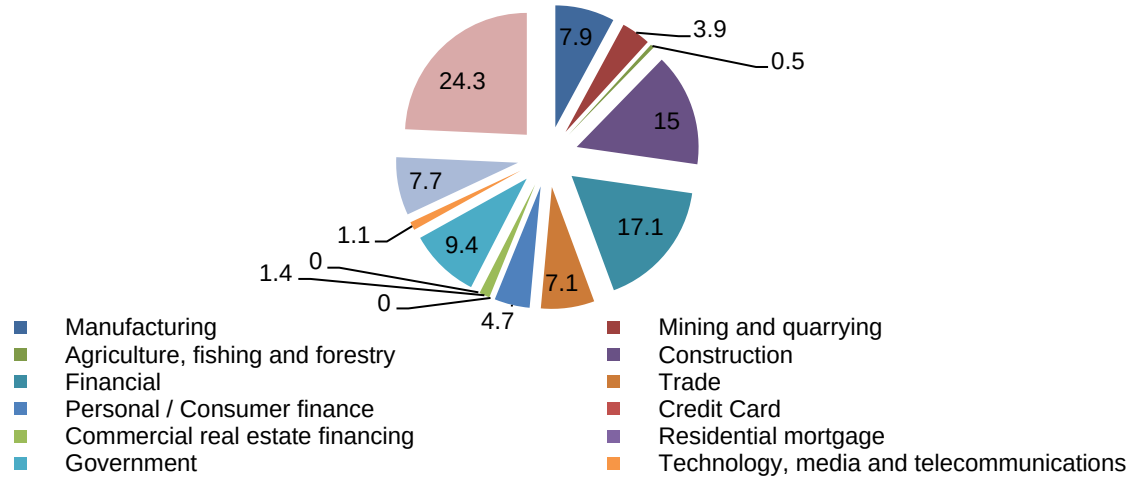
Table 4-14: Distribution of Conventional Overseas Wholesale Banks' Lending (% total Loans)*

	March 2016	Sep. 2016	Change
Manufacturing	8.7	7.9	(0.8)
Mining and quarrying	4.8	3.9	(0.9)
Agriculture, fishing and forestry	0.5	0.5	0.0
Construction	14.0	15.0	1.0
Financial	16.9	17.1	0.2
Trade	6.4	7.1	0.7
Personal / Consumer finance	4.8	4.7	(0.1)
Credit Card	0.0	0.0	0
Commercial real estate financing	1.3	1.4	0.1
Residential mortgage	0.0	0.0	0.0
Government	8.4	9.4	1.0

Technology, media and telecommunications	1.5	1.1	(0.4)
Transport	6.8	7.7	0.9
Other sectors	25.9	24.3	(1.6)
Top two recipient sectors	**42.8**	**41.4**	**(1.4)**
Real Estate/ Construction Exposure**	**15.3**	**16.3**	**1.0**

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

Chart 4-8: Distribution of Overseas Wholesale Banks' Lending (%)



Source: Central Bank of Bahrain

Increased earnings for wholesale banks

ROA for the conventional wholesale banking sector was at 0.6% in September 2016, an increase from the 0.4% in September 2015. The ROA for *local wholesale banks* increased from 0.3% to 0.4% over the same period. ROA for overseas wholesale banks also increased from 0.5% to 0.9% over the same period.

ROE for *local wholesale banks* increased from 2.5% to 3.6%. Net interest income as a proportion of total income decreased from 81.1% to 61.0% in September 2016. Operating expenses as a proportion of total income showed a decrease from 63.2% in September 2015 to 53.2% in September 2016.

Table 4-15: Profitability of Wholesale Banks (%)

	Sep. 2015	Sep. 2016
ROA *	0.4	0.6
ROA Locally Incorporated Banks	0.3	0.4
ROA Overseas Banks	0.5	0.9
ROE**	2.5	3.6
Net interest income (% total income)	81.1	61.0
Operating expenses (% total income)	63.2	53.2

Source: Central Bank of Bahrain

**ROA = ratio of net income to assets*
***ROE = ratio of net income to tier 1 capital (for locally incorporated banks only*

Liquidity position increases

As at end-September 2016, the overall loan-deposit ratio for conventional wholesale banks stood at 66.7%, a decrease from the 67.8% in March 2016. The loan deposit ratio for *local wholesale banks* decreased to 66.8% in September from the 69.1% in March 2016. Over the same period, the loan deposit ratio for *overseas wholesale* bank stood at 66.6% after it was 66.5%. Liquid assets for wholesale banks as a proportion of total assets increased to 24.6% in September 2016 from 22.7% in March 2015. *Locally incorporated wholesale banks* had a liquid asset ratio of 37.0% in September 2016 an increase from the 34.2% in March 2016. *Overseas wholesale banks* had a ratio of 10.5%, slightly higher than the 10.0% registered in March 2016. Liquid assets as a proportion of short-term liabilities increased to 35.4% in September 2016 from 33.3% in March 2016. Lastly, the deposits from non-bank sources as a proportion of total deposits stood at 43.1%, a decrease from the level achieved in March 2016 of 44.8%, bank deposits increased from 55.2% in March 2016 to 56.9% in September 2016.

Table 4-16: Wholesale Banks' Liquidity Profile (%)

	Mar. 2016	Sep. 2016
Liquid Asset Ratio	22.7	24.6
Loan-Deposit Ratio	67.8	66.7
Non-Bank Deposits as a % of total deposits	44.8	43.1

Source: Central Bank of Bahrain.

4.4 Overall Assessment of the Conventional Banking Sector

The financial soundness indicators show that conventional banks witnessed an increase in capital adequacy ratio. Capital adequacy ratios for conventional retail banks increased to 19.6% in September 2016. Capital adequacy ratio for conventional wholesale banks was 19.8% at the same period. Non-performing loans have shown an increase between periods of March 2016 to September 2016 from 4.0% to 4.7%, for conventional retail banks. As for conventional wholesale banks, loans classified as non-performing were at 5.5% in September 2016 compared to 5.1% in March 2016. Loan concentration remains high for conventional retail and wholesale banks despite some decreases in some sectors.

As at end-September 2016, return-on-assets (ROA) slightly decreased to 1.1 for conventional retail banks but increased for conventional wholesale banks to stand at 0.6%. Return-on-equity (ROE) for *local retail banks* increased from 10.5% in September 2015 to 11.4% in September 2016. ROE for *local wholesale banks* increased from 2.5% to 3.6% over the same period. For conventional retail banks, liquid assets as a proportion of total assets decreased over the period of March 2016 to September 2016 to reach 24.4%. Liquid assets for wholesale banks as a proportion of total assets increased from 22.7% in March 2016 to 24.7% in September 2016.

5. Islamic Banks

Chapter 5

Key Points

- Capital positions for Islamic retail and wholesale banks increased.
- Decrease in non-performing facilities (NPFs) for Islamic retail banks and stability in wholesale banks.
- Concentration of facilities for both Islamic retail banks and Islamic wholesale Banks continues.
- Earnings remained positive for Islamic retail and Islamic wholesale banks.
- Liquidity positions deteriorated for Islamic retail banks while it declines for Islamic wholesale banks.

5.1 Overview

This chapter analyzes the banking sector under the following categories: Islamic retail banks (section 5.2) and Islamic wholesale banks (section 5.3). Section 5.4 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-March 2016 and compared with end-September 2016.

This chapter offers macroprudential analysis of the Islamic banking sector based on a set of selected Financial Soundess Indicators (FSIs).[12] **Annex1 presents selected *Financial Soundness Indicators* (FSIs) for the different banking segments. Annex 2 presents selected graphs showing the development of selected indicators over time.**

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

5.2 Islamic Retail Banks

Increase in capital positions

The CAR of Islamic retail banks increased from 15.8% in March 2016 to 17.1% in September 2016. Tier 1 capital also increased from 13.7% in March 2016 to 14.9% in September 2016.

Table 5-1: Capital Provisions Ratios for Islamic Retail Banks

Indicator	Mar. 2016	Sep. 2016
Capital Adequacy Ratio	15.8%	17.1%
Tier 1 Capital Adequacy Ratio	13.7%	14.9%
NPFs net of provisions to capital	26.5%	28.3%

Source: Central Bank of Bahrain

The ratio of non-performing facilities (NPFs) net of provisions to capital increased from 26.5% to 28.3% for the same period.

Decrease in non-performing facilities

Non-performing facilities (NPF) ratio decreased to 12.1% in September 2016, compared to 12.4% in March 2016. Specific Provisoining also decreased from 40.8% in March 2016 to 34.1% in September 2016.

Table5-2: NPF Figures for Islamic Retail Banks

Indicator	Mar. 2016	Sep. 2016
NPFs (% Gross)	12.4	12.1
Specific Provisions (% of NPFs)	40.8	34.1

Source: Central Bank of Bahrain

A look at the non-performing facilities by sector indicates that the “construction” sector had the highest impairment of 29.4% in September 2016 (7.6% increase compared to March 2016) followed by “Manufacturing” and “commercial real estat financing” with 26.1% and 20.2% respectively.

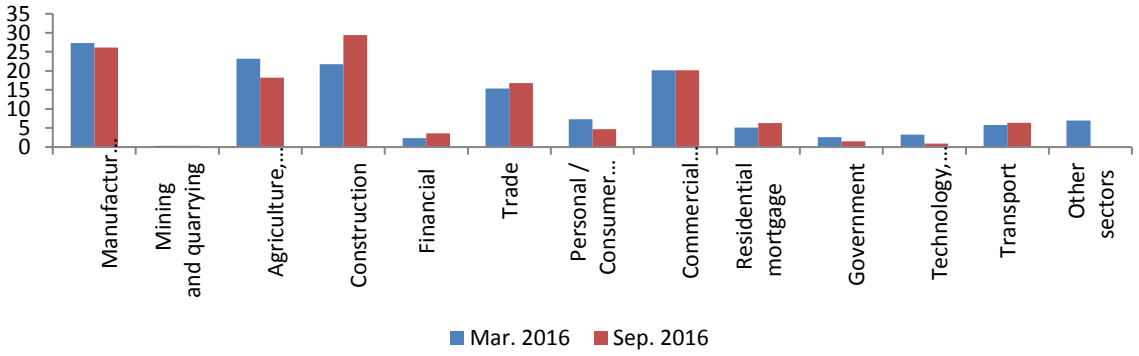
The biggest declines in NPF’s by sector was in the “Agriculture,fishingand forestry” Sector with a 5.0% decrease in NPFs from March 2016 to September 2016. The biggest increase in NPF’s was the “Construction” sector with an increase of 7.6%.

Table 5-3: Islamic Retail Banks' NPF Ratios by Sector (% of gross facilities per sector)

	Mar. 2016	Sep. 2016	Change
Manufacturing	27.3	26.1	-1.2
Mining and quarrying	0.3	0.3	0.0
Agriculture, fishing and forestry	23.2	18.2	-5.0
Construction	21.8	29.4	7.6
Financial	2.3	3.6	1.3
Trade	15.4	16.8	1.4
Personal / Consumer finance	7.3	4.7	-2.6
Credit Card	6.2	2.3	-3.9
Commercial real estate financing	20.2	20.2	0.0
Residential mortgage	5.1	6.3	1.2
Government	2.6	1.5	-1.1
Technology, media and telecommunications	3.3	0.9	-2.4
Transport	5.8	6.4	0.6
Other sectors	7.0	5.2	-1.8

Source: Central Bank of Bahrain

Chart 5-1: Islamic Retail Bank's NPF's by Sector (% of gross facilities per sector)



Source: Central Bank of Bahrain

Increases in asset concentration (loan portfolio)

There have been an increase in the asset concentration among most of the sectors. At the end of March 2016, the top recipient of financing was "Personal / Consumer finance" at 23.6% up from 20.8% in March 2016. The top two recipients of financing ("Personal / Consumer finance" and "Commercial real estate financing") accounted for 38.9 of total facilities extended compared to 35.7% for the top two sectors in March 2016. Moreover, the share of "Financial" sector declined from 11.0% in March 2016 to 6.5% in September 2016.

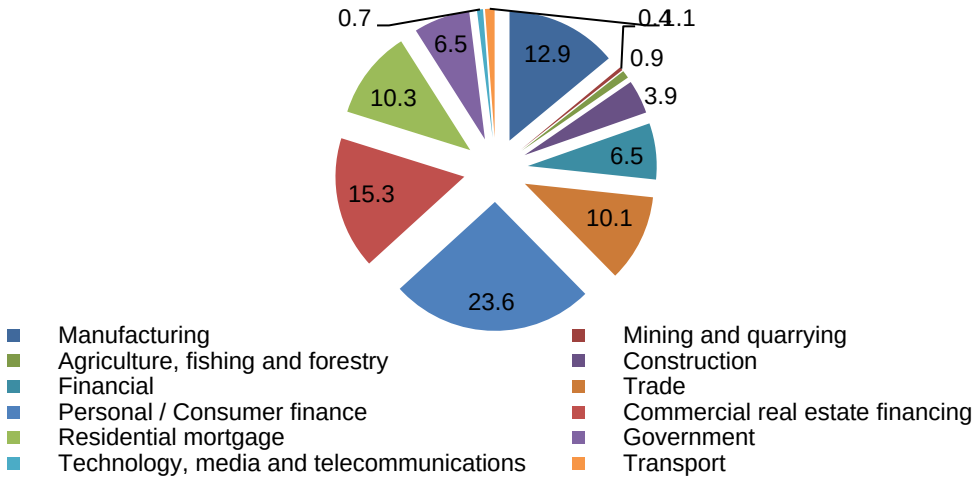
"Real Estate/ Construction" exposure slightly decreased from 29.5% in March 2016 to 29.4% in September 2016.

Table 5-4: Distribution of Islamic Retail Banks' Lending by Economic Activity (% of total facilities)*

	Mar. 2016	Sep. 2016	Change
Manufacturing	12.5	12.9	0.4
Mining and quarrying	0.4	0.4	0.0
Agriculture, fishing and forestry	0.7	0.9	0.2
Construction	5.3	3.9	-1.4
Financial	11.0	6.5	-4.5
Trade	10.1	10.1	0.0
Personal / Consumer finance	20.8	23.6	2.8
Credit Card	0.9	1.0	0.1
Commercial real estate financing	14.9	15.3	0.4
Residential mortgage	9.3	10.3	1.0
Government	6.7	6.5	-0.2
Technology, media and telecommunications	0.7	0.7	0.0
Transport	0.8	1.1	0.3
Other sectors	6.0	7.0	1.0
Top two recipient sectors	**35.7**	**38.9**	**3.2**
Real Estate/ Construction Exposure**	**29.5**	**29.4**	**-0.1**

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

Chart 5-2: Distribution of Islamic Retail Bank's Lending by Economic Activity (% of total facilities)



Source: Central Bank of Bahrain

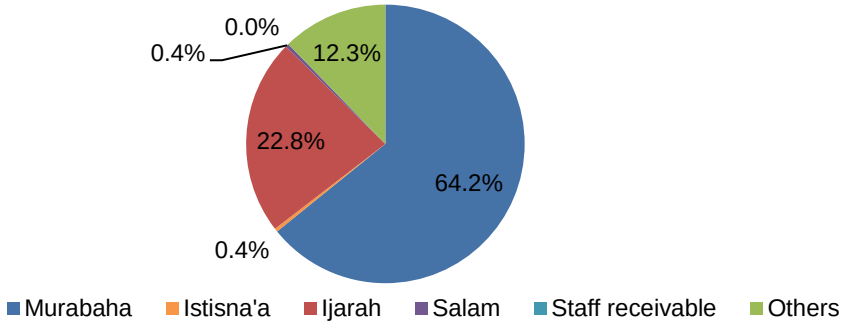
Lending distribution by Islamic instrument remained nearly unchanged over the past quarter. At the end of September 2016, the top recipient of finance was "Murabaha" at 64.2% down from 66.9% in March 2016. This was followed by "Ijarah" which increased from 20.0% to 22.8% for the same period.

Table 5-5: Distribution of Islamic Retail Banks' Lending by Islamic Instrument (% of total facilities)*

	Mar. 2016	Sep. 2016	Change
Murabaha	66.9	64.2	-2.7
Istisna'a	0.3	0.4	0.1
Ijarah	20.0	22.8	2.8
Salam	0.4	0.4	0.0
Staff receivable	0.0	0.0	0.0
Others	12.4	12.3	-0.1

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

Chart 5-3: Distribution of Islamic Retail Bank's Lending by Islamic Instrument (% of total facilities)



Source: Central Bank of Bahrain

Decline in earnings

The return on assets (ROA) for Islamic retail banks decreased to reach 0.2% in September 2016 compared to 0.4% in September 2015. Return on equity (ROE) decreased from 3.2% to 1.6% for the same period. In contrast, operating expenses increased from 74.6% in September 2015 to 82.9% in September 2016.

Table 5-6: Profitability of Islamic Retail Banks (%)

	Sep. 2015	Sep. 2016
ROA*	0.4	0.2
ROE**	3.2	1.6
Operating expenses (% total operating income)	74.6	82.9

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

Increase in liquidity

The volume of liquid assets available to Islamic retail banks increased from 10.5% of total assets in March 2016 to 12.3% in September 2016. The ratio of total facilities to deposits decreased from 87.0% in March 2016 to 82.9% in September 2016.

Table 5-7: Liquidity Measures for Islamic Retail Banks

Indicator	Mar. 2016	Sep. 2016
Liquid Assets (% of total assets)	10.5	12.3
Facilities – deposits ratio (%)	87.0	82.9

Source: Central Bank of Bahrain

5.3 Islamic Wholesale Banks

Increase in capital positions

As at end-September 2016, the CAR for Islamic wholesale banks increased from 19.1% in March 2016 to 19.3% in September 2016. Tier1 capital decreased from 18.6% to 18.5% over the same period. Similarly, the ratio of NPFs net of provisions to capital decreased from 2.9 to 1.5%.

Table 5-8: Capital Provisions Ratios for Islamic Wholesale Banks

Indicator	Mar. 2016	Sep. 2016
Capital Adequacy Ratio	19.1	19.3
Tier 1 Capital Adequacy Ratio	18.6	18.5
NPFs net of provisions to capital	2.9	1.5

Source: Central Bank of Bahrain

Decreasing non-performing facilities (NPFs)

As of end-September 2016, NPF ratio for Islamic wholesale banks decreased to 2.9%. Provisioning for NPF's increased from 80.3% to 82.4% over the same period.

Table 5-9: NPF Figures for Islamic Wholesale Banks

Indicator	Mar. 2016	Sep. 2016
NPFs (% Gross)	4.8	2.9
Specific Provisioning (% of NPFs)	80.3	82.4

Source: Central Bank of Bahrain

The sector with the highest impairment was the "Technology, media and telecommunications" sector with 53.2% in September 2016, down from the 55.5% in March 2016. This was followed by the "Commercial Real Estate Financing" "Mining and quarrying" sectors.

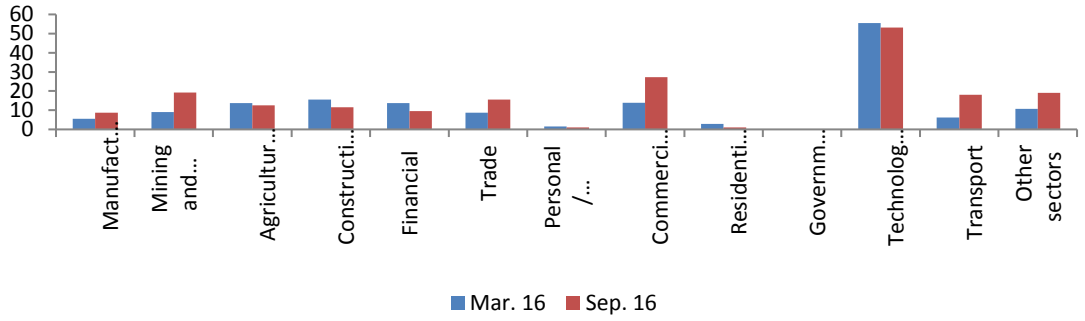
Available data on the sectoral breakdown of non-performing facilities shows that the biggest drop was in the "Financial" with a decrease of 4.1% from 13.7% in March 2016 to 9.6% in September 2016. The biggest increase was in the "Commercial real estate financing" sector with an increase of 13.4%.

Table 5-10: Islamic Wholesale Banks' NPF Ratios by Sector (% of gross facilities per sector)

	Mar. 2016	Sep. 2016	Change
Manufacturing	5.5	8.8	3.3
Mining and quarrying	9.0	19.2	10.2
Agriculture, fishing and forestry	13.7	12.5	(1.2)
Construction	15.5	11.6	(3.9)
Financial	13.7	9.6	(4.1)
Trade	8.8	15.5	6.7
Personal / Consumer finance	1.6	1.1	(0.5)
Commercial real estate financing	13.9	27.3	13.4
Residential mortgage	2.9	1.1	(1.8)
Government	0.0	0.0	0.0
Technology, media and telecommunications	55.5	53.2	(2.3)
Transport	6.2	18.0	11.8
Other sectors	10.7	19.0	8.3

Source: Central Bank of Bahrain

Chart 5-4: Islamic Wholesale Bank's NPF's by Sector (% of gross facilities per sector)



Source: Central Bank of Bahrain

Asset concentration remains high in some sectors

At end-March 2016, the "Personal/Consumer Finance" sector remained the top recipient of financing from Islamic wholesale banks, at 21.3%, surpassing "Manufacturing" at 19.2%. The Financial Sector decreased from 9.8% in March 2016 to 9.3% in September 2016.

Table 5-11: Distribution of Islamic Wholesale Banks' Lending by Economic Activity (% total facilities)*

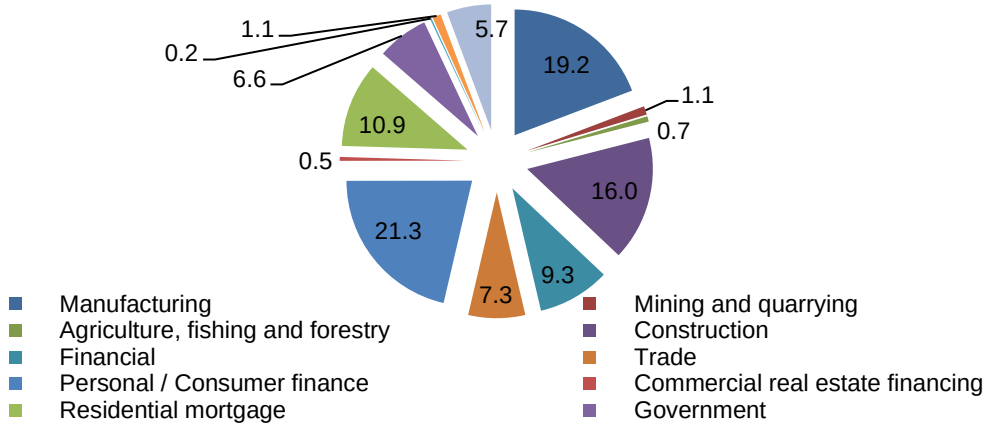
	Mar. 2016	Sep. 2016	Change
Manufacturing	24.4	19.2	(5.2)
Mining and quarrying	0.7	1.1	0.4
Agriculture, fishing and forestry	0.6	0.7	0.1
Construction	17.3	16.0	(1.3)
Financial	9.8	9.3	(0.5)
Trade	10.9	7.3	(3.6)
Personal / Consumer finance	9.7	21.3	11.6
Commercial real estate financing	0.9	0.5	(0.4)

Residential mortgage	3.0	10.9	7.9
Government	7.4	6.6	(0.8)
Technology, media and telecommunications	0.2	0.2	0.0
Transport	1.7	1.1	(0.6)
Other sectors	13.4	5.7	(7.7)
Top two recipient sectors	**41.7**	**40.6**	**(1.1)**
Real Estate/ Construction Exposure**	**30.7**	**27.4**	**(3.3)**

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 September 2016 ("Personal / Consumer Finance" and "Manufacturing") jointly represented 40.6% of total financing, down from 41.7% in March 2016. Real estate/ construction exposure decreased to 27.4% in September 2016 from 30.7% in March 2016.

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



Source: Central Bank of Bahrain

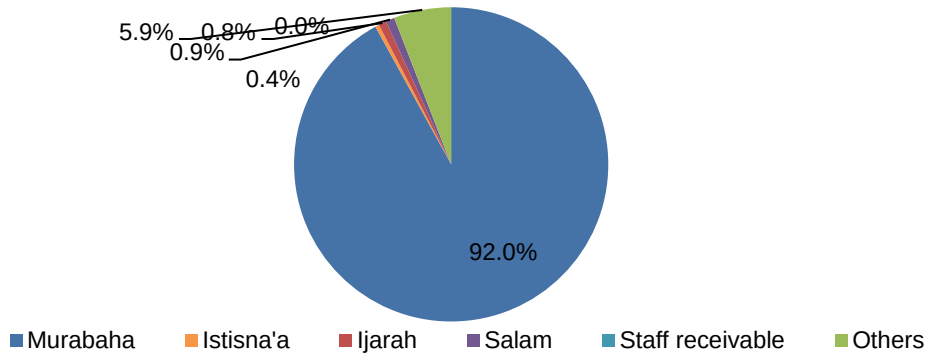
Lending distribution by Islamic instrument shows that at the end of September 2016, the top recipient of finance was "Murabaha" at 91.9%.

Table 5-12: Distribution of Islamic Wholesale Banks' Lending by Islamic Instrument (% of total facilities)*

	Mar. 2016	Sep. 2016	Change
Murabaha	90.1	91.9	1.8
Istisna'a	0.4	0.4	0.0
Ijarah	0.8	0.8	0.0
Salam	0.9	0.9	0.0
Staff receivable	0.0	0.0	0.0
Others	7.8	5.9	(1.9)

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

Chart 5-6: Distribution of Islamic Wholesale Bank's Lending by Islamic Instrument (% of total facilities)



Source: Central Bank of Bahrain

Increase in earnings

The earnings performance of Islamic wholesale banks increased over the period from September 2015 to September 2016. Return on assets (ROA) increased from -0.1 % in September 2015 to 0.2% in September 2016. Return on equity (ROE) increased as well from -0.7% to 1.6% in September 2016. Also, operating expenses (as % of total income) decreased from 63.3% in September 2015 to 61.1% in September 2016.

Table 5-13: Profitability of Islamic Wholesale Banks (%)

	September 2015	September 2016
ROA*	-0.1	0.2
ROE**	-0.7	1.6
Operating expenses (% total operating income)	63.3	61.1

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

Liquidity position declines slightly

As of end-September 2016, liquid assets of Islamic wholesale banks represented 18.9% of total assets, 1.3% lower than the 20.2% registered in March 2016. Additionally, the facilities deposit ratio decreased from 62.1% to 61.6% in September 2016.

Table 5-14: Liquidity Measures for Islamic Wholesale Banks

Indicator	Mar. 2016	Sep. 2016
Liquid assets (% of total)	20.2	18.9
Facilities-deposit ratio	62.1	61.6

Source: Central Bank of Bahrain

5.4 Overall Assessment of the Islamic Banking Sector

The financial soundness indicators show that Islamic retail banks capital positions increased while wholesale banks decreased during the period between March 2016 and September 2016 reaching 17.1% and 19.3% respectively.

Non-performing facilities decreased for Islamic retail and Islamic wholesale to reach 12.1% and 2.9% respectively. Facilities concentration has decreased in some sectors while increasing in others in retail Islamic banks and wholesale Islamic banks.

Earnings declined for Islamic retail banks while ROE and ROA increased for Islamic wholesale banks.

Islamic retail banks experienced some changes in its liquidity position as the liquid asset ratio increased and facilities to deposits ratio decreased. Islamic wholesale's liquidity positions showed a decrease in liquid assets and facilities to deposit ratio.

Part III:

Developments in the Equity Market and Payment Systems

6. Performance of Equity Market

Chapter 6

Key Points

- Increase in the Bahrain All Share index.
- Year-on-year decline in market capitalization.
- Year-on-year increase in price-earnings ratio.
- Improvements in GCC indices.

6.1 Overview

Bahrain Stock Exchange (BSE) was established in June 1989, it started by having 29 Bahraini shareholding companies listed. In 2010, in order to comply with Law No. (57) The Bahrain Stock Exchange got restructured into a closed shareholding company hence Bahrain Bourse. The latest highlights include the Launch of first tradable Sukuks in the Middle East in addition to the Launch of REIT listing rules in 2015. Additionally, in November 2016, Bahrain Bourse accounted that all listed companies have transferred their shares to the electronic registry and deposited them in the Bourse's Central Depository System.

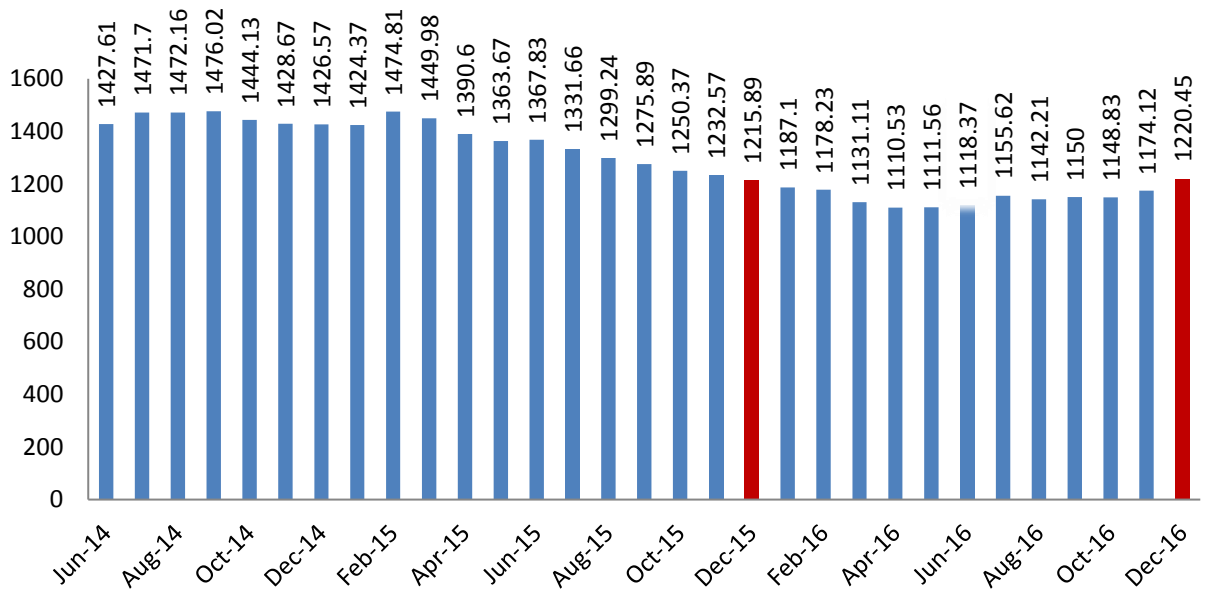
As at December 2016, Bahrain Bourse recorded a total listing of 44 Companies, 19 Mutual funds and 14 Bonds and Sukuks. “Commercial Banks” sector represents the highest value in traded shares by scoring 54.9% of total shares. Nevertheless, the largest 5 companies in terms of Market Capitalization are UAB, Batelco, ALBA and GFH which account for 53.12% of the total market. Furthermore, the value traded by Bahraini increased from 66.53% in 2015 to 69.69% in 2016 which reflects the improved market conditions.

6.2 Bahrain Market Trends

Increase in market index

Year-on-year data demonstrates that the Bahrain All Share Index increased by 4.56 points (0.372%) between Dec 2015 and Dec 2016 (Chart 6-1). Observing this period, the index started with 1187.1 points in Jan 2016, where the index began to drop until April 2016 where the index scored the lowest point at 1110.53. Subsequently, the index started to increase reaching the maximum value in Dec 2016 by 1220.45. Month on month basis, the index increased from 1174.12 in Nov 2016 to 1220.45 in Dec 2016 (3.95%).

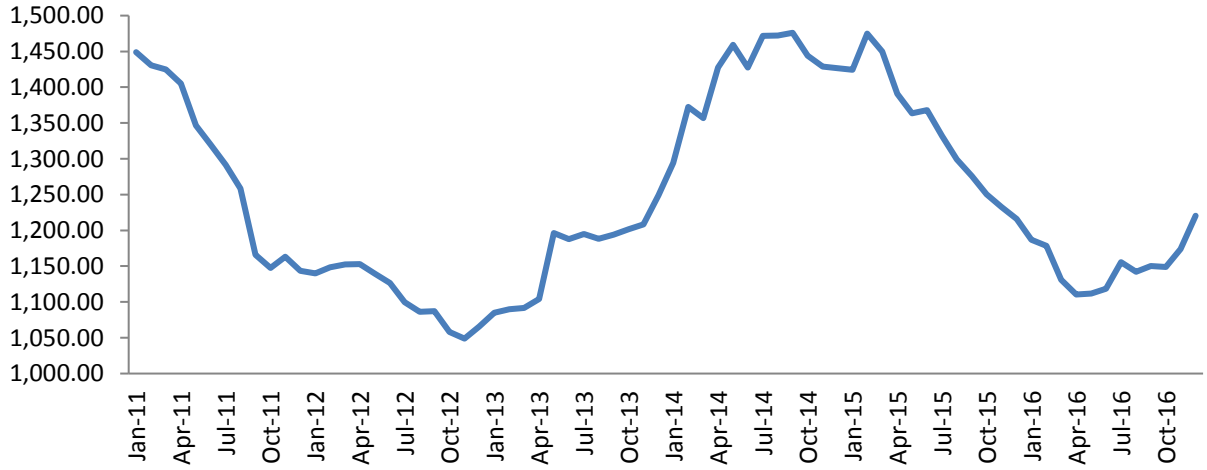
Chart 6-1: Recent Trends in the Bahrain All-Share Index, Jan 2014-Dec 2016.



Source of Data: Bahrain Bourse

Chart 6-2 below provides a complete representation of the Bahrain All Share Index performance over the past 5 years. The index experienced a fluctuated trend, where it decrease steadily from Jan 2011 and reached the lowest point in October 2012. Afterwards, the index began to rise sharply just before it started dropping back in Jan 2016 where the Index remained at around 1200 points.

Chart 6-2: Bahrain All-Share Index, Jan 2011-Dec 2016



Source of Data: Bahrain Bourse

Decrease in market capitalization

As at end-Dec 2016, market capitalization of the Bahrain Bourse stood at BD 3.7 billion (Table 6-1). This level of market capitalization is 43.8% lower than the level attained in June 2016 and 48.1% lower *year-on-year*.

Table 6-1: Market Capitalization on the Bahrain Bourse

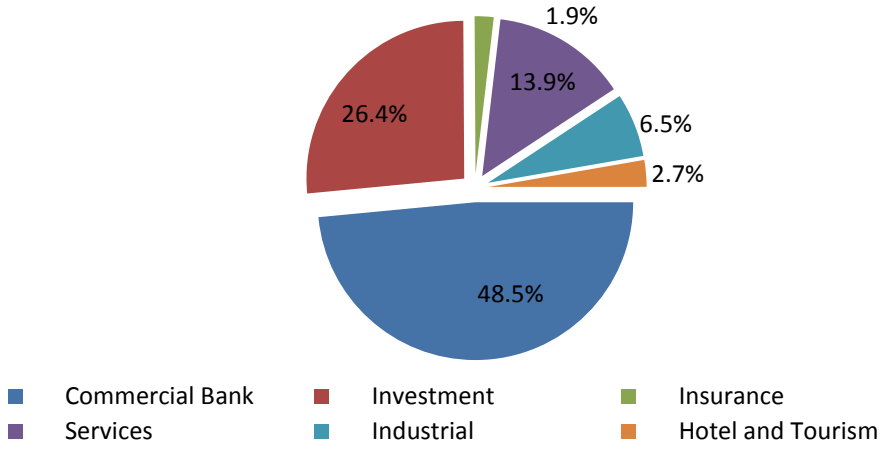
(BD)

Sector	Dec. 2015	Jun. 2016	Dec. 2016	June. 2016-Dec 2016 (% Change)	Dec. 2015-Dec. 2016 (% Change)
Commercial banks	3,483,477,135	3,230,784,925	3,514,830,525	8.8	1.0
Investment	1,723,042,243	1,626,074,000	1,914,779,013	17.7	11.2
Insurance	146,903,190	142,019,918	140,862,578	(0.8)	(4.2)
Services	1,096,383,238	1,039,701,020	1,005,531,994	(3.3)	(8.3)
Industrial	547,911,644	414,431,644	473,972,314	14.4	(13.5)
Hotel and Tourism	202,190,375	198,561,019	198,468,527	(0.1)	(1.9)
Total	**7,199,907,825**	**6,651,572,525**	**3,737,129,256.53**	**(43.8)**	**(48.1)**

Source: Bahrain Bourse

A breakdown of market capitalization by sector indicates that Industrial recorded the highest *year-on-year* decline in market capitalization (13.5%) followed by Services (8.3%) and Insurance (4.2%). Hotel and Tourism scored the lowest decreases among other market capitalization sectors with only 1.9% decrease, whereas Investments recorded the highest increase (11.2%).

Chart 6-3: Market Capitalisation by Sector, June 2016



Source: Bahrain Bourse

Increase in price-earnings ratios

As Dec 2016, the price-earnings ratio (P-E ratio) for the stock market stood at 8.9, an increase from the 8.42 attained in June 2016 and the 8.85 in Dec 2015. All sectors experienced progress in their P/E ratio compared to Dec 2015 except Commercial Banks (by 0.75%) and Services sectors (by 0.62%).

Table 6-2: Price-Earnings Multiples

Sector	Dec. 2015	Jun. 2016	Dec. 2016
Commercial banks	10.55	9.01	9.8
Investment	6.88	6.39	6.9
Insurance	8.74	13.01	13.0
Services	10.92	10.68	10.3
Industrial	5.57	6.74	7.7
Hotel and Tourism	10.63	11.81	11.8
Total Market	8.85	8.42	8.9

Source: Bahrain Bourse

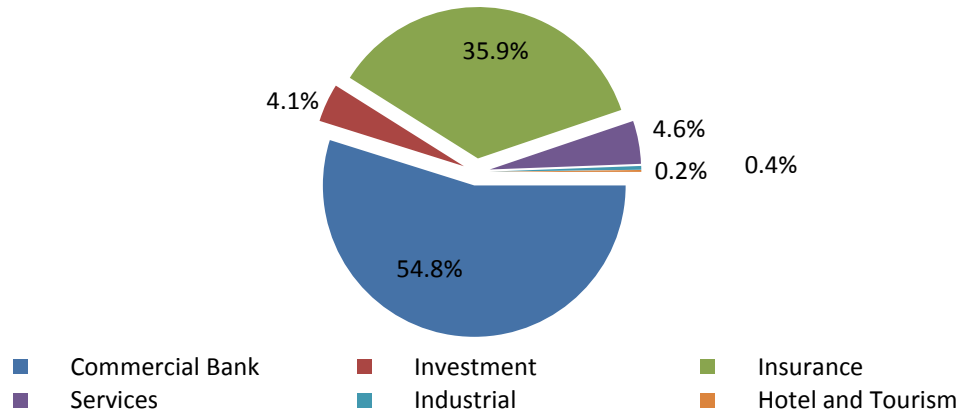
The bulk of the value of shares traded in Dec 2016 was the "Commercial Banks" sector whose traded shares (by value) represented 54.9% of total shares, which is less than what was attained in Dec 2015. The "Insurance" sector represents the second greatest level at being 35.9% of the total value of shares traded in Dec 2016, which experienced a dramatic increase after being merely 0.3% December 2015. The "Hotel and Tourism" sector was the lowest traded shares in Dec 2016 whose traded shares by value represented only 0.2% of total traded shares. (Table 6-3)

Table 6-3: Sectoral Distribution of Shares Traded by Value (% of all shares traded)

Sector	Dec. 2015	Jun. 2016	Dec. 2016
Commercial banks	75.5	24.3	54.9
Investment	6.6	15.8	4.1
Insurance	0.3	1.6	35.9
Services	12.7	44.7	4.6
Industrial	3.3	3.1	0.4
Hotel and Tourism	1.6	10.6	0.2

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

Chart 6-4: Sectoral Distribution of Shares Traded by Value (% of all shares traded) in Dec 2016



Source: Bahrain Bourse

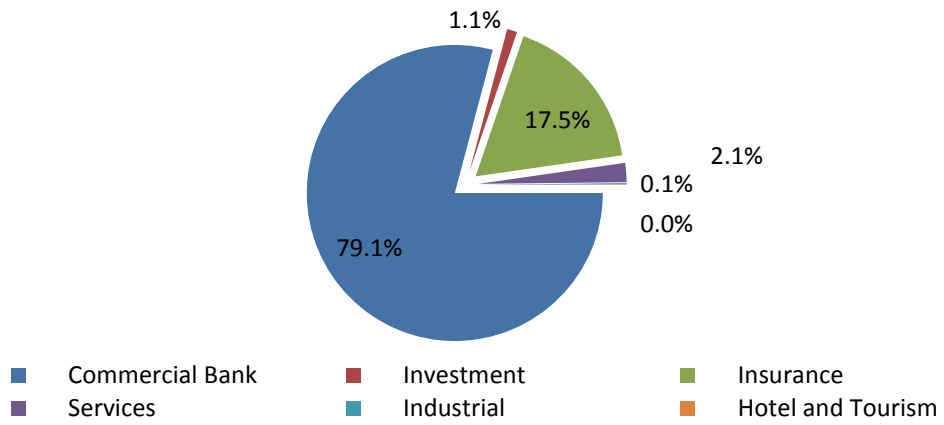
The bulk of the volume of shares traded in December 2016 was the "Commercial banks" sector representing 79.14% of the total volume of shares traded, followed by the "Insurance" sector at 17.49%. The lowest level was attained by the "Hotel and Tourism" sector at 0.4%, after it was 1.5% in December 2015. The volume of shares traded of the commercial banks was at 40.7% in June 2016 while the Insurance sector was at 0.9%, as represented at Table 5-4 and Chart 5-5.

Table 6-4: Sectoral Distribution of Shares Traded by Volume (% of all shares traded)

Sector	Dec. 2015	Jun. 2016	Dec. 2016
Commercial banks	84.7	40.7	79.1
Investment	5.0	12.4	1.11
Insurance	0.3	0.9	17.5
Services	6.9	40.0	2.1
Industrial	1.6	2.4	0.1
Hotel and Tourism	1.5	3.6	0.04

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

Chart 6-5: Sectoral Distribution of Shares Traded by Volume (% of all shares traded) in Dec 2016



Source: Bahrain Bourse

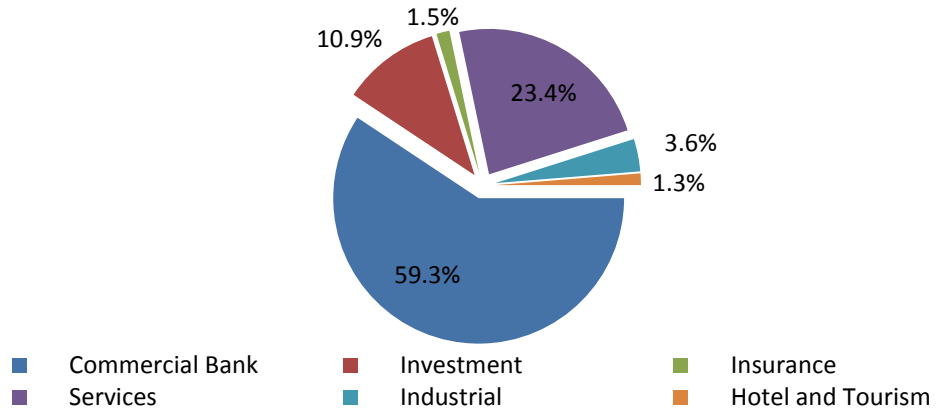
The majority of the number of transactions in December 2016 (1,163 transactions and a 33.2% increase compared to June 2016) was attained by the "Commercial Banks" sector at 690 transactions (59.3% of all transactions), followed by the "Services" sector at 272 transactions (23.4%), and the "Investment" sector at 127 transactions (10.9%). Contrarily, in June 2016, the highest number of transactions was recorded by the Services sector at 361 transactions, followed by the Commercial Banks sector at 286 transactions and the Investment sector at 137 transactions (Table 6-5).

Table 6-5: Number of Transactions by Sector

	Dec. 2015	Jun. 2016	Dec. 2016
Commercial Banks	637	286	690
Investment	116	137	127
Insurance	6	13	17
Services	186	361	272
Industrial	67	58	42
Hotels and Tourism	24	18	15
Total	1,036	873	1,163

Source: Bahrain Bourse

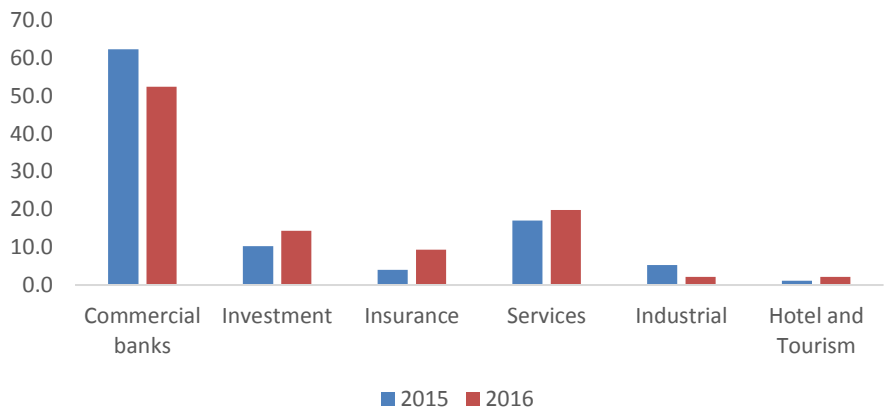
Chart 6-6: Sectoral Distribution of Number of Transactions Traded (% of all transactions traded) in Dec 2016



Source: Bahrain Bourse

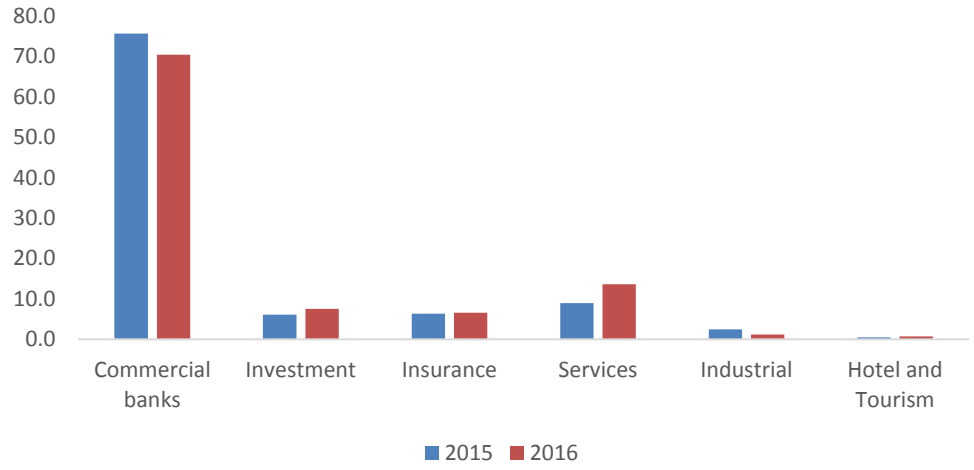
Below are the Annual Statistics of the Bahrain (January to December 2016) with regards to traded shares by value, volume, and number of transactions. "Commercial Banks" remain the dominant sector traded in terms of value, volume, and number of transactions.

Chart 6-7: Annual Shares Traded by Value (% of all shares traded) (2015 vs 2016)



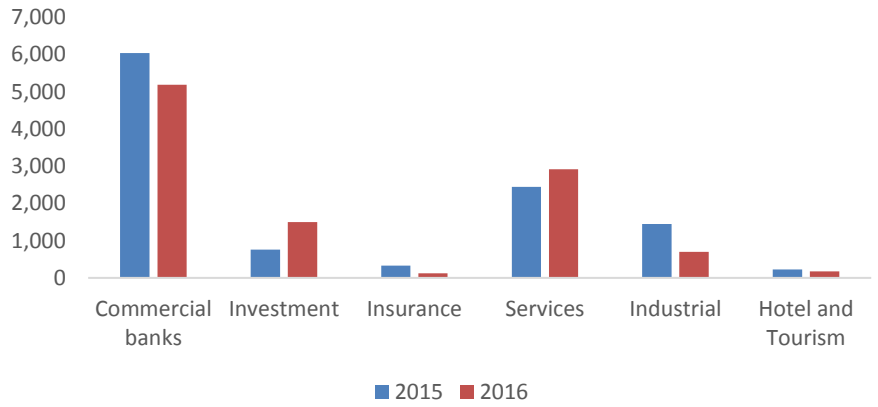
Source: Bahrain Bourse

Chart 6-8: Annual Shares Traded by Volume (% of all shares traded) (2015 vs 2016)



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

Chart 6-9: Annual Number of Transactions by Sector (2015 vs 2016)



Source: Bahrain Bourse

6.3 GCC Market Trends

The GCC equity markets improved by the end of 2016 which can be caused by the relatively slight increases in oil prices. The price of a barrel of oil was $48.38 in June 2016 but then it reached $53.72 by the end of December 2016. As a result, all of GCC indices recorded positive rates compared to June 2016. The highest increase was recorded by the Bahrain All Share Index 9.2% compared to other GCC equity markets when compared to June 2016, followed by Tadawul All Share Index with an increase of 8.7%. The only decrease was recorded by Muscat Securities Market Index 30 when compared to December 2015 by -10%.

Table 6-6: Stock Market Indices in GCC counties

Index	Dec. 2015	June 2016	Dec. 2016	June 2016 -Dec 2016 (%)	Dec 2015 - Dec 2016 (%)
Bahrain All Share Index	1,215.89	1,118.37	1220.45	9.2	0.4
Tadawul All Share Index	6,911.76	6,637.70	7210.43	8.7	4.4
Kuwait Market Index	5,615.12	5,408.54	5748.09	6.3	2.4
Qatar Exchange Index	10,429.12	9,807.28	10436.76	6.5	0.1
Dubai Financial Market Index	3,151.00	3,324.38	3530.88	6.3	12.1
Abu Dhabi Index	4,307.26	4,352.62	4546.37	4.5	5.6
Muscat Securities Market Index 30	6,424.60	5,406.22	5782.71	7.0	(10)

**December 31st, or latest available. Sources: Stock Exchange of Each Country*

6.4 International Market Trends

The US market improved as the Dow Jones industrial average gained about 29 points after rising 111.54 points at session highs whereas the S&P 500 gained 0.3 percent. After the US elections, all of the major US indexes have shown improvement with some sectors such as financial, energy, and telecom being big winners.

However, European equities traded mostly flat ahead of the inauguration which added to the fact that ECB announced it would keep its monetary policy stance unchanged, with the pan-European Stoxx 600 falling just 0.07 percent.

Asian markets nonetheless finished mixed as of the most recent closing prices. The Shanghai Composite gained 0.70% and the Nikkei 225 rose 0.34%. The Hang Seng lost 0.71%.

6.5 Overall assessment of the equity market

The overall performance experienced an upward trend compared to the previous period. Bahrain All Share Index started improving by an increase of 9.2% when compared to June 2016 and 0.4% year-on-year., the market capitalization decreased by 48.1%, and the P/E ratio plunged by 8.9%.

Furthermore, the indices of the GCC equity markets have been experiencing a slight recovery, which was affected by the increased in stock trading activities by volume (33.2%) when compared to June 2016, and due to the improvements in oil prices. The overall market conditions and performances are seen to be uncertain in the medium term because of the current international economic circumstances that might have an indirect spill-over on the GCC equity markets.

7. Payments and Settlements Systems

Chapter 7

Key Points

- The Payment and Settlement Systems in the Kingdom of Bahrain continue to function safely and efficiently.
- Oversee the payment developments in the Kingdom of Bahrain and observe the market demand.
- CBB introduced the Electronic Fund Transfer System (EFTS).
- FinTech challenges to Payment and Settlement Systems.

7.1 Overview

Payment and Settlement Systems are central to the smooth operations of the financial sector and the efficient functioning of the overall economy. Therefore, the safety and soundness of Payment and Settlement Systems is important for the evaluation of risks to financial stability.

Bahrain's Payment and Settlement Framework continues to function safely, securely and efficiently. The current Payments and Settlement infrastructure in Bahrain comprises of five main components: i) the Real Time Gross Settlement System (RTGS); ii) the Scripless Securities Settlement System (SSSS); iii) the ATM Clearing System (ATM); iv) the Bahrain Cheque Truncation System (BCTS) and v) the Electronic Fund Transfer System (EFTS).

The launch of the Bahrain Cheque Truncation System (BCTS) was a milestone to the Bahraini financial sector which raised efficiency and Customer satisfaction. Furthermore, the Kingdom of Bahrain took a step forward in line with the global trend of going cashless by introducing the Electronic Fund Transfer System (EFTS) that enabled electronic fund transfers within Bahrain with three options Fawri+ (Near Real-time (NRT)), Fawri (Deferred Net Settlement (DNS)) and Fawateer (Electronic Bill Presentment and Payment (EBPP)).

This chapter describes recent trends in the Payment and Settlement Systems.

7.2 Real Time Gross Settlement System (RTGS)

The CBB operates a Real Time Gross Settlement (RTGS) System where all inter-Bank payments are processed and settled in real time on-line mode which went live on the 14th of June, 2007. The RTGS System provides for Payment and Settlement of Customer transactions as a value addition.

The RTGS System enables the Banks to have real time information on, for example, account balances, used and available intra-day credit, queue status, transaction status etc. The RTGS System is multi-currency capable and based on Straight Through Processing (STP).

The number of direct participants in the RTGS are twenty eight (28) participants including the Central Bank of Bahrain (CBB).

The daily average volume of Bank transfers from 1st July, 2016 to 31st December 2016 (second half of 2016) have decreased by 21.2% to 227 transfers compared to 288 transfers from 1st January, 2016 to 30th June, 2016 (first half of 2016). Furthermore, the daily average volume of Bank transfers for 1st July, 2016 to 31st December 2016 decreased by 44.4% from 408 transfers to 227 transfers when compared to 1st July, 2015 to 31st December, 2015 (second half of 2015).

Although the daily average volume of Bank transfers through the RTGS are decreasing, the value of those transfers have increased in the second half of 2016 by 14.6% when compared to the first half of 2016 from BD226.2 million to BD259.3 million. Moreover, the daily average value of Bank transfers for the second half of 2016 increased by 28.2% i.e. by BD57.1 million transfers from BD202.2 million to BD259.3 million when compared to the second half of 2015.

Table 7-1: RTGS Daily Average and Volume

RTGS	Daily Average Volume	Daily Average Value (BD)
1st July, 2015 to 31st December, 2015	408	202.2 million
1st January, 2016 to 30th June, 2016	288	226.2 million
1st July, 2016 to 31st December, 2016	227	259.3 million

Source: Central Bank of Bahrain

7.3 Scripless Securities Settlement System (SSSS)

The CBB operates and oversees Scripless Securities Settlement System (SSSS) that provides the Depository and Settlement Services for holdings and transactions in Government Securities including Treasury Bills (T-Bills), Governments Bonds and Islamic Securities (Sukuk). Moreover, the SSSS went live on the 14th of June, 2007 along with the RTGS System.

The number of direct participants are twenty eight (28) participants and indirect participants are fifty seven (57) members in the SSSS.

The volume of issues for 1st July, 2016 to 31st December, 2016 increased compared to 1st January, 2016 to 30th June, 2016 by 4.9% from 41 issues to 43 issues. Moreover, the volume of issues has decreased in the second half of 2016 by 4.4% compared to the second half of 2015 from 45 issues to 43 issues.

The aggregate value of issues for the second half of 2016 increased slightly by 0.7% from BD3.04 billion in second half of 2015 to BD3.06 billion. Additionally, the aggregate value of issues for the second half of 2016 increased when compared to the first half of 2016 by 15.5% from BD2.65 billion to BD3.06 billion.

Table 7-2: SSS Daily Average and Volume

SSSS	Daily Average Volume	Daily Average Value (BD billion)
1st July, 2015 to 31st December, 2015	45	3.04
1st January, 2016 to 30th June, 2016	41	2.65
1st July, 2016 to 31st December, 2016	43	3.06

Source: Central Bank of Bahrain

The volume of issues did not pose problems to the System's processing capacity and the risk of significant participant's failure is minimised due to executing and settling in Real Time Gross Settlement System (RTGS).

The SSSS continued to operate smoothly and efficiently for the period from 1st July, 2016 to 31st December, 2016.

7.4 ATM Clearing System (ATM)

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).

The daily average volume of ATM transactions for the 1st July, 2016 to 31st December, 2016 increased by 14.9% from 31,143 transactions per day to 39,242 compared to 1st January, 2016 to 30th June, 2016. In addition, the daily average volume of ATM transaction increased by 22.9 from 30,676 to 39,242 when comparing the two periods 1st July, 2016 to 31st December, 2016 with 1st July, 2015 to 31st December, 2015.

The daily average value of ATM transactions increased by 11.7% from BD3.4 million in the second half of 2016 to BD3.8 million when comparing first half of 2016. Furthermore, the daily average value of cheques for the second half of 2016 decreased by 22.7% from BD3.1 million to BD3.8 million compared to the second half of 2015.

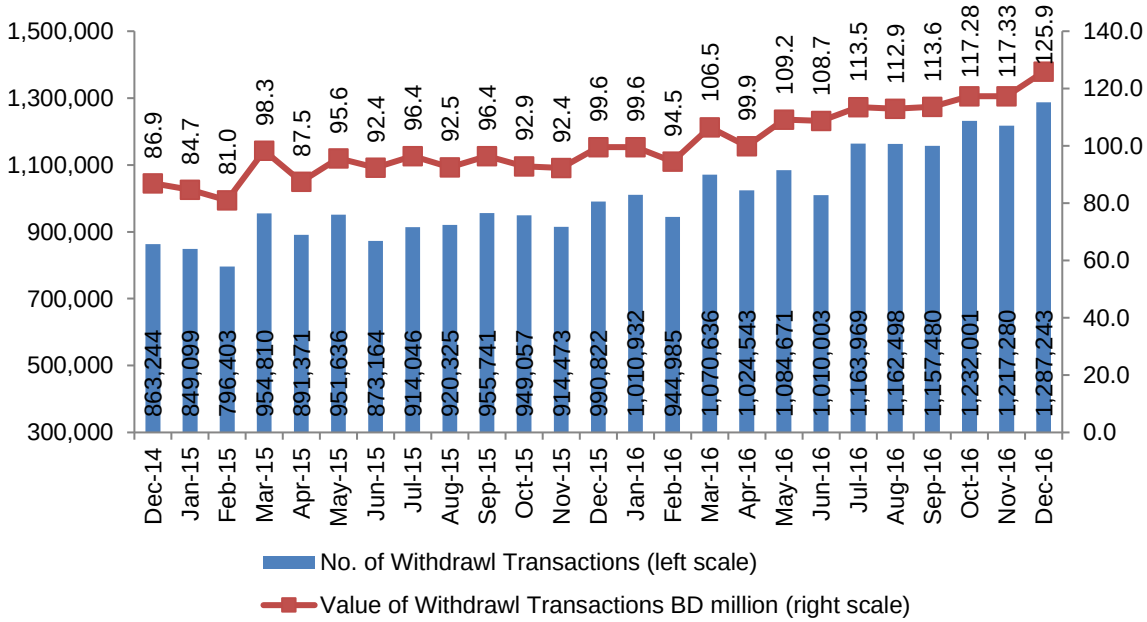
Table 7-3: ATM Transactions Daily Average and Volume

ATM Transitions	Daily Average Volume	Daily Average Value (BD million)
1st July, 2015 to 31st December, 2015	30,676	3.1
1st January, 2016 to 30th June, 2016	34,143	3.4
1st July, 2016 to 31st December, 2016	39,242	3.8

Source: Benefit

There have been minor up and down fluctuations in both the value and volume of transactions between December 2015 and June 2016. Overall though, there is an upward trend in both the value and the volume. Since December 2015, the highest value of withdrawals was witnessed in December 2016 at BD 125.9 million and the lowest value of withdrawals was in February 2016 at BD 94.5 million.

Chart 7-1: Number and Value of ATM Transactions, December 2014- December 2016



Source: The Benefit Company

7.5 Bahrain Cheque Truncation System (BCTS)

Cheques are seen as one of the most popular instruments in use among Retail Customers and Corporate Customers.

As part of the Central Bank of Bahrain vision to replace the paper based Automated Cheque Clearing System operated by the CBB, the Bahrain Cheque Truncation System (BCTS) commenced its operations in co-operation with the BENEFIT Company (BENEFIT) on the 13th May, 2012. Under the BCTS, cheques presented for payment will be scanned at the Bank where the Customer deposits his/her cheque(s) and the electronic images and payment information, instead of the physical cheque, will be transmitted to the BCTS Clearing House.

The main feature of the BCTS is the increasing efficiency and speed of the cheque clearing as it facilitates Bank Customers to have their cheques cleared and obtain their funds on the same day or maximum by the next working day in addition to providing Customers with a more secure and convenient service. The BCTS is operated by BENEFIT and overseen by CBB.

The number of participants in the BCTS are twenty nine (29) participants. The daily average volume of cheques for the second half of 2016 decreased by 6.2% when compared to the first half of 2016 from 284,150 cheques to 266,400 cheques. In addition, the daily average volume of cheques fell by 2.8% from 274,200 cheques to 266,400 cheques between the second half of 2015 and the second half of 2016.

Table 7-4: BCTS Daily Average Volume and Value

BCTS	Daily Average Volume	Daily Average Value (BD million)
1st July, 2015 to 31st December, 2015	274,200	842.2
1st January, 2016 to 30th June, 2016	284,150	887.6
1st July, 2016 to 31st December, 2016	266,400	793.7

Source: Benefit

This marginal decrease that continued throughout the year 2016 might be attributed to the introduction of the Electronic Fund Transfer System (EFTS) on the 5th of November, 2015. This system enabled faster and safer electronic fund transfers that contributed to the decrease of using cheques.

The BCTS continued to operate smoothly and efficiently for the period from 1st July, 2016 to 31st December, 2016.

7.6 Electronic Fund Transfer System (EFTS)

With the introduction of International Bank Account Number (IBAN) in January, 2012, transfers were easier and less time consuming for both Customers and Banks nevertheless, secured and more convenient. It was perceived that further uses of the IBAN can be utilised. Therefore, the Electronic Fund Transfer System (EFTS) was launched on the 5th of November, 2015, operated by BENEFIT and overseen by CBB.

The EFTS is an electronic system that interconnects all Retail Banks in Bahrain with each other and major billers in the Kingdom of Bahrain in order to enhance the efficiency of fund transfers and bill payments promoting a more proactive and forward-thinking Banking sector.

Fawri+ and Fawri provide fund transfers and real-time bill payments offering the public easier access, faster processes and virtually no mistakes.

The number of participants offering outward EFTS Services has reached twenty five (25) participants.

The daily average volume of Fawri+ transfers increased significantly by 107.9% from 229 transfers during the period of 1st July, 2016 to 31st December, 2016 to 476 transfer during the period of 1st January, 2016 to 30th June, 2016. In addition, the daily average value of Fawri+ transfers increased by 80.9% from BD67,100 to BD121,400 over the same period. .

The daily average volume of Fawri transfers increased for the second half of 2016 by 34.2% from 6,044 transfers to 8,111 transfers compared with the first half of 2016. Moreover, the daily average value of Fawri transfers increased by 21.5% from BD17.7 million to BD21.5 million over the same period.

Table 7-5: EFTS Fawri+ Daily Average and Volume

EFTS: Fawri+	Daily Average Volume	Daily Average Value (BD million)
1st January, 2016 to 30th June, 2016	229	67,100
1st July, 2016 to 31st December, 2016	476	121,400

Source: Benefit

Table 7-6: EFTS Fawri Daily Average Volume and Value

EFTS: Fawri	Daily Average Volume	Daily Average Value (BD million)
1st January, 2016 to 30th June, 2016	6,044	17.7
1st July, 2016 to 31st December, 2016	8,111	21.5

Source: Benefit

The EFTS continued to operate smoothly and efficiently from 1st January, 2016 to 31st December, 2016.

The CBB continued to assess the EFTS in terms of compliance with the requirements set by the Principles for Financial Market Infrastructures (PFMI) and CBB's Directives.

7.7 Opportunities and challenges of the rise of FinTech

The recent trends triggered by the technological innovations have opened new endeavours for methods of transacting and settling of payments. Untraditional market players were introduced to the financial sector mainly being technology start-ups and third party service providers such as telecommunication companies.

Offering low cost, convenient and instant payments, FinTech has also posed the regulators with the challenge of disintermediation of current payment systems in the emerging

settlement technologies such as distributed ledgers and blockchains. Furthermore, cybersecurity concerns rise in parallel with the rise of those new technologies.

The Payment Systems Oversight of the CBB is closely monitoring and observing the developments of this field and its implications globally and locally.

Box Table 1: Debit and Credit Card Statistics

Box Table 1: Cards issued and Payment card functions

(thousands, end of year)

	2010	2011	2012	2013	2014	2015
Total number of payment cards (irrespective of the number of functions on the card)	**998.78**	**1104.88**	**1195.35**	**1247.57**	**1233.00**	**1351.29**
Cards with a debit function	815.62	898.09	976.38	1,002.22	1,010.56	1,097.17
Cards with a credit function	173.75	189.57	187.74	202.26	222.04	253.31
Cards with an e-money function	9.41	17.22	31.24	43.09	55.32	59.24
of which: cards with a combined debit, cash and e-money function	-	-	-	-	0.28	0.94

Source:

Box Table 2: Volume of Transactions per type of payment instrument, Indicators of the use of payment instruments and terminals by non-banks

(thousands, total for the year)

	2010	2011	2012	2013	2014	2015
Card payments with cards issued in the country	14,308.6	15,529.4	18,849.7	22,048.3	26,709.0	31,853.6
payments by cards with a debit function	*8,652.0*	*9,632.1*	*11,999.9*	*14,261.3*	*17,683.0*	*20,808.8*
payments by cards with a credit function	*5,656.5*	*5,897.3*	*6,849.7*	*7,787.0*	*9,026.0*	*11,044.8*
POS payment transactions	16,102.6	16,567.6	19,958.4	23,427.1	28,097.6	34,203.1

Source:

Box Table 3: Volume of Transactions per type of payment instrument, Indicators of the use of payment instruments and terminals by non-banks

(BD million, end of year)

	2010	2011	2012	2013	2014	2015
Card payments with cards issued in the country	809.37	909.21	989.04	1,193.99	1,351.51	1,537.84
payments by cards with a debit function	*412.67*	*478.30*	*502.21*	*552.43*	*613.21*	*658.40*
payments by cards with a credit function	*396.70*	*430.91*	*486.83*	*641.56*	*738.30*	*879.45*
POS payment transactions	*717.37*	*729.55*	*873.41*	*1,089.26*	*1,269.03*	*1,996.47*

Source:

Annex:

Financial Soundness Indicators And Selected Graphs

Annex 1: Financial Soundness Indicators

Annex1 Table 1:
Selected Financial Soundness Indicators—Overall Banking System

(End of period)

	Sep-15	Mar-16	Sep-16
Capital Adequacy			
Total capital adequacy ratio (%) *	18.7	18.4	19.2
Tier 1 capital adequacy ratio (%) *	17.2	16.8	17.6
Leverage (assets/capital)(times)*	6.8	6.9	7.8
Asset Quality			
Non-performing loans (% of gross loans)	5.4	5.2	5.5
Specific provisions (% of NPLs)	58.1	59.1	54.1
Loan concentration (share of top-2 sectors) (%)	31.7	30.8	29.3
Real Estate/ Construction exposure (%) **	21.0	21.6	22.2
Earnings			
ROA Retail banks (%)	0.9	0.5	1.0
ROE Local Retail banks (%) ***	3.9	1.7	5.0
Net interest income (% of gross income) ****	75.6	57.8	67.8
Net fees & commissions (% of gross income) ****	20.2	24.3	16.9
Operating expenses (% of gross income)	56.3	55.6	55.8
Liquidity			
Liquid assets (% of total assets)	21.7	22.0	22.8
Loan-deposit ratio (%)	67.0	69.5	67.9

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

Source: Central Bank of Bahrain

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

(End of period)

	Sep-15	Mar-16	Sep-16
Capital Adequacy			
Total capital adequacy ratio (%) *	18.7	18.1	19.6
Tier 1 capital adequacy ratio (%) *	16.9	16.2	17.8
Leverage (assets/capital)(times)*	7.4	7.6	7.7
Non-performing loans net provisions to capital ratio (%)*	7.9	5.7	6.1
Asset Quality			
Non-performing loans (% of gross loans)	3.6	3.6	4.7
Specific provisions (% of NPLs)	52.3	55.5	49.9
Net non-performing loans (% of net loans)	1.8	1.6	2.4
Loan concentration (share of top-2 sectors) (%)	31.6	31.7	31.7
**Real Estate/ Construction exposure (%) ** **	29.6	29.9	29.8
Earnings			
ROA Retail banks (%)	1.2	0.4	1.1
ROA Local Retail banks (%)	1.3	0.5	1.3
ROA Overseas Retail banks (%)	1.1	0.3	0.6
ROE Local Retail banks (%)***	10.5	3.8	11.4
Net interest income (% of gross income)	71.9	73.4	73.9
Net fees & commissions (% of gross income)	15.9	14.9	13.2
Operating expenses (% of gross income)	42.9	52.2	47.5
Liquidity			
Liquid assets (% of total assets)	26.3	25.3	24.4
Liquid assets (% of short-term liabilities)	40.2	38.1	37.1
Loan-deposit ratio (%)	72.2	70.8	70.0
Deposits from non-bank sources (% of total deposits)	79.6	79.1	79.9

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

Annex1 Table 3:
Selected Financial Soundness Indicators—Conventional Wholesale Banks

(End of period)

	Sep-15	Mar-16	Sep-16
Capital Adequacy			
Total capital adequacy ratio (%) *	19.6	19.4	19.8
Tier 1 capital adequacy ratio (%) *	17.9	17.8	18.4
Leverage (assets/capital)(times)*	6.6	6.6	9.4
Non-performing loans net provisions to capital ratio (%)*	3.7	3.8	7.2
Asset Quality			
Non-performing loans (% of gross loans)	5.7	5.1	5.5
Specific provisions (% of NPLs)	65.8	66.3	63.0
Net non-performing loans (% of net loans)	2.1	1.8	2.1
Loan concentration (share of top-2 sectors) (%)	40.6	39.2	38.2
**Real Estate/ Construction exposure (%) ** **	11.9	12.6	12.7
Earnings			
ROA Wholesale banks (%)	0.4	0.3	0.6
ROA Local Wholesale banks (%)	0.3	0.2	0.4
ROA Overseas Wholesale banks (%)	0.5	0.5	0.9
ROE Local Wholesale banks (%)***	2.5	1.1	3.6
Net interest income (% of gross income)	81.1	42.2	61.0
Net fees & commissions (% of gross income)	32.1	39.1	23.2
Operating expenses (% of gross income)	63.2	52.0	53.2
Liquidity			
Liquid assets (% of total assets)	20.8	22.7	24.6
Liquid assets (% of short-term liabilities)	30.5	33.3	35.4
Loan-deposit ratio (%)	64.6	67.8	66.7
Deposits from non-bank sources (% of total deposits)	45.8	44.8	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 lending.*
**** ROE is defined as net profit over Tier 1 Capital.*
Source: Central Bank of Bahrain

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

(End of period)

	Sep-15	Mar-16	Sep-16
Capital Adequacy			
Total capital adequacy ratio (%) *	15.6	15.8	17.1
Tier 1 capital adequacy ratio (%) *	13.6	13.7	14.9
Leverage (assets/capital)(times)*	6.8	6.7	6.4
Non-performing facilities net provisions to capital ratio (%)*	23.8	26.5	28.3
Asset Quality			
Non-performing facilities(% of gross facilities)	11.7	12.4	12.1
Specific provisions (% of NPFs)	36.8	40.7	34.1
Net non-performing facilities (% of net facilities)	7.1	7.1	7.8
Facilities concentration (share of top-2 sectors) (%)	36.1	35.7	38.9
**Real Estate/ Construction exposure (%) ** **	28.4	29.5	29.4
Earnings			
ROA (%)	0.4	0.1	0.2
ROE (%)***	3.2	1.1	1.6
Net income from own funds, current accounts and other banking activities (% of operating income)	64.7	59.9	58.8
Net income from jointly financed accounts and Mudarib fees (% of operating income)	23.5	30.1	33.5
Operating expenses (% of gross income)	74.6	72.0	82.9
Liquidity			
Liquid assets (% of total assets)	11.2	10.3	12.3
Facilities-deposit ratio (%)	75.4	87.5	82.9
Current accounts from non-banks (% of non-capital liabilities, excl. URIA)	26.5	27.5	29.5

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

Annex1 Table 5:
Selected Financial Soundness Indicators—Islamic Wholesale Banks

(End of period)

	Sep-15	Mar-16	Sep-16
Capital Adequacy			
Total capital adequacy ratio (%) *	19.4	19.1	19.3
Tier 1 capital adequacy ratio (%) *	19.1	18.6	18.5
Leverage (assets/capital)(times)*	6.4	6.7	6.7
Non-performing facilities net provisions to capital ratio (%)*	2.7	2.9	1.5
Asset Quality			
Non-performing facilities(% of gross facilities)	4.7	4.8	2.9
Specific provisions (% of NPFs)	79.4	80.3	82.4
Net non-performing facilities (% of net facilities)	1.0	0.9	0.5
Facilities concentration (share of top-2 sectors) (%)	41.2	41.7	40.6
**Real Estate/ Construction exposure (%) ** **	21.4	21.2	27.4
Earnings			
ROA (%)	-0.1	0.1	0.2
ROE (%)***	-0.7	1.0	1.6
Net income from own funds, current accounts and other banking activities (% of operating income)	56.7	57.5	55.3
Net income from jointly financed accounts and Mudarib fees (% of operating income)	42.2	42.2	45.4
Operating expenses (% of gross income)	63.3	62.8	61.1
Liquidity			
Liquid assets (% of total assets)	19.9	19.1	18.9
Facilities-deposit ratio (%)	60.9	64.7	61.6
Current accounts from non-banks (% of non-capital liabilities, excl. URIA)	40.6	43.3	43.8

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

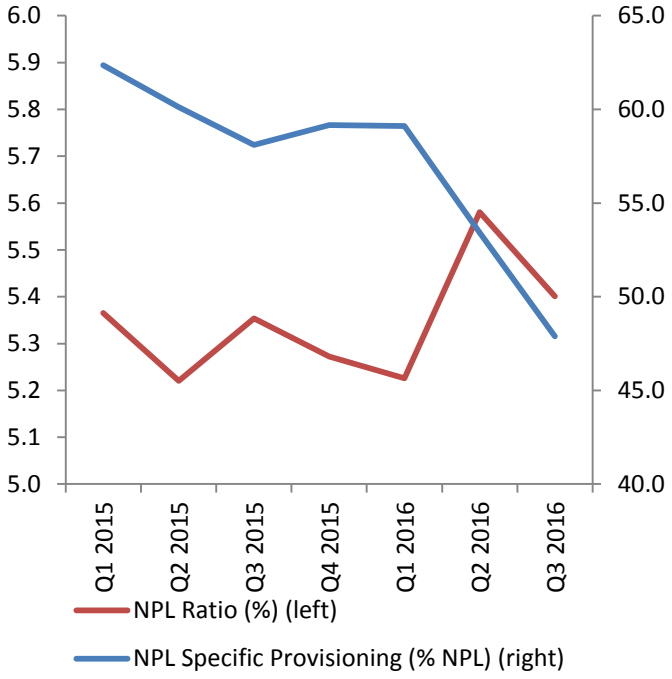
Annex 2: Selected Graphs

A. Overall Banking Sector

Annex 2 Graph 1: CAR

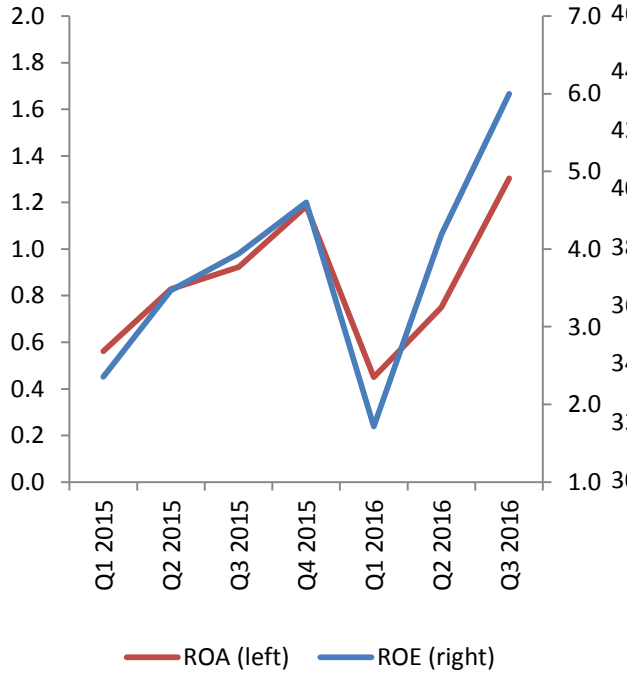
Source: Central Bank of Bahrain

Annex 2 Graph 2: NPL and Provisioning



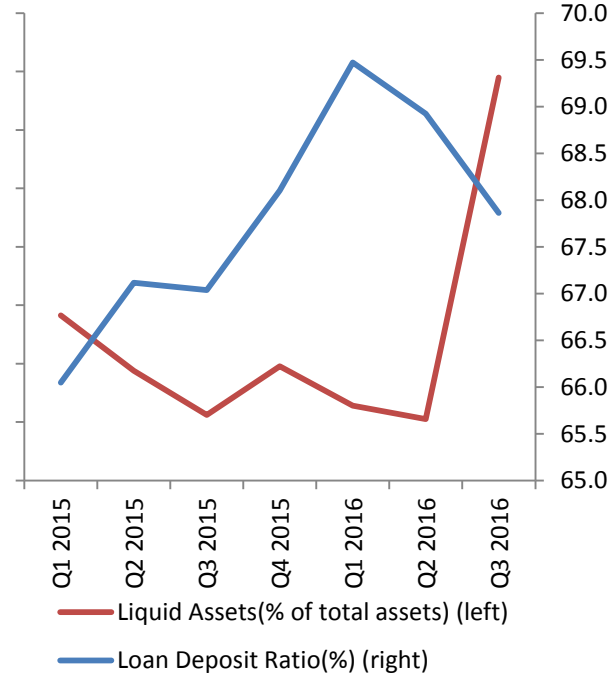
Source: Central Bank of Bahrain

Annex 2 Graph 3: Profitability



Source: Central Bank of Bahrain

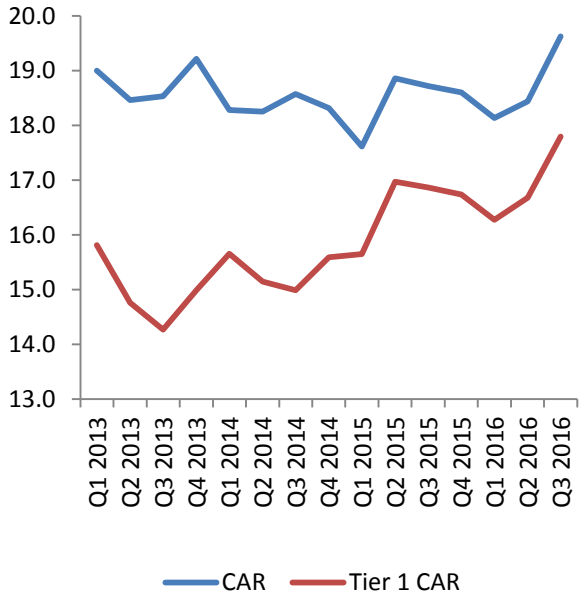
Annex 2 Graph 4: Liquidity



Source: Central Bank of Bahrain

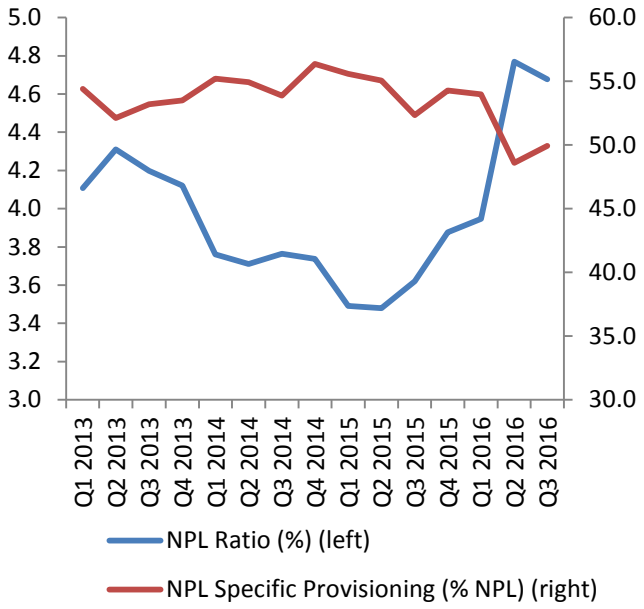
B. Conventional Retail

Annex 2 Graph 5: CAR



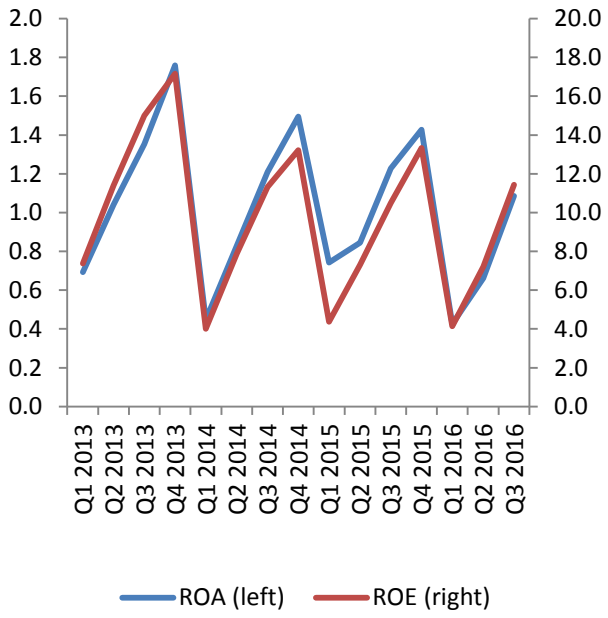
Source: Central Bank of Bahrain

Annex 2 Graph 6: NPL and Provisioning



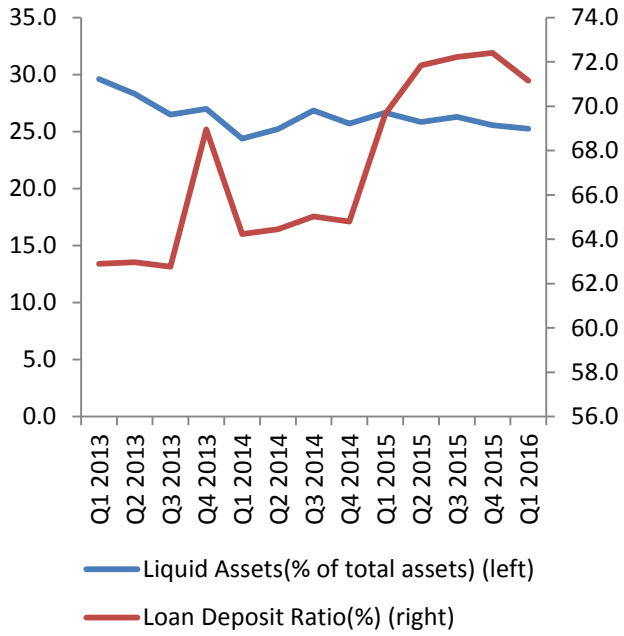
Source: Central Bank of Bahrain

Annex 2 Graph 7: Profitability



Source: Central Bank of Bahrain

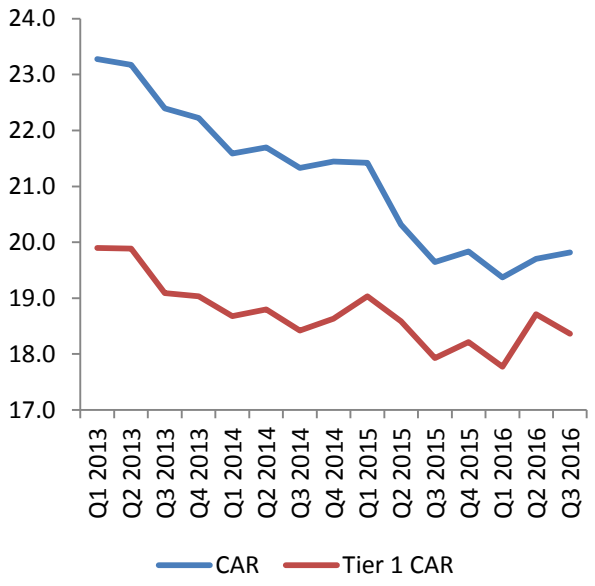
Annex 2 Graph 8: Liquidity



Source: Central Bank of Bahrain

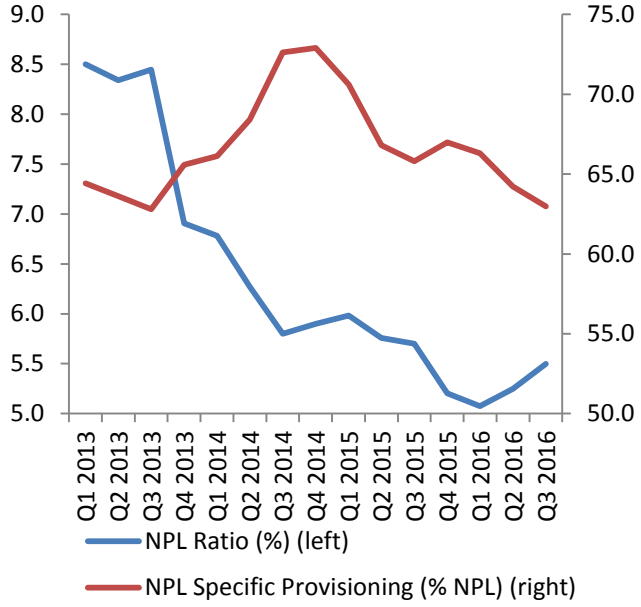
C. Conventional Wholesale

Annex 2 Graph 9: CAR



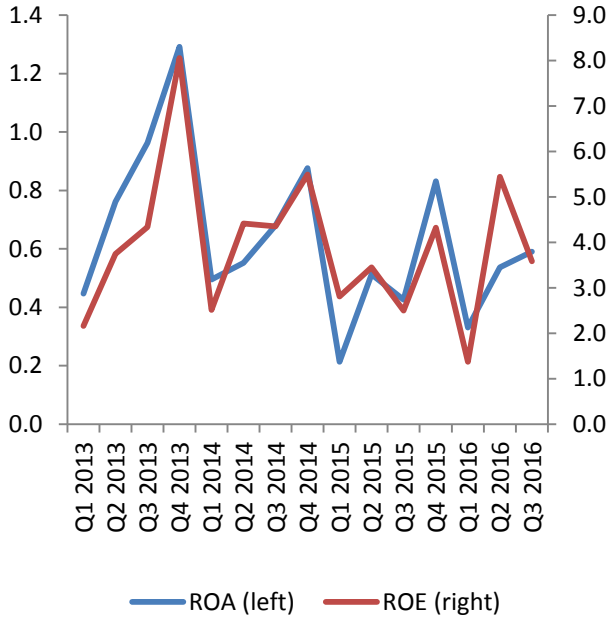
Source: Central Bank of Bahrain

Annex 2 Graph 10: NPL and Provisioning



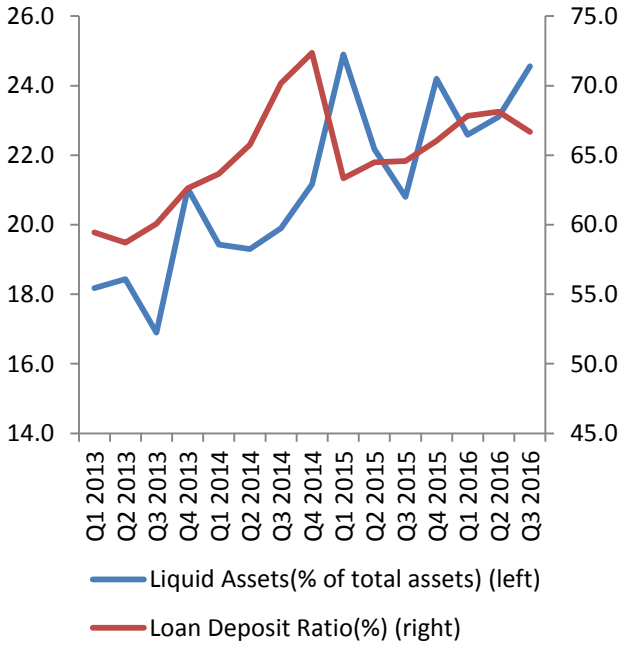
Source: Central Bank of Bahrain

Annex 2 Graph 11: Profitability



Source: Central Bank of Bahrain

Annex 2 Graph 12: Liquidity



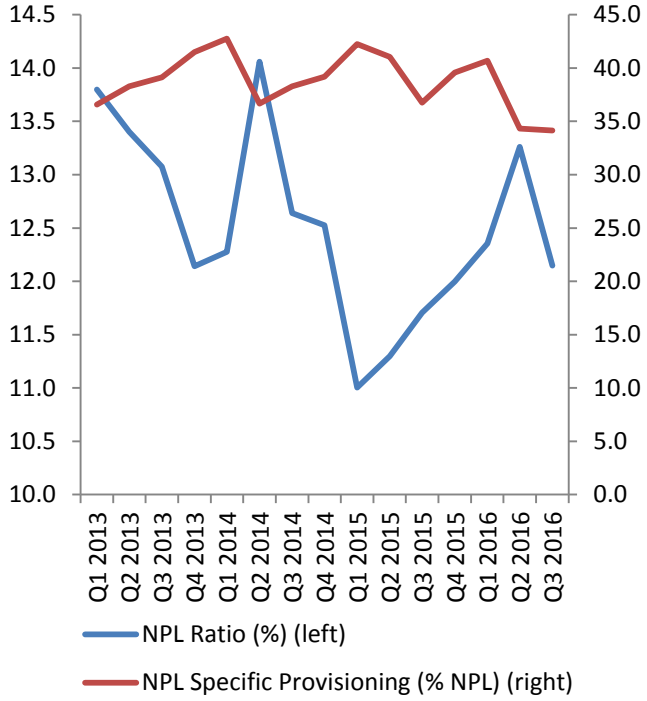
Source: Central Bank of Bahrain

D. Islamic Retail

Annex 2 Graph 13: CAR

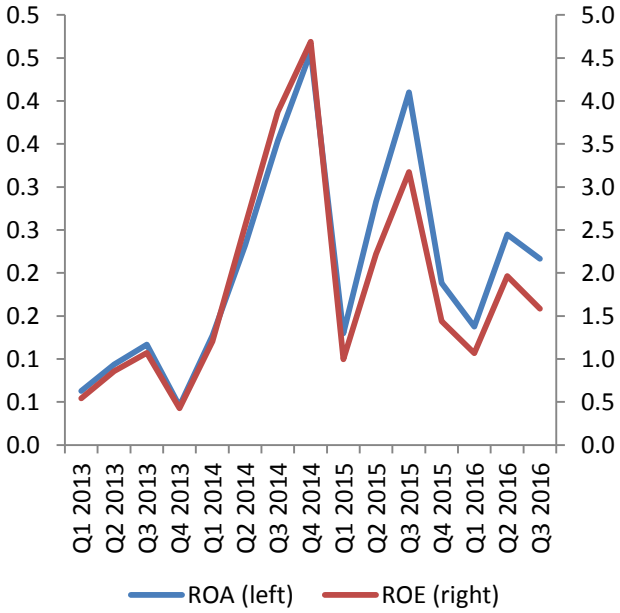
Source: Central Bank of Bahrain

Annex 2 Graph 5: NPL and Provisioning



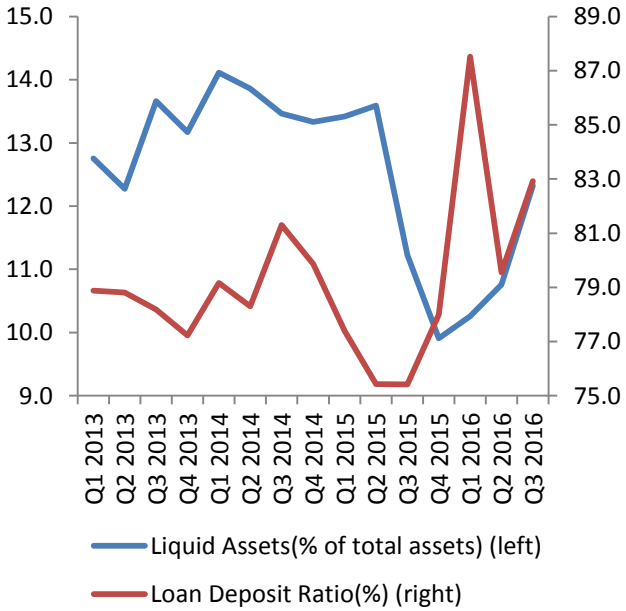
Source: Central Bank of Bahrain

Annex 2 Graph 6: Profitability



Source: Central Bank of Bahrain

Annex 2 Graph 7: Liquidity



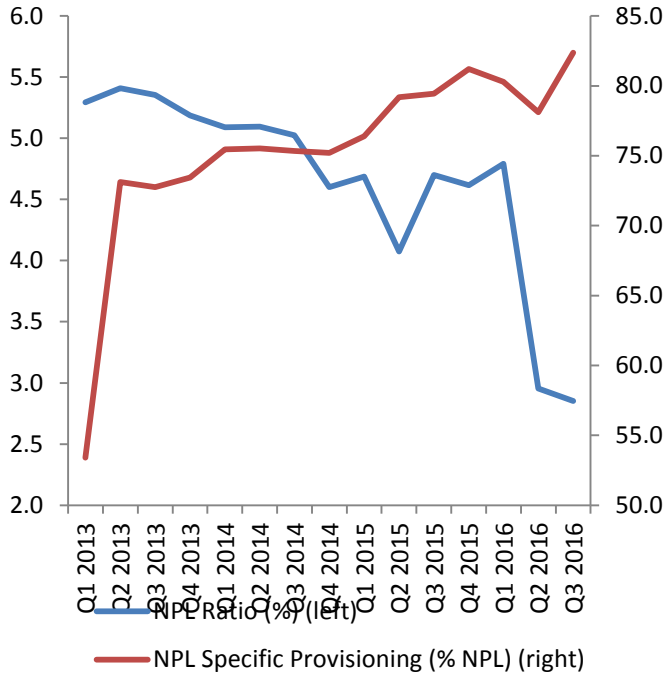
Source: Central Bank of Bahrain

E. Islamic Wholesale

Annex 2 Graph 8: CAR

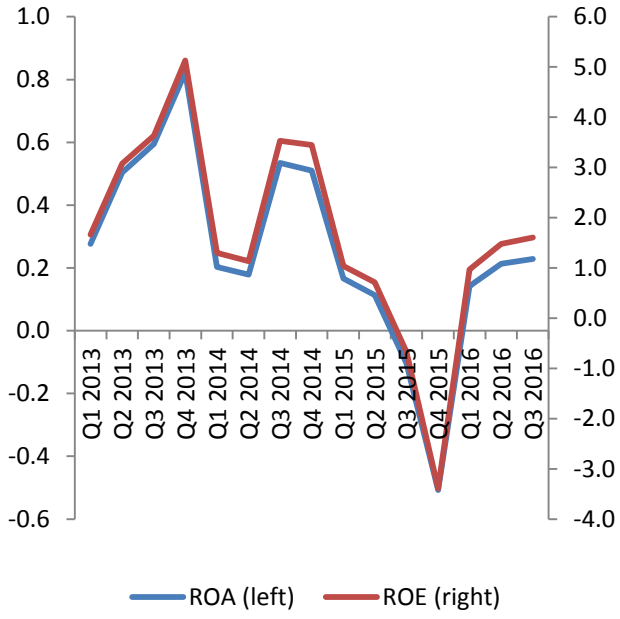
Source: Central Bank of Bahrain

Annex 2 Graph 9: NPL and Provisioning



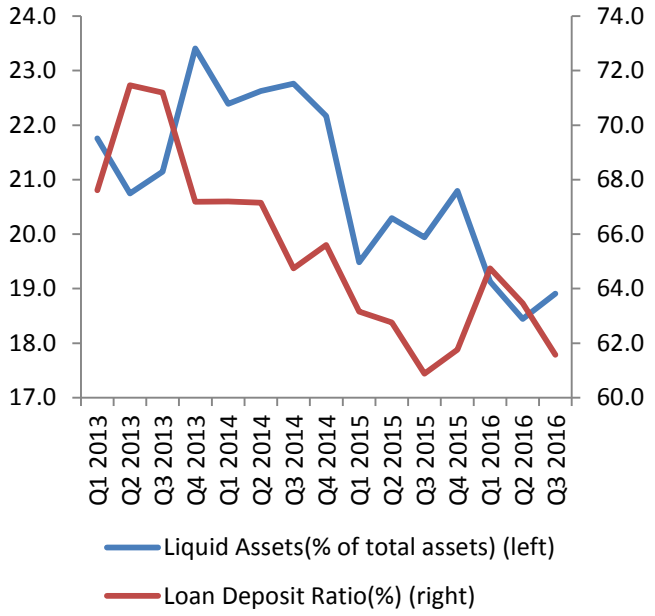
Source: Central Bank of Bahrain

Annex 2 Graph 10: Profitability



Source: Central Bank of Bahrain

Annex 2 Graph 20: Liquidity



Source: Central Bank of Bahrain