

The effects of the financial crisis measurable

Just like other GCC countries, the current global economic crisis has also dented in Bahrain's banking sector and economy, but the magnitude of the effect is measurable, according to senior officials from the economic department and Central Bank of Bahrain. A **MONEYworks** report from Manama.

The global economic turmoil has definitely touched the shores of Bahrain, affecting the overall growth of the country, but it hasn't been able to overwhelm businesses nor has it scared the economy.

The financial health of the economy is sound and the effect of the economic crisis is comparatively low and measurable. The economy is still growing, the employment scenario has improved in the first quarter of the current financial year and the banking industry is comparatively less hit as there is no bailout or major capital injection in this sector.

"Bahrain is expected to grow two-three per cent this year despite the crisis, though the rate of growth is lower than in previous years," according to Shaikh Mohammed Bin Essa Al Khalifa, chief executive, Bahrain Economic Development Board.

"It is due to our no boom and bust approach," he explains.

"The effect is comparatively less due to the gradual and steady approach towards

financial and economic development, keeping fundamentals strong, markets well regulated and lastly, due to the existence of forward-looking regulations from the Central Bank of Bahrain (CBB) in partnership with the industry," he adds.

In fact, Al Khalifa feels certain proactive measures combined with the constant monitoring of the financial and economic sectors have gone a long way in staving off what could have been a concern. The government in association with the CBB has been able to contain the effect of the economic crisis to the bare minimum and take remedial measures wherever necessary, he adds.

Measures taken

Valuation of property projects and banks' exposure to the real estate sector has been one of the most intriguing issues of the current crisis in some of the GCC countries. However, in Bahrain there has been continuous forward-looking valuation of the real estate projects due to the initiative of the regulator. Back in December 2007, the CBB had issued a consultative paper on banks' exposure to the real estate sector to assess the current situation. The Kingdom's rules on real estate funding are based on both qualitative and quantitative criteria. Banks operating in the country were allowed to allocate only 30 per cent of their credit portfolio to the real estate sector. All these had helped achieving the objective of containing risk in this sector.

Also, due to CBB's well regulated regime, banks in Bahrain are well capitalised. In 2006, wholesale banks in the Bahrain were asked to increase capital by a minimum of BHD100 million.

Interestingly, CBB stipulates that banks operating in Bahrain should maintain a

capital adequacy ratio of 12 per cent. Last year, banks in Bahrain averaged 19 per cent. This compares very well with the required capital adequacy ratio as per Basel II of eight per cent for banks.

Bahrain hasn't taken any drastic remedial measures during the current crisis. There have been hardly any cases of bailouts or massive capital infusion in the financial system barring a few exceptions among investment banks.

Khalid Hamad, executive director, banking supervision, CBB, puts the Bahraini scene into perspective, when he says: "It is wrong to say that we are not affected, but the magnitude is different and Bahrain's banking sector is quite resilient to that extent."

Out of a total of 410 licensed financial organisations (which includes banks, financial institutions, insurance companies, investment banks, etc. Bahrain has not reported a single bank failure during the crisis, according to Hamad.

A handful of banks that reported losses during the crisis and had exposure to toxic assets have already been taken care of. The CBB has so far injected just US\$150 million into the banking system. This compares favourably with some of the larger amounts injected by other regional central banks and governments into their respective banking systems.

According to Hamad, certain criteria adopted by the CBB have helped the Bahraini financial sector to better weather the economic storm. The already existing regulatory framework, 35 years of proactive role by the CBB, regular inspection and assessment of the banks by the CBB are some of the important ones, he notes. In addition to these, a number of different measures have



Shaikh Mohammed Bin Essa Al Khalifa



been adopted, such as recruitment of consultancy firms to assess local banks' risk management frameworks, focused compliance process with regular follow up, corporate governance run by rules rather than by codes, etc., have ensured the smooth functioning of the banking sector, he adds.

Another reason for Bahrain's resilience to the crisis is due to its strong focus on Islamic finance, a sector where the country has played a central role for the Gulf region since 1978.

"Islamic finance has benefited from this crisis, as it is ethical and we have seen a 15 to 16 fold increase in assets in the Islamic finance industry during the past decade," adds Al Khalifa.

CBB is actively involved in the development of Islamic finance in collaboration with other renowned Islamic organisations. It is promoting Islamic capital and financial markets, while on the other hand, it is working towards promoting the standardisation of Shari'ah laws.

In collaboration with the New York-based International Swap and Derivative Association, CBB plans to soon launch a master agreement of commodity murabaha and the instruments of hedging and risk management within a Shari'ah-compliant framework.

"The two most important growth areas in Bahrain are Islamic finance and investment business," notes Hamad.

Maintaining a healthy balance between the private and public sector has also been instrumental to Bahrain's growth, according to him.

"Bahrain is all about partnership and balance," adds Al Khalifa. By allowing the private sector to become the engine of economic growth and by focusing on transparency and visibility, the country has been able to achieve investors' confidence, he says. This has benefited it over the years, helping it to improve quality standards. In fact, the financial sector alone contributes to one third of the country's GDP.

The government is, however, aware that, along with growth in the financial sector, investment in human capital is equally important. Guided by this philosophy, more than 70 per cent of the

people working in the financial sector are Bahrainis.

"It is equally important to develop human capital along with the development in other sectors, as growth is all about improving life," Al Khalifa points out.

He also adds: "Growth is welcome, but it must have a purpose. It has to be demand-driven, not supply-led. And because of that Bahrain is not about being one of the biggest, or glamorous or attractive countries. We believe in steady growth, investment in human capital and this is why we have the lowest inflation rate in this region."

Does it mean that Bahrain is complacent about its growth strategy and not really concerned about the increasing financial and economic competition from the other neighbouring countries? The Bahraini authorities have a different view on the subject.

According to them, the GCC region is a large enough place for everyone to grow and to have more than one financial centre. They believe that by further developing the financial services sector, there will be increased overall development in this region.

"We have become mature and grown enough to sustain local demand. Our ambition is to grow our economy and play an important role in that. As a region we want to grow the pie," emphasises Al Khalifa.



Khalid Hamad