"Navigating Global Volatility: Assessing the Resilience and Innovation of Bahrain's Financial Sector Through the 2025 Financial Stability Report"

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ABSTRACT

This research paper presents a comprehensive evaluation of the Bahraini financial system, grounded in the Central Bank of Bahrain's Financial Stability Report (FSR), March 2025. The paper systematically examines key developments across various financial sub-sectors, including the banking industry, capital markets, insurance services, monetary indicators, and the growing digital payments and FinTech ecosystem. The analysis focuses on the year ending December 2024. The findings underscore the resilience and adaptability of Bahrain's financial institutions amidst a globally volatile economic environment characterized by geopolitical uncertainties and tightening monetary conditions. The study highlights how strong capital adequacy, diversified financial services, effective supervision, and a commitment to financial innovation have collectively contributed to preserving financial stability. By offering a macro prudential perspective on Bahrain's economy, this research aims to support regional discourse on sustainable financial development and guide policy formulation.

Keywords: *B*ahrain, financial sector, banking performance, capital markets, FinTech, insurance, Islamic finance, macro prudential policy, financial innovation, digital transformation, monetary indicators, GCC economy.

INTRODUCTION

Financial stability is indispensable for the functioning and sustainability of any economy. A stable financial system facilitates efficient capital allocation, promotes investment, and supports long-term economic growth. In Bahrain, the Central Bank of Bahrain (CBB) is mandated with the task of ensuring monetary and financial stability. The CBB oversees the operations of a multi-layered financial ecosystem that includes conventional and Islamic retail and wholesale banks, insurance companies, capital markets, and an evolving FinTech infrastructure.

The Financial Stability Report (FSR), a semi-annual publication by the CBB's Financial Stability Directorate (FSD), serves as a critical tool for macro prudential surveillance. The March 2025 FSR provides a timely evaluation of risks and resilience within Bahrain's financial sector and reflects the performance of the system through the end of 2024. This paper offers a detailed sector-wise analysis of the report, identifying trends, assessing risks, and proposing areas for policy focus to maintain and enhance systemic robustness.

METHODOLOGY AND ANALYTICAL FRAMEWORK

This study is based on the **CBB's March 2025 FSR** and employs a **descriptive-analytical methodology**. The analysis is guided by the **IMF/BIS Financial Soundness Indicators (FSIs)** framework, focusing on:

1. **Capital Adequacy** – CAR, Tier 1 capital compared to global minimums.
2. **Asset Quality** – NPL ratios, provisioning levels, sectoral lending concentration.
3. **Liquidity** – LDRs, liquidity buffers relative to regional benchmarks.

4. **Profitability** – ROE and ROA in comparison to GCC peers.
5. **Financial Innovation and Diversification** – Islamic finance and FinTech ecosystems.

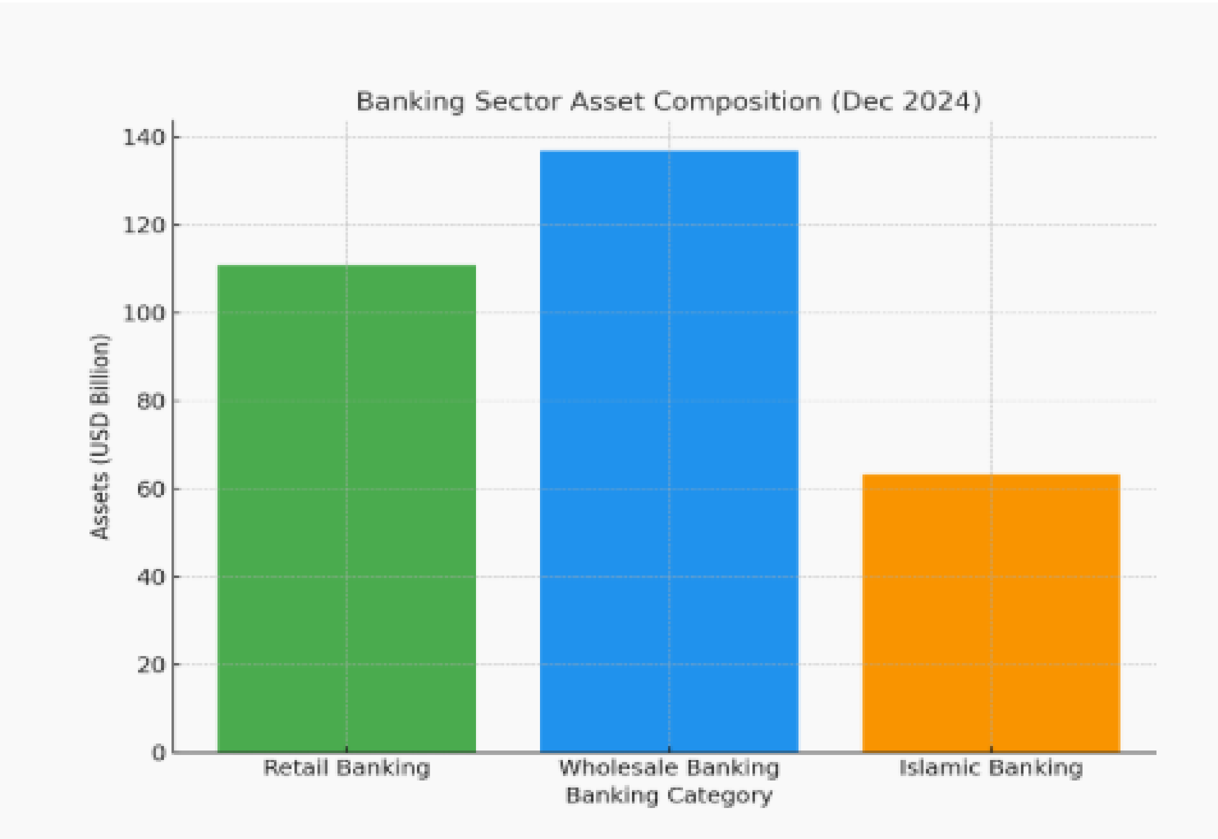
This framework allows us to assess not only resilience but also **innovation-driven transformation**. Comparative insights are drawn from other GCC economies (Saudi Arabia, UAE, and Qatar) where available.

Financial Sector Overview

As of December 2024, Bahrain's financial sector had reached a total asset value of USD 247.8 billion, reflecting a 3.9% increase compared to the previous year. Retail banks accounted for USD 110.9 billion of these assets, wholesale banks for USD 136.9 billion, and Islamic banks for USD 63.3 billion. Notably, the Islamic banking sector experienced a dramatic 65.7% year-over-year increase, highlighting growing consumer preference for Sharia-compliant financial solutions.

The financial sector contributed 17.3% to the Kingdom's real GDP, reaffirming its critical role in Bahrain's economic diversification efforts. The sector's resilience was underpinned by prudent macroeconomic policies, stable exchange rate management, and well-regulated financial institutions.

Graph 1.1



Source: CBB reports compilation

4. Banking Sector Performance

4.1 Capital Adequacy and Profitability The Bahraini banking system demonstrated strong capitalization, with an overall Capital Adequacy Ratio (CAR) of 21.2%, significantly above the minimum international benchmark of 8%. Tier 1 capital, a key indicator of financial strength, was reported at 19.8%, indicating robust internal buffers. The Return on Equity (ROE) improved to 11.2%, driven by improved margins and efficient asset utilization, while Return on Assets (ROA) held steady at 1.3%. The leverage ratio stood at 9.3, reflecting balanced use of capital relative to total assets.

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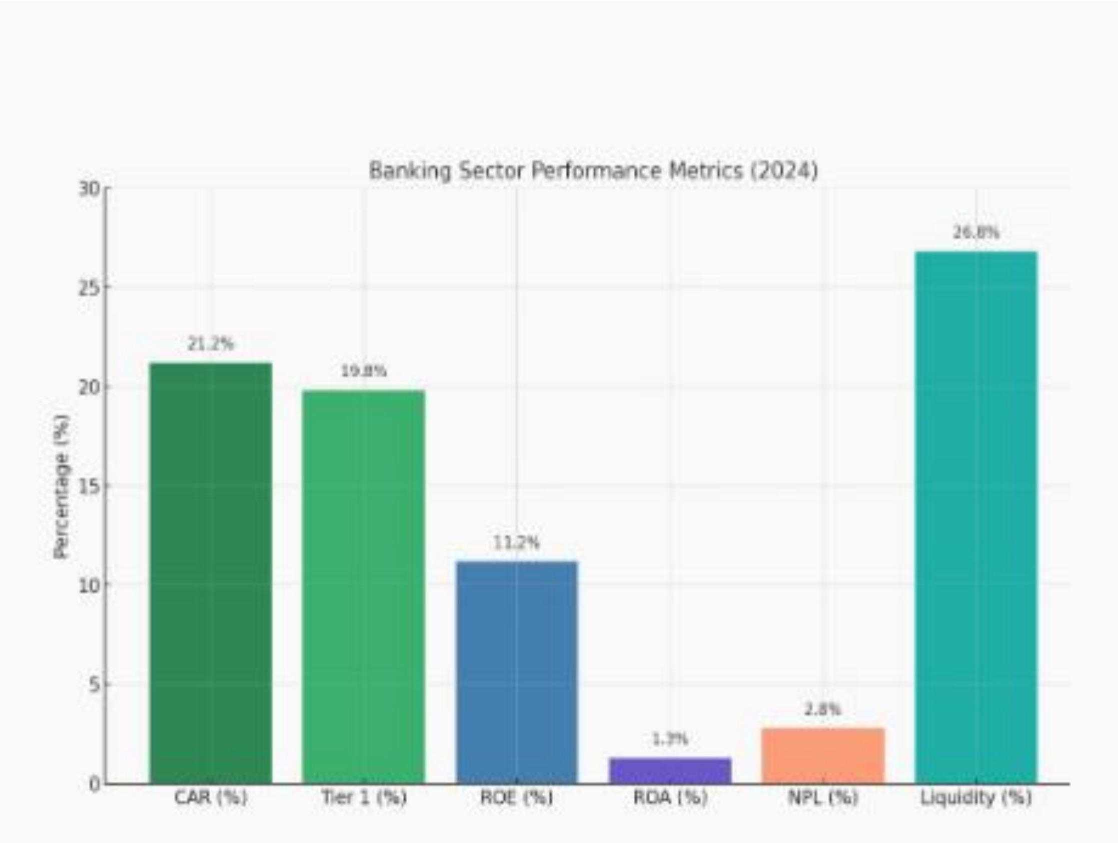
4.2 Asset Quality Non-performing loans (NPLs) declined marginally to 2.8% of total loans, underscoring improved credit quality. Provisioning levels remained adequate, with specific provisions covering 53.3% of NPLs. The data suggests post-pandemic credit normalization and sound risk management practices across the sector.

4.3 Liquidity Position Liquidity remained a strength, with liquid assets representing 26.8% of total banking assets. The loan-to-deposit ratio (LDR) stood at 62.2%, providing further evidence of conservative liquidity practices. Retail banks' deposit base expanded to BD 20.6 billion, supported largely by domestic savings and time deposits.

Graph 1.2



Source: CBB reports compilation

5. Credit Developments

5.1 Personal Sector Lending Personal credit rose to BD 5.9 billion, marking a 2.0% annual increase. The majority of these loans (50.9%) were secured by property mortgages, while 29.8% were tied to salary-based repayment plans. Lower interest rates on personal loans, which decreased to 5.16% from 6.14%, facilitated household borrowing.

5.2 Business Sector Lending Business lending reached BD 5.2 billion, growing 3.8% from the previous year. The sectoral breakdown shows that construction and real estate led with a 28.1% share, followed by manufacturing (25.4%) and trade (12.3%). The average interest rates on business loans experienced a downward trend, suggesting accommodative credit conditions.

5.3 SME Financing Loans to small and medium-sized enterprises (SMEs) stood at BD 573.8 million, accounting for 11.0% of total business lending and 4.7% of all lending. The CBB's Financial Sector Development Strategy (2022–2026) specifically targets improved access to finance for SMEs, with ongoing reforms aimed at reducing collateral requirements and enhancing credit scoring systems.

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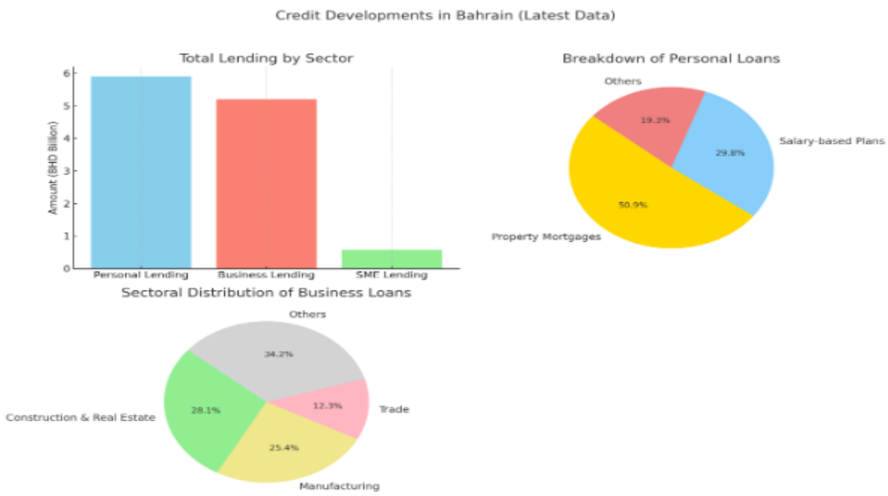
Graph 1.3



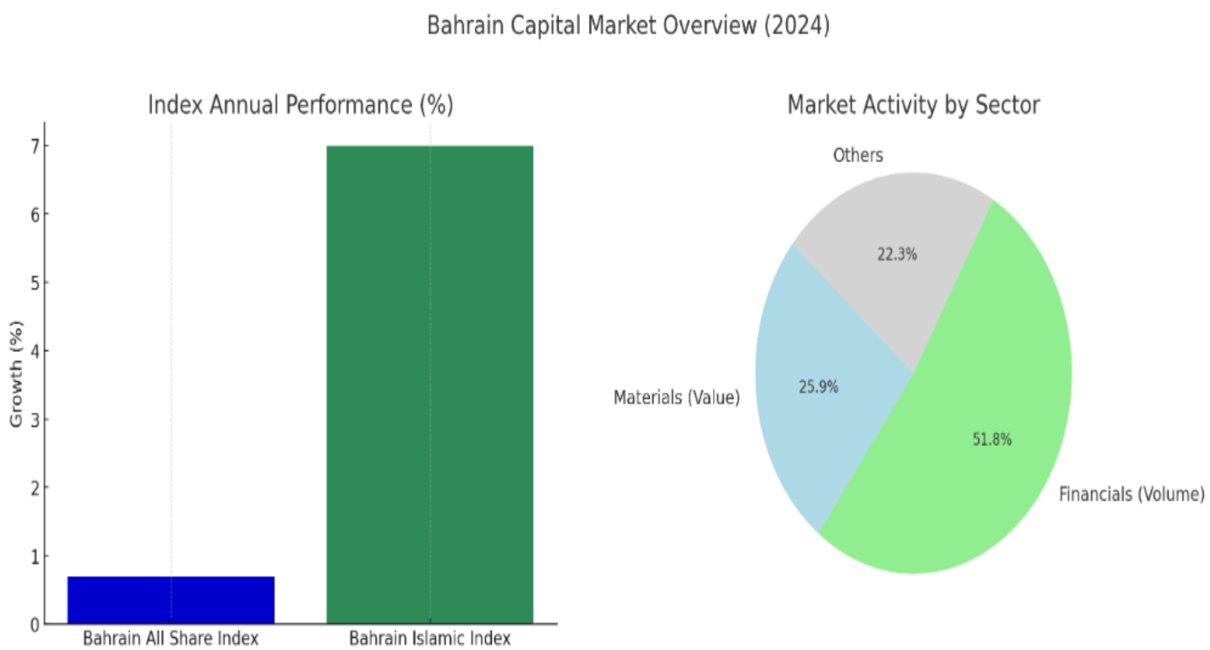
Source: CBB reports compilation

6. Capital Markets Performance

Bahrain Bourse activity remained stable with 41 listed companies, 3 mutual funds, and 19 bonds and sukuk instruments by the end of 2024. The Bahrain All Share Index closed at 1,985.91 points, reflecting a 0.7% annual gain. The Bahrain Islamic Index performed significantly better, climbing 6.99% to reach 779.85 points.

Market capitalization totaled BD 7.7 billion, with the materials sector accounting for the highest value of traded shares (42.3%) and the financial sector dominating transaction volume (84.8%). The CBB's ongoing capital market development initiatives focus on transparency, investor protection, and the promotion of environmental, social, and governance (ESG)-linked instruments.

Graph 1.4



Source: CBB reports compilation

7. Insurance Sector Analysis

The insurance sector posted strong growth, with total assets rising to BD 2.43 billion as of September 2024, a 9.6% year-over-year increase. Conventional insurance firms accounted for the bulk of assets (BD 2.21 billion), though this segment contracted by 9.2%. In contrast, Takaful firms expanded their asset base by 13.2%, reaching BD 223 million.

Gross premiums totaled BD 239.4 million, with medical insurance contributing 34.2% of premiums and 36.7% of claims. Local conventional insurers held the majority market share (56.8%), followed by Takaful providers (28.9%). Regulatory changes continue to emphasize solvency requirements, digital onboarding, and consumer protection.

Graph 1.5

Source: CBB reports compilation

8. Digital Payments and FinTech

The digital payments ecosystem advanced markedly during 2024, led by the CBB's digital transformation agenda. Key developments include:

- Fawri+ daily transaction volume rose by 20.5% YoY, with value growth of 13.2%.
- Point-of-sale (POS) transaction volumes increased 13.9%, while values grew by 8.1%.
- Contactless transactions made up 78.6% of all POS volume, underscoring a shift in consumer behavior.
- The Regulatory Sandbox accommodated 21 FinTech companies, facilitating innovation in areas such as blockchain, robo-advisory services, and digital wallets.

These trends highlight Bahrain's growing regional profile as a FinTech hub combining Islamic and conventional innovation.

9. Monetary Indicators and Inflation

Broad money supply (M2) reached BD 14.7 billion in December 2024, registering a modest 0.4% YoY increase. M3, which includes government deposits, grew by 1.6% to BD 16.2 billion. Notably, general government deposits surged 15.4%, enhancing the public sector's role in liquidity dynamics.

Inflation averaged 0.5% in 2024, up from -0.3% the previous year. Food and beverage costs were the primary drivers of upward inflation, while housing and transport categories exerted downward pressure. The fixed exchange rate peg to the US Dollar contributed to price stability and investor confidence.

10. Discussion: Interlinkages, Resilience, and Vulnerabilities

The analysis suggests that Bahrain's financial sector exhibits **remarkable resilience**, largely due to:

- High capitalization and liquidity buffers.
- Effective macroprudential supervision by the CBB.
- Strong growth in Islamic finance and FinTech.

However, systemic **vulnerabilities** persist:

1. **Concentration Risk** – Heavy dependence on real estate lending could amplify shocks in a downturn.
2. **Market Depth** – Capital markets remain underdeveloped, limiting investment diversification.
3. **FinTech Sustainability** – Rapid growth raises questions of scalability, cybersecurity, and regulatory arbitrage.
4. **Regional Comparisons** – While resilient, Bahrain trails larger GCC peers in profitability, market depth, and financial innovation scale.

CONCLUSION AND POLICY IMPLICATIONS

The analysis of the March 2025 Financial Stability Report reveals that Bahrain's financial system is well-capitalized, liquid, and operationally sound. The sector's resilience is underpinned by prudent regulatory practices, healthy banking fundamentals, and a proactive stance on financial innovation.

The continued growth in Islamic banking and insurance, the expansion of SME credit access, and the rise of digital transactions are promising indicators of structural transformation. Policymakers are encouraged to deepen efforts in climate risk integration, ESG compliance, and cross-border financial linkages. By maintaining its forward-looking regulatory posture, Bahrain can reinforce its position as a regional financial center. However, to sustain stability amid global volatility, policymakers should:

1. **Diversify Lending Beyond Real Estate** – Expand SME financing and green finance initiatives.
2. **Deepen Capital Markets** – Enhance listing incentives, improve liquidity, and expand ESG-linked offerings.
3. **Strengthen FinTech Oversight** – Focus on cybersecurity, cross-border regulatory harmonization, and SME-oriented digital finance.
4. **Enhance Regional Benchmarking** – Continue aligning with GCC peers on financial soundness indicators and innovation ecosystems.

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