Bahrain Banking Sector 2022 Outlook
Edging Closer To Pre-Pandemic Profitability

This article does not constitute a rating action
Key Takeaways

- We expect Bahrain’s economic recovery to continue in 2022 because of higher oil prices and increasing regional economic activity.

- We believe that further deterioration in banks' asset-quality indicators will remain contained as the economy improves and corporate activity recovers. We expect part of the deterioration to come from deferred exposures once the Central Bank of Bahrain's (CBB’s) support measures are withdrawn and loans to companies in still-vulnerable sectors, including real estate, hospitality, and small-to-midsize enterprises (SMEs), are reclassified.

- We expect credit growth to pick up slightly to 5%-6%, supported by the economic recovery and improving business and consumer sentiment.

- The Bahraini banking sector is set to benefit from expected interest rate hikes, assuming banks adopt a pragmatic approach by not reflecting the rate increase systematically where it could cause borrowers to default.

- Although its contribution to the overall funding profile is moderate, external debt could prove vulnerable to domestic or regional stresses.

- We expect the impact of the Russia-Ukraine conflict on the Bahraini banking system to be limited for now.
Three Key Risks

- A COVID-19 resurgence that derails the economic recovery
- A rapid rise in interest rates
- A weakening property market
The Impact Of The Russia-Ukraine Conflict Is Limited…For Now

- The direct impact is likely to be limited given rated banks’ limited exposure to Russian and Ukrainian counterparties.

- An indirect impact could materialize through one of the following channels:
  - A higher oil price, which is likely to boost confidence and sentiment in the Bahraini economy. It remains to be seen if the recent increase in oil price can change the macro-picture or lead to a further acceleration of lending.
  - Investors’ increased risk aversion. While Bahrain’s retail banking system operates with a substantial net external debt position—13.7% of systemwide domestic loans at year-end 2021—we understand that a large portion of the banking sector's external funding is from the Gulf Cooperation Council countries, and we expect it to be rolled over.

S&P Global Ratings acknowledges a high degree of uncertainty about the extent, outcome, and consequences of the military conflict between Russia and Ukraine. Irrespective of the duration of military hostilities, sanctions and related political risks are likely to remain in place for some time. Potential effects could include dislocated commodities markets—namely for oil and gas—supply chain disruptions, inflationary pressures, weaker growth, and capital market volatility. As the situation evolves, we will update our assumptions and estimates accordingly. See our macroeconomic and credit updates here: Russia-Ukraine Macro, Market, & Credit Risks. Note that the timing of publication for rating decisions on European issuers is subject to European regulatory requirements.
The Economic Recovery Will Continue

- We have raised our assumption for Brent oil prices to average $85 in 2022. Increased mobility and improved business and consumer sentiment will support a recovery in the banking sector. That said, certain sectors like real estate, tourism, and hospitality will take longer to recover.

GDP Growth Moves In Line With Oil Prices

Bahrain Benefits From High Vaccination Rates

- Bahrain

Source: S&P Global Ratings, Stastica.com

Source: Our World In Data. Data as of March 5, 2022. Share of people who completed the initial COVID-19 vaccination protocol.

S&P Global Ratings
Credit Growth Will Be Driven By The Retail Sector

- We expect lending growth to improve slightly in 2022, primarily driven by demand from retail consumers. We expect corporate lending growth to remain muted due to lower spending by the government.
- Although we expect banks to adopt a pragmatic approach by not reflecting the full extent of the increase in rates, lending growth may slow down in the second half of the year once we see a meaningful increase in interest rates.

Credit Growth To Improve Slightly

Asset-Quality Deterioration Will Remain Contained

- We expect further increases in problem loans to remain contained as the economy improves and corporate activity recovers. We believe that part of the deterioration will come from deferred exposures once the CBB’s support measures are lifted and loans to companies in still-vulnerable sectors are reclassified.

- Real estate prices have remained under pressure for quite a long time, and we expect a further normalization of prices given the excessive supply in the market. We believe that the real estate sector will be key contributor to new nonperforming loans (NPLs).

- Fiscal consolidation measures, including an increase in VAT from Jan. 1, 2022, a reduction in manpower expenses, and the rationalization of social subsidies, will also put pressure on retail borrowers’ debt-repayment capacity.

Manageable Increase in The NPL Ratio

Breakdown Of Loan Portfolio By Sector

NPL--Nonperforming loan. Weighted-average NPLs (Stage 3) for onshore retail banks. e--Estimate. f--Forecast. Source: S&P Global Ratings.
Credit Costs Will Increase Slightly

- We forecast that credit costs will reach pre-pandemic levels of 80 basis points (bps)-90 bps as credit conditions improve.
- We expect the cost of risk to increase in 2022 but remain below 2020 levels after the CBB’s support measures are withdrawn in June 2022, and banks are required to book additional provisions against exposures to companies in vulnerable sectors, including real estate and hospitality, and to SMEs.

Credits Costs Fell Sharply In 2021

Credit Costs Are Broadly in Line With Regional Peers'

Increase In Interest Rates Will Support Profitability

Bahraini Banks Stand To Benefit From The Increase In Rates

- We expect the CBB to mirror the Fed’s planned interest rate hikes, which will benefit banks in Bahrain.
- We calculate a 7.4% increase in net income for every 100 basis-point increase (parallel shift).
- As we expect the cost of risk to increase only slightly, we think that Bahraini banks’ profitability will keep improving, while reaching pre-pandemic levels by 2023.
- Investments in technology and the use of digitization to improve operations will be a key focus area.

Strong Capitalization Provides A Buffer

- Despite lower profitability in 2020-2021, the banking sector was supported by strong capital buffers. With an increase in profitability likely, we expect banks to further strengthen their capital buffers.
- As profitability improves, we believe that banks will start paying dividends at pre-pandemic levels from 2022.

Bahraini Banks Have Strong Capital Positions

Data for local retail banks. Sources: S&P Global Ratings, Central Bank of Bahrain.
The Private Sector Is Driving Deposit Growth

- Banking sector deposits have been resilient throughout various episodes of instability.
- While government deposits have been declining, we expect the private sector, led by households, to steer the deposit growth.

Banking Sector Deposits Have Remained Resilient

Proportion Of Govt. Deposits Has Been Declining

Source: S&P Global Ratings, Central Bank of Bahrain.
External Debt Could Prove Vulnerable To Domestic Or Regional Stresses

- Bahrain's retail banks are in a net external liability position.
- Net external debt weakened to 13.7% of systemwide domestic loans at year-end 2021, compared with 12.8% at year-end 2020.
- However, we understand that a large portion of the banking sector's external funding is from the Gulf Cooperation Council countries, and we expect it to be rolled over.

Net External Funding Has Been Increasing

Related Research

- Credit FAQ: How The Russia-Ukraine Conflict Could Affect Middle East And African Banks, March 4, 2022
- SLIDES: UAE Banking Sector 2022 Outlook: On The Path To Recovery, March 3, 2022
- Ratings On Three Bahraini Banks Affirmed Under Revised Criteria; Outlooks Unchanged, Jan. 19, 2022
- GCC Banking Sector Outlook: On The Recovery Path In 2022, Jan. 11, 2022
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