

Rasheed Mohammed Al-Maraj: Luxembourg – a global financial services centre

Keynote address by HE Rasheed Mohammed Al-Maraj, Governor of the Central Bank of Bahrain, at a seminar “Luxembourg – a global financial services centre”, Manama, 11 January 2010.

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Your Excellencies, Ladies and Gentlemen:

On behalf of the Central Bank of Bahrain, it gives me great pleasure to welcome you to Bahrain and to have this opportunity to discuss matters of common interest between Luxembourg and Bahrain.

As I am sure you know, the economies of Bahrain and Luxembourg have many similarities. In both cases we act as a financial services hub for a wider economic region. In Bahrain’s case, this region is the Middle East and North Africa, including the six member States of the Gulf Cooperation Council. In consequence, like Luxembourg, the combined assets of our financial industry represents several multiples of the size of our economy.

Traditionally, Bahrain has concentrated on developing our banking industry, including the wholesale banks that provide project finance throughout the wider MENA region. However, in recent years, in line with the Vision 2030 Plan, Bahrain has sought to diversify its financial sector. We have seen a growing presence of insurance companies and fund managers. As of November 2009, there were 2,610 authorised funds established in Bahrain managing assets of over nine billion US dollars. While I realize that this is small in comparison with the size of Luxembourg’s fund management industry, this is part of the financial sector that we are seeking to develop further and we expect it to grow rapidly in the coming years.

The financial crisis has caused many financial centres to review their development strategies. Bahrain is no exception to this trend, even though the crisis has had only a modest impact on our financial system. Throughout the difficult period of 2008 and 2009, our financial markets continued to function normally and the Government of Bahrain did not consider it necessary to take some of the extraordinary measures, such as recapitalization of banks and providing blanket guarantees, that had been adopted in other parts of the world. Although we needed to place two wholesale banks into administration in the course of 2009, these events did not have a spill-over effect to the wider financial system. In fact, the financial markets seem to have taken comfort from the prompt and effective action taken by the CBB in dealing with these two problem banks.

In Bahrain, as in the rest of the world, the impact of the financial crisis was felt first through a withdrawal of liquidity, especially in US dollars. In the final quarter of 2008 we faced a situation in which our financial institutions were facing liquidity pressures, owing to the market reaction to the Lehman Brothers failure. To offset the liquidity outflow that had taken place after the bankruptcy of Lehman Brothers, the Central Bank instituted a new swap facility that permitted banks to exchange US dollars for Bahrain dinar at no penalty. This helped greatly to ease liquidity conditions in Bahrain’s money markets and allowed the 2008 year-end to pass without any significant market disruptions.

As 2009 unfolded, liquidity pressures gave way to rising credit losses. Within Bahrain itself, losses reported by banks have been in line with those we would expect in a normal business cycle. The domestic impact of the crisis has been limited in large part due to the fact that our real estate market had not experienced high levels of speculative activity. However, since Bahraini banks are major providers of credit throughout the MENA region, they have been affected by credit defaults elsewhere, and by problems in the real estate sector elsewhere in

the region. Nonetheless, the high levels of capital adequacy of our banks has allowed them to absorb these losses and the banking system remains on a very solid footing.

A further source of strength for Bahrain's financial sector has been our position as a hub for Islamic finance. Owing to the Sharia prohibition on speculative activity and the requirement that financial transactions be backed by real assets, the Islamic financial industry has been less affected by the global financial crisis than the conventional sector. While this sector has no room for complacency, as its customers are just as likely to suffer from the economic downturn as those of conventional banks, we nonetheless believe that there are enormous opportunities for Sharia-compliant finance to take up some of the slack created by problems in the conventional financial industry. The Sukuk market, in particular, is one that we believe provides a flexible financing mechanism which contains enormous potential. With Bahrain's long track-record and supportive regulatory regime for Islamic finance, we believe that this is an aspect of the financial sector that is ripe for further development.

Let me again welcome you to Bahrain and thank you for your participation in this important event.