Central Bank of Oman
Continuous Enhancement & Prosperity

# FINANCIAL STABILITY
# REPORT

His Majesty Sultan Haitham bin Tariq


البنك المركزي العماني

# FOREWORD

It is my pleasure to present the Financial Stability Report 2024, which analyzes and assesses potential vulnerabilities and risks while summarizing our perspectives on financial stability in Oman.

Since the release of the previous FSR, we have witnessed a period marked by significant global and domestic developments that have tested the resilience of financial institutions and markets worldwide. It is encouraging to note that, despite formidable headwinds stemming from global events, the Omani financial system has remained robust, demonstrating significant stability. Participants of our latest Systemic Risk Survey also expressed continued confidence in the Omani macro-financial system.

Globally, the financial landscape has been shaped by geopolitical tensions, disruptions in international trade, and tightened monetary policies. While, global inflation has moderated compared to the previous year, with the European Central Bank easing its monetary policy. Whereas, the Federal Reserve has maintained its interest rate steady, with no indications of any further hikes.

Domestically, Oman has experienced a series of favorable developments leading to positive rating actions by all three major rating agencies. These improvements stem from broad-based fiscal reforms, improved debt sustainability, growth in the economic activities, endeavors in economic diversification, and a resilient financial system. These positive trends underscore judicious policy implementation and reflect the confidence of the international community in Oman's economic stewardship and future prospects.

The Omani banking sector continues to exhibit remarkable strength, bolstering its capacity to navigate any potential risks. The stress testing results showed that our banks maintain strong solvency and liquidity positions, demonstrating resilience even in the face of rigorous solvency and liquidity stress scenarios. This stability is a testament to the prudent regulatory framework and effective risk management practices within the sector.

On the emerging risks front, although Oman has not experienced any significant cyber incidents, cyber threats and climate change remain at the top of the risk agenda. The Central Bank of Oman plays a proactive role in advising financial institutions to strengthen their risk management frameworks by incorporating climate risks. We are committed to embracing green financing initiatives, ensuring that our financial sector not only remains stable but also contributes to sustainable development.

In the near term, our assessment indicates that the risks to the outlook for financial stability in Oman remain low and the Omani banking system is well-poised to leverage its strength to support businesses and households in the event of any unforeseen shocks. The Central Bank of Oman remains unwavering in its determination to safeguard financial stability. We will continue to meticulously take stock of global and domestic developments and adopt international best practices ensuring that our financial system remains resilient and fully capable of supporting the economic growth and prosperity of our nation.

**Tahir Salim Abdullah Al Amri**
**Executive President**

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# LIST OF SELECT ABBREVIATIONS

| | |
|---|---|
| ACH | Automated Clearing House |
| AED | Arab Emirates Dirham |
| CBO | Central Bank of Oman |
| CBDC | Central Bank Digital Currencies |
| CCS | Credit Conditions Survey |
| CCyB | Countercyclical Capital Buffers |
| CET1 | Common Equity Tier 1 |
| CFSI | Composite Financial Stability Indicator |
| CRAR | Capital to Risk-weighted Assets Ratio |
| DFRATE | Default rate |
| D-SIBs | Domestic Systemically Important Banks |
| ECC | Electronic Cheque Clearing |
| ECL | Expected Credit Loss |
| FB | Fiscal Balance |
| FIs | Financial Institutions |
| FDI | Foreign Direct Investment |
| FLCs | Finance & Lease Companies |
| FMIs | Financial market infrastructures |
| FSR | Financial Stability Report |
| FX | Foreign Exchange |
| GCC | Gulf Cooperation Council |
| GDP | Gross Domestic Product |
| HHI | Herfindahl-Hirschman Index |
| IBEs | Islamic Banking Entities (IBEs) |
| IMF | International Monetary Fund |
| LCR | Liquidity Coverage Ratio |
| LLP | Loan Loss Provisions |
| MICR | Magnetic Inc. Character Recognition |
| MPCSS | Mobile Payments Clearing & Settlement System |
| MTFP | Medium-term Fiscal Plan |
| NCSI | National Centre for Statistics and Information |
| NIM | Net Interest Margin |
| NII | Net Interest Income |
| NPF | Non-Performing Financing |
| NPL | Non-Performing Loans |
| NSFR | Net Stable Funding Ratio |
| NTI | Net Trading Income |
| NYCB | New York Community Bancorp |
| OCI | Other Comprehensive Income |
| OLS | Ordinary Least Squares |
| OPEC | Organization of the Petroleum Exporting Countries |
| PD | Probability of Default |
| POS | Point of Sale |
| PSS | Payment Settlement System |
| PSP | Payment Service Provider |
| RHS | Right Hand Side |
| RO | Rial Omani |
| ROA | Return on Assets |
| ROE | Return on Equity |
| RoW | Rest of the World |
| RTGS | Real-Time Gross Settlement |
| RWA | Risk Weighted Assets |
| SMEs | (Micro)Small and Medium-sized Enterprises |
| SRS | Systemic Risk Survey |
| US; USA | United States of America |
| USD | United States Dollar |
| YoY | Year on Year |

**SECTION**

# OVERVIEW OF FINANCIAL STABILITY AND SYSTEMIC RISKS

## Amid Heightened Global Uncertainty Stemming from Geopolitical Tensions and Tightened Monetary Policy, Short-term Risks to Financial Stability in the Sultanate Remain Low

Geopolitical risks have intensified following recent events in the Middle East and the protracted conflict in Europe, exacerbating uncertainty regarding the economic outlook, particularly in relation to commodity prices, energy markets, and global value chains. The inflation has remained higher than targets set by central banks, but the recent efforts to combat inflation are showing signs of success in many countries. Notably, the European Central Bank cut key interest rates by 25 basis points in June 2024, marking the first reduction since 2019. Nevertheless, the lagged impact of the "higher for longer" interest rates is expected to persist for some time.

These factors have tested the resilience of the financial sectors and economies. Any further escalation of geopolitical uncertainty could precipitate adverse spillovers, suppress economic activity, exacerbate inflation, depress asset prices, and heighten financial market volatility. Despite these headwinds, Oman has capitalized on favorable domestic conditions duly supported by higher oil prices and fiscal discipline, effectively shielding its financial system from unfavorable global conditions. Consequently, during the past two years of tightened monetary policy, the banking sector in Oman continues to report robust earnings, strong capital positions, ample liquidity, and sufficient provisions for loan losses.

Looking ahead, a range of external factors – including the monetary policy stance of the US Federal Reserve, geopolitical developments in Europe and the Middle East, and the future trajectory of the OPEC+ agreement – will be pivotal in shaping macroeconomic and financial stability outcomes in Oman. Despite these challenges, the near-term risks to financial stability remain subdued.

## Systemic Risk Survey Reveals Strong Confidence in Oman's Macro-financial Stability, Positive Rating Reviews Validate the Robustness of the Macro-financial Outlook

The Systemic Risk Survey conducted in January 2024 among a diverse group of market participants and stakeholders revealed an increased confidence in the Omani financial system despite ongoing geopolitical concerns, although they perceived a slight increase in the perceived likelihood of a highly negative event over the short term. Specialized banks and foreign commercial banks were viewed as the most robust, whereas insurance companies and capital market institutions were deemed more vulnerable by the survey participants. The major distress points for Oman included global output and trade deterioration, geopolitical risks, and cyber-attacks (Refer to Box 1.1: Systemic Risk Survey Results). The optimism about Oman's macro-financial stability is also reflected in the positive rating reviews from the three leading rating agencies since late 2021. These upgrades underscore the growing confidence of the international community in Oman's economy and future prospects.

## The Composite Financial Stability Indicator Showed Sustained Stability

The Composite Financial Stability Indicator (CFSI) comprises five sub-indicators reflecting Banking Stability, Systemic Risk, Debt Sustainability, Currency Stability, and Capital Market. The CFSI demonstrated sustained stability during 2023 primarily on the back of improvement in debt sustainability and banking sub-indicators.

## Omani Banking Sector Remains Strong, Bolstering Capacity to Mitigate Any Adverse Shocks

The banking sector balance sheet continued to witness a notable expansion propelled by favorable operating conditions. Despite over two years of tightened monetary policy, the banking sector in Oman continue to report robust earnings, strong capital positions, ample liquidity, and sufficient provisions for loan losses. The non-performing loans (NPLs) rate remained low, while various stress tests indicate that banks are capable of withstanding a variety of potential shocks. The prudential liquidity indicators consistently remained well-above Basel requirements. Thus, the Omani banking system remained well-positioned to leverage its strength to support businesses and households in the event of any unforeseen shocks.

## Credit Conditions Survey Reveals Rising Loan Demand Across Sectors

The 2023 Credit Conditions Survey indicates a significant rise in demand for loans by households. This trend is expected to continue into 2024, driven by economic growth, increased consumer confidence, and affordable lending rates. Credit availability for households in 2023 remained consistent with the previous three years, although mortgage lending terms were stricter. Corporate lending demand also increased in 2023, for both working capital and capital expenditures, with further increases anticipated in 2024 by the survey respondents. However, credit availability for corporates somewhat tightened in 2023, with expectations of continued stringent lending standards in 2024, particularly concerning collateral, service-ability standards, loan covenants, and risk pricing.

## The Banking Sector Showed Resilience in the Face of Rigorous Solvency and Liquidity Stress Scenarios

The stress tests conducted using data from December 2023 revealed that, under the assumed adverse macroeconomic scenarios, all banks would withstand such shocks without breaching the CBO's minimum required Capital to Risk-weighted Assets Ratio (CRAR) of 13.5 percent. Despite facing a significant rise in credit provisioning expenses due to the increase in their Non-Performing Loans (NPLs) ratio under adverse scenario, banks would manage to cover these losses and maintain profitability during the stress horizon. Similarly, the Reverse Stress Tests demonstrated banks' ability to absorb a substantial increase in Non-Performing Loans (NPLs) without compromising their solvency.

The Liquidity Stress Tests conducted as of December 2023 indicated that all banks could uphold a 100 percent Liquidity Coverage Ratio (LCR) under stress testing. Furthermore, system-wide liquidity analysis revealed that the banking system possesses ample counterbalancing capacity to endure persistently simulated cash outflows over the six-month reference period.

## Rising Cyber Threats and Climate Change Pose Concerns for Financial Stability

With the rapid digitization of financial systems, cyber security concerns present novel challenges to financial stability. The rise in cyberattacks, particularly targeting financial institutions worldwide can have systemic consequences if they erode the confidence of the users in the digital delivery channels. The CBO remains vigilant of the cyber-risks, crafting policies to mitigate these risks and safeguard market integrity.

Climate change presents another formidable threat, with its far-reaching impacts increasingly felt across the globe. The urgency of transitioning to a zero-emission economy is paramount, as physical shocks and the transition's risks loom large. The CBO plays a proactive role, advising financial institutions to strengthen their risk management frameworks by incorporating climate risks and embracing green financing initiatives.

## Box 1.1: The Systemic Risk Survey Results – 2024

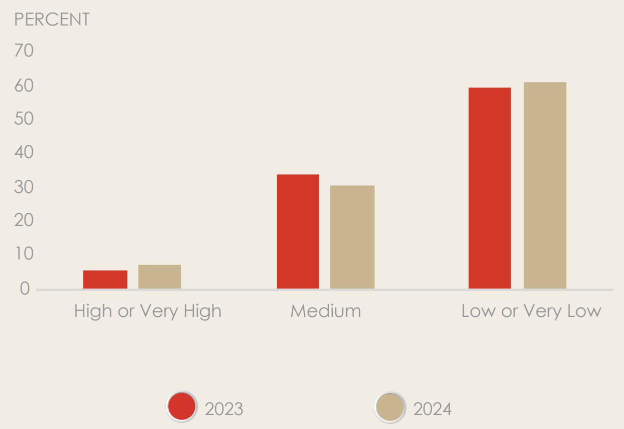
The purpose of the CBO's annual Systemic Risk Survey (SRS) is to collect input from diverse stakeholders to assess their level of confidence in Oman's macro-financial system and their perspectives on associated risks. The survey is typically completed by representatives from banks, non-bank financial institutions, financial sector regulators, government entities, professionals from the public and private sectors, as well as finance and economics experts. The data presented in this report reflects the responses gathered during the January 2024 edition of the survey.

### Divergence in Views Regarding Expectations of an Adverse High-Impact Event Increased amid Stable Economic Conditions while Worsening Geopolitical Circumstances in the Region

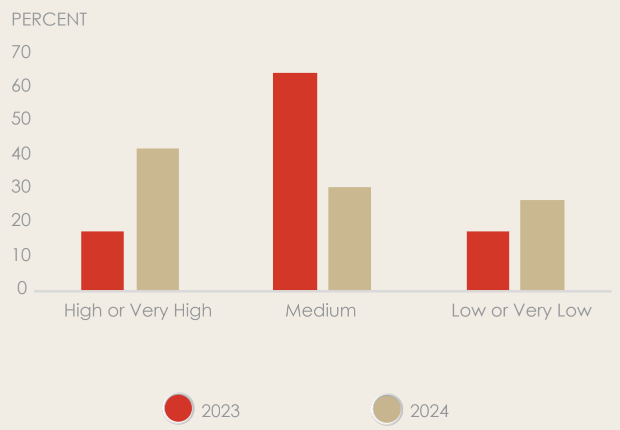
Based on the SRS 2024 findings, there was a slight increase in the perceived likelihood of a highly negative event occurring in Oman's financial system over the short term (up to one year). This increase can be attributed to heightened tensions in the Middle East. Approximately 7.7 percent of respondents considered this probability to be 'High' or 'Very High' in 2024, compared to 6 percent in the SRS 2023. Conversely, the percentage of respondents who perceived this probability as 'Low' or 'Very Low' slightly increased from 60 percent in 2023 to 61.5 percent in 2024 (Graph 1.1.1).

The respondents' perception of the probability of such an event occurring in the medium term (1-3 years ahead) was mixed due to the prevailing high degree of uncertainty. Around 27 percent of respondents viewed this probability as 'Low' or 'Very Low' in 2024, up from 18 percent in 2023. Conversely, the percentage of respondents who considered it 'High' or 'Very High' also increased to 42 percent in 2024 from 18 percent in 2023 (Graph 1.1.2).

**GRAPH 1.1.1**
**PROBABILITY OF A HIGH EVENT - SHORT TERM**



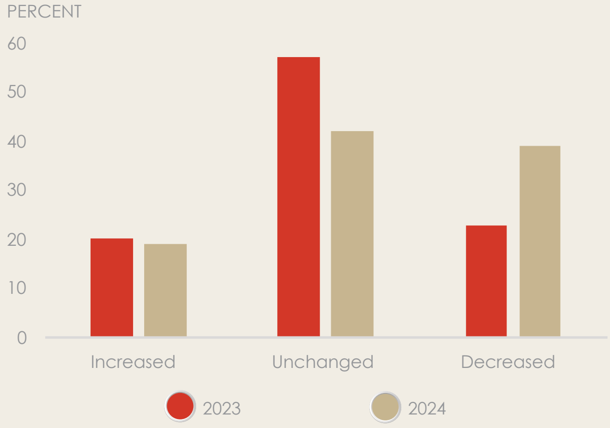

**GRAPH 1.1.2**
**PROBABILITY OF A HIGH EVENT - MEDIUM TERM**



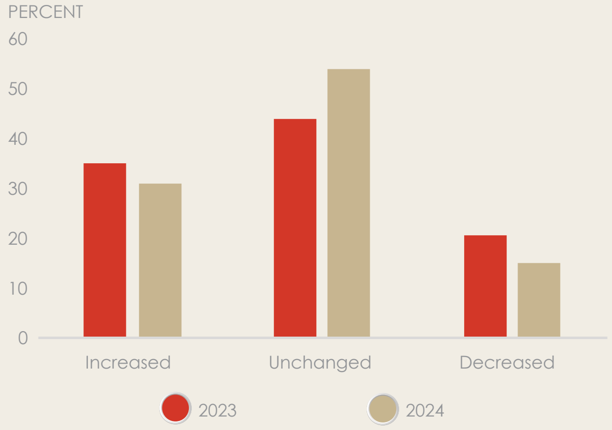
Respondents participating in the SRS 2024 displayed relatively higher levels of optimism when reflecting on their perception of the likelihood of an adverse event occurring in the near future, despite heightened global uncertainty stemming from supply chain disruptions and the geopolitical tensions in the Middle East. In 2024, only 19 percent of respondents indicated a slight increase in this probability, compared to 20 percent in the previous SRS conducted in 2023. Furthermore, 42 percent of respondents reported that this probability remained unchanged in 2024 (Graph 1.1.3).

However, there was an increase of 15 percentage points in the proportion of respondents who believed that this probability had decreased over the past six months, rising from 23 percent in 2023 to 38 percent in 2024 (Graph 1.1.4).

**GRAPH 1.1.3**
**CHANGE IN CONFIDENCE IN LEVEL OF OPTIMISM -SHORT TERM**




**GRAPH 1.1.4**
**CHANGE IN CONFIDENCE IN LEVEL OF OPTIMISM - MEDIUM TERM**



## Confidence in the Omani Macro-Financial System shows improvement

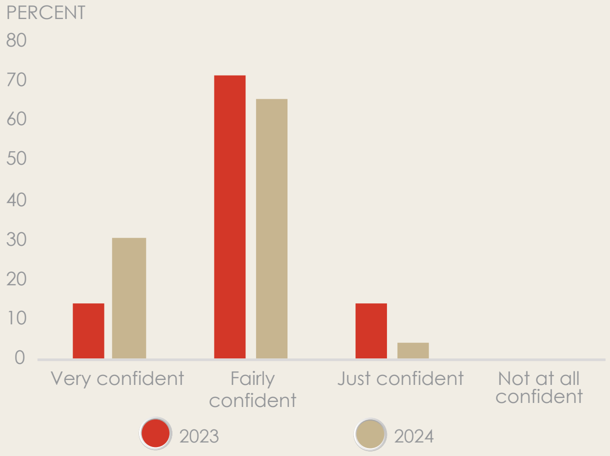
The SRS 2024 findings indicate an improvement in the level of confidence in the Oman's macro-financial system, despite persistent geopolitical concerns and ongoing uncertainty. The percentage of respondents who expressed being 'very confident' in the Omani macro-financial system increased from 14 percent in 2023 to 31 percent in 2024. The majority of respondents 65 percent expressed a fair level of confidence in the system. Conversely, the proportion of respondents who described themselves as 'just confident' decreased to 4 percent in 2024 from 14 percent in the previous year (Graph 1.1.5).

Remarkably, despite the high degree of geopolitical uncertainty throughout 2024, nearly 58 percent of respondents reported an 'unchanged' level of confidence in the Omani macro-financial system compared to 40 percent in 2023 (Graph 1.1.6).

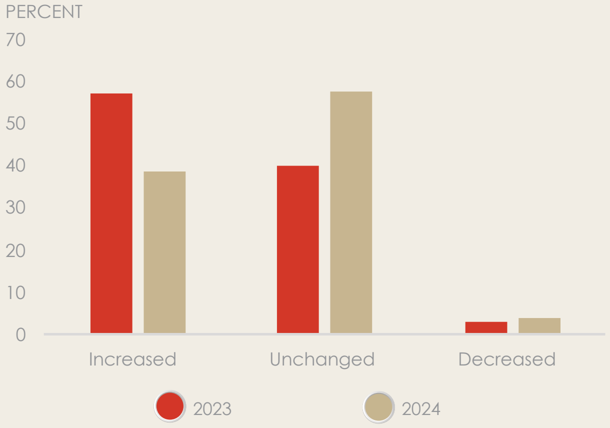
## Specialized Banks and Foreign Commercial Banks are Viewed as the Most Solid Financial Intermediaries (FIs) in 2024, While Insurance Companies and Capital Market Institutions are Perceived as the Most Vulnerable to Adverse Shocks

Respondents were asked to assess the potential negative impact on various categories of financial institutions (FIs) in the event of a country-wide adverse event occurring in the near future. They were asked to classify each category of FIs into four vulnerability classes: high vulnerability, moderate vulnerability, low vulnerability, and very low vulnerability.

**GRAPH 1.1.5**
**CONFIDENCE IN OMANI MACRO-FINANCIAL STABILITY**




**GRAPH 1.1.6**
**CHANGE IN CONFIDENCE IN OMANI MACRO-FINANCIAL STABILITY**



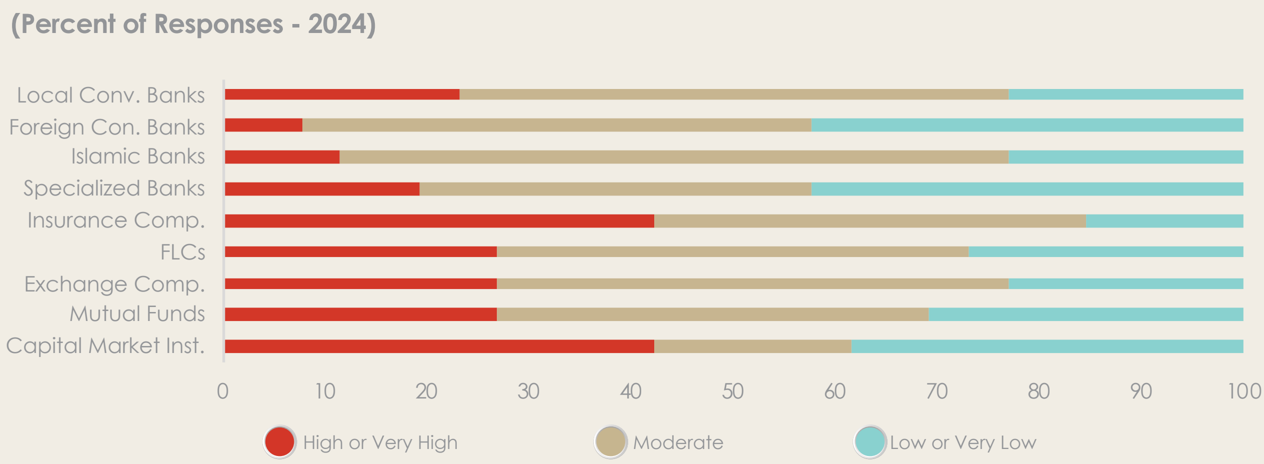
In the 2024 survey, the majority of respondents (averaging 52 percent) considered Omani financial institutions (FIs) to fall within the "moderate vulnerability" category. Insurance companies and capital market institutions were identified as the most "highly vulnerable" by 42 percent of respondents, followed by mutual funds and currency exchange companies, which were identified as highly vulnerable by 27 percent of survey respondents. Specialized banks and foreign commercial banks, on the other hand, were perceived as less vulnerable, with 42.31 percent of respondents considering them to have "low or very low vulnerability" (Graph 1.1.7).

These results are largely consistent with the findings of the 2023 survey, where mutual funds and currency exchange companies were also seen as the most "highly vulnerable" by 34 percent and 17 percent of respondents, respectively. However, in the SRS 2023, specialized banks and foreign commercial banks received were perceived to have "low or very low vulnerability".

## Deterioration in the Global Output and Trade, Geopolitical Risks and Cyber Attacks in Oman are Apparent to be the Major Potential Distress Points in 2024

Respondents were provided with a distinct series of inquiries aimed at assessing the probability and potential impact of twenty adverse events on the Omani financial system. Worth to highlight that in the 2024 survey, six new hypothetical events, namely "Funding difficulties at banks", "Reduction in market liquidity", "Rising defaults in the household/corporate sector", "Pandemic risk", "Loss of confidence in regulation", and "Banks' IT infrastructure disruption," were included alongside the previous list of adverse events, resulting in a total of twenty hypothetical events.

**GRAPH 1.1.7**
**PERCEIVED VULNERABILITY OF FINANCIAL INSTITUTIONS TO ADVERSE SHOCKS**

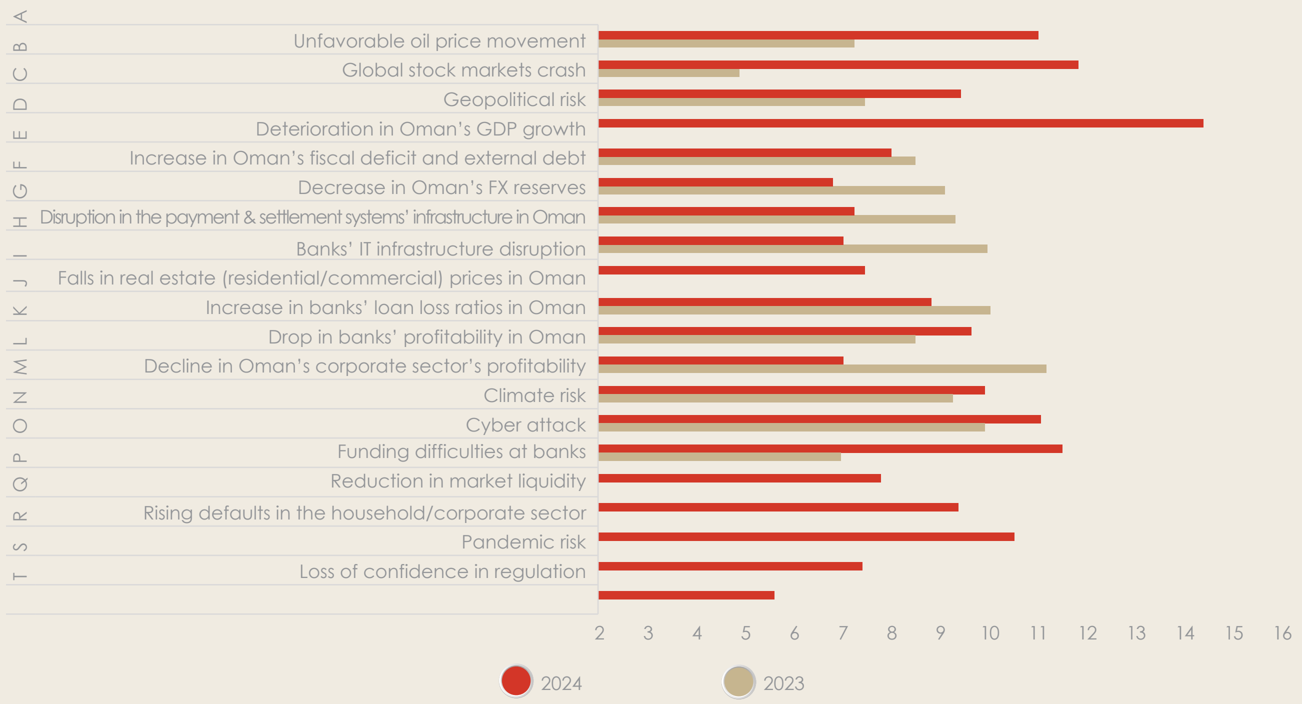


Using a scoring system ranging from “very high” to “very low,” respondents assigned a numerical value from 1 to 5 to rate the probability and impact of each event. The expected impact for each event was determined by multiplying the assigned scores for probability and impact by each respondent and subsequently averaging the values across all responses. The resulting expected impact values encompassed a range from 1 to 20.

In comparison to the 2023 findings, respondents in 2024 displayed a decrease in their perception of the probability of systemic risks materializing. However, there was an increase in their perception of the impact these risks could have, suggesting a shift in how risks are perceived in terms of their likelihood and the recognition of their potential severity to Omani macro-financial system. The average probability and impact scores for the 20 events changed from 3.3 and 2.6 in 2023 to 2.76 and 3.28 in 2024, respectively. As a result, the average expected impact rose from 8.7 in 2023 to 9.11 in 2024.

Market participants may be recognizing that while the likelihood of risks materializing has diminished, the potential impact of such risks if they were to occur, could be more severe than previously anticipated. This acknowledgment is particularly relevant given the prevailing instability in the region, which introduces geopolitical risks capable of destabilizing the region and generating broader economic consequences. These risks have the potential to influence energy prices, regional investment flows, and geopolitical relationships, thereby potentially impacting Oman’s macro-financial system. It is worth highlighting that “Political instability in the region”, “Unfavorable oil price movement”, and “Cyber attack” were recognized as the top three systemic risks concerning their perceived expected impact on the Omani financial system. These risks also pose significant challenges in terms of management and mitigation.

**GRAPH 1.1.8**
**EXPECTED IMPACT OF 20 HYPOTHETICAL EVENTS ON THE OMANI MACRO-FINANCIAL SYSTEM in 2024**



The findings of the current survey diverge from those of the 2023 survey. In 2023, the two most notable systemic risks in terms of their perceived expected impact were the "Drop in banks' profitability in Oman" and the "Plunge in real estate prices in Oman." However, in 2024, the perceived significance of these risks has shifted. Instead, the "Increase in Oman's fiscal deficit and external debt" and the "Decrease in Oman's FX reserves" were considered the least significant systemic risks to Oman's macro-financial stability (Graph 1.1.8). In contrast, in 2023, both the "Unfavorable oil price movement" and "Cyber attack" were perceived as the least significant factors.

## Systemic Risk Perception Matrix Classifies the Hypothetical Events into Five Levels of Expected Severity, Providing a Useful Guide to Omani Policymakers

The Systemic Risk Perception Matrix for the Omani macro-financial system (Table 1.1.1) was constructed using the average scores of probability and impact. In this matrix, the rows represent three categories indicating the likelihood of an event occurring, while the columns represent three categories indicating the severity of the event if it were to materialize. The matrix consists of nine cells, which help identify five different levels of expected severity for the 20 hypothetical events. These severity levels range from "Very Low" for unlikely events with low impact to "Very High" for probable events with strong impact.

**Table 1.1.1: Systemic Risk Perception Matrix for the Omani Macro-Financial System 2023**

| | | Impact if Event Materializes | | |
|---|---|---|---|---|
| **Probability of Event's Occurance** | | **Acceptable** (Relatively Weak Impact) | **Tolerable** (Moderate Impact) | **Unacceptable** (Relatively Strong Impact) |
| | **Unlikely** (Relatively Low Probability) | VERY LOW<br>F;G;L;P;T | LOW<br>C;E;H;I;J;K;Q;S | MEDIUM<br>B;R |
| | **Possible** (Moderate Probability) | LOW | MEDIUM | HIGH |
| | **Probable** (Relatively High Probability) | MEDIUM | HIGH<br>M;N | VERY HIGH<br>A;D;O |

To classify events, the average score for probability and impact is compared to percentile thresholds. Events with an average score below the 25th percentile are classified as unlikely with acceptable impact. Conversely, events with an average score above the 75th percentile are classified as probable with unacceptable impact. Events falling between the 25th and 75th percentiles for both probability and impact are classified as possible with tolerable impact. Based on the survey responses for the current year, this methodology establishes two cut-off points for the average scores of probability (2.36 and 3.1) and impact (3.13 and 3.4) respectively.

Using the numbering system indicated in (Graph1.1.6) each of the twenty hypothetical factors was assigned to the corresponding cell in the systemic risk perception matrix presented in (Table 1.1.1) The matrix highlights three events that respondents perceived as having a "Very High" expected severity. These events, namely "Deterioration in the global output and trade", "Geopolitical risk", and "Cyber attack", should receive significant attention from policymakers. Additionally, two other hypothetical events, the "Decline in Oman's corporate sector's profitability" and "Climate risk", were deemed to have a "High" expected severity, warranting close attention from policymakers as well. On the other hand, the matrix indicates that five potential systemic risks, including "Increase in Oman's fiscal deficit and external debt", "Decrease in Oman's FX reserves", "Drop in banks' profitability in Oman", "Funding difficulties at banks", and "Loss of confidence in regulation", were perceived to have a "Very Low" expected severity.

In a surprising shift, "Cyber attack" has emerged as one of the most notable risks in 2024, potentially attributed to its capacity to disrupt critical infrastructure, induce financial losses, compromise data privacy, pose national security threats, and exploit geopolitical vulnerabilities.

### Respondents Suggest Additional Factors that Could Impact the Omani Macro-Financial System

In addition to the aforementioned section, the survey participants were asked to identify significant risks that could potentially impact the Omani macro-financial system, even if not explicitly mentioned earlier. They were also tasked with evaluating the likelihood and impact of each identified risk. The results of the most commonly provided responses are summarized in (Table 1.1.2).

**Table 1.1.2: Additional Risk Factors Suggested by the Respondents to SRS 2023**

| | Risk | Probability Range | Impact Range |
|---|---|---|---|
| 1 | Health Crises and Pandemics | Medium | High |
| 2 | Geographical Constraints | High | High |
| 3 | Credit risk | Low | Low to High |
| 4 | Inflationary Pressures | Medium to Very High | Medium to Very High |
| 5 | Demographic Shifts | Medium | Medium |
| 6 | Exchange Rate Fluctuations | Low to Medium | Medium to High |
| 7 | Commodity Price Volatility | Medium to Very High | Medium to Very High |
| 8 | Natural Disasters | Medium | High |
| 9 | Market Disruption in Debt Markets | Low | High |
| 10 | Decrease in public consumption | Low | Medium |
| 11 | Unfavorable policy/regulatory changes in Oman | Low to High | High to Very High |
| 12 | Inability to maintain and attract more FDI | Medium to High | High to Very High |
| 13 | Recession in the economy | Medium | High |
| 14 | Changes in Global Financial Regulations | Low to Medium | High |
| 15 | Sovereign Debt Crisis | Low | High |
| 16 | Unemployment and labor market disruptions | High | High |
| 17 | Reduction in domestic consumption | High | High |

## Box 1.2: A Rating-Based Composite Financial Stability Indicator

The stability of the financial system is crucial for facilitating the efficient allocation of financial resources, ultimately promoting economic growth. Financial stability is a complex phenomenon, typically measured using an array of qualitative and quantitative indicators. To streamline and summarize the assessment of financial stability, CBO uses a rating-based Composite Financial Stability Indicator (CFSI)[1]. The CFSI endeavors to augment transparency and communication with both the public and stakeholders. Moreover, it aids policymakers in deciphering the origins and factors contributing to any stress on financial stability.

The CFSI is composed of five sub-indicators that best reflect financial stability in Oman. These comprise the Banking Stability, Systemic Risk, Debt Sustainability, Currency Stability, and Capital Market Certainty sub-indicators. Each sub-indicator encompasses a set of pertinent variables with each variable being assigned a rating of 1(least stable) to 5(very stable) based on regulatory requirements, international benchmarks, or expert judgment. These variables are then aggregated to form sub-indicators, which are subsequently integrated into the CFSI based on predetermined weights assigned to each sub-indicator as follows:

$$CFSI=0.40BSI+0.10SRI+0.20DSI+0.20CSI+0.10CMI$$

Where: BSI is the Banking Stability Sub-indicator; SRI is the Systemic Risk Sub-indicator; DSI is the Debt Sustainability Sub-indicator; CSI is the Currency Stability Sub-indicator; and CMI is the Capital Market Sub-indicator. The weighting scheme of sub-indicators reflects the relative significance of each sub-indicator for financial stability.

The CFSI is calculated quarterly from 2008Q1 to 2023Q4, with the findings presented in Graph 1.2.1. The results indicate sustained stability in the macro-financial landscape during 2023. This favorable trend is primarily attributed to the ongoing improvement in operating conditions.

The banking sector Sub-indicator demonstrates a robust performance, highlighting the strength and resilience of the banking sector with a rating of 4.05 as of 2023Q4 (compared to 3.98 in 2022Q4). The favorable economic environment has resulted in improved liquidity and profitability for banks, alongside better asset quality compared to the preceding period.

The rating of the systemic risk sub-indicator in 2023Q4 stood at 5 (2022Q4: 4.66) indicating the absence of indications of excessive risk-taking that could precipitate system-wide stress within the financial sector.

[1]More details on the paper is available at www.cbo.gov.om

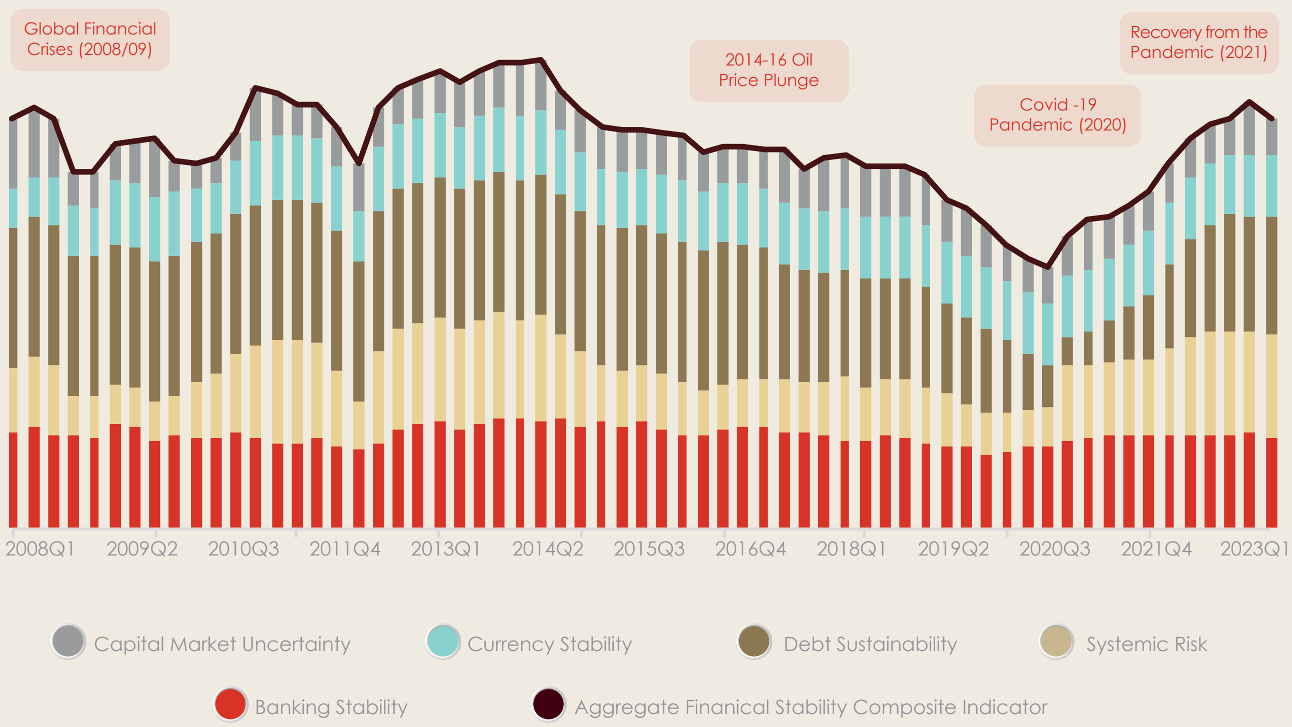
Earlier, the systemic risk sub-indicator exhibited decline during periods of financial crises (2008-2009), low oil Prices (2015-2019), and during the COVID-19 pandemic (2020).

The debt sustainability sub-indicator shows that the Omani debt sustainability has considerably improved as compared to last year which stood at 4.28 in 2023Q4 as compared to 3.77 during the previous period due to accelerated repayment of external debt. The improvement in debt sustainability indicates a more manageable debt profile and reduced vulnerability to potential fiscal challenges.

The currency stability sub-indicator continued to show strong stability with a rating of 4.36 during 2023Q4 as compared to 4.39 a year ago. The capital market stability sub-indicator tends to be more volatile than any other sub-indicator included in the model as market-based indicators are fast to react to changing conditions. The rating of the Omani capital market stability indicator as of 2023Q4 rose as compared to the previous period (2023Q4: 3.13; 2022Q4: 2.90). The increase is largely due to a rise in market turnover.

On an overall basis, the CFSI revealed positive trends largely due to favorable economic factors, particularly higher Oil prices; with an overall rating of 4.2 as of 2023Q4.

**GRAPH 1.2.1**
**COMPOSITE INDICATOR OF FINANCIAL STABILITY**



## Box 1.3: Regulatory Developments to Facilitate Digitization in Oman

The Central Bank of Oman (CBO) has undertaken substantial initiatives to facilitate the digitization of financial services in Oman. The following initiatives have been implemented to enhance efficiency, improve customer experience, and promote innovation in the financial sector:

**1. Digital Onboarding and Electronic KYC:** As part of its efforts to establish a reliable and independent source of customer data for digital onboarding, CBO has created the National Digital Onboarding Registry. The establishment of this registry and the issuance of guidelines on digital onboarding and electronic Know Your Customer (e-KYC) have laid the foundation for the digital onboarding of individuals and non-individuals by licensed institutions. This serves as a crucial cornerstone for the digitalization of financial services, potentially driving open banking initiatives and the development of innovative digital products.

**2. Improvement in Participation of Non-bank Entities in the Digital Ecosystem:**
To support digitalization, CBO has introduced a liberalized licensing framework for Payment Service Providers (PSP). Entities offering ancillary payment services are now required to register through a licensed bank, rather than obtaining direct licensing. This regulatory change paves the way for the introduction of innovative payment solutions in the market[1]. Reporting of key indicators by licensed banks for Ancillary Payment Service Providers has been implemented as part of the supervisory mechanism, enabling effective monitoring of their business activities. Additionally, CBO has granted licenses to five new Payment Service Providers, one through sandbox and 4 through operational licenses in the past two years. Some fintech players have successfully graduated from CBO's Fintech Regulatory Sandbox, further contributing to the digital ecosystem. The new regulations on Money Service Businesses facilitate their participation in offering digital products. CBO remains agile in developing new frameworks to support different types of business activities, with recent fintech participation focused on alternate modes of finance such as Buy Now Pay Later.

**3. Supporting Fintech and Key Technology Initiatives:**

- CBO has demonstrated its support for fintech and key technology initiatives through various measures:
- CBO has taken significant steps to support the development of innovative financial products and services, such as Buy Now Pay Later (BNPL). This includes the approval of new regulations governing the business of Buy Now Pay Later and the ongoing development of a draft licensing and regulatory framework for financial technology entities extending microfinance to individuals with limited access to traditional banking services, known as the BNPL framework, which is currently undergoing public consultation.

[1] Through BM1192 under Ancillary Payment Service.

- Ongoing development of a regulatory framework for Digital Banks, targeting a rollout in 2024, following the establishment of key foundations for digitization such as frameworks for Digital Onboarding, Cybersecurity, and Cloud services.
- Advancement in finalizing the Open Banking framework, with collaboration between CBO, banks, and fintech players for testing under the Fintech Regulatory Sandbox (FRS).
- Implementation of a Reg-tech tool called STRIX in the Anti-Money Laundering (AML) Department to enhance compliance processes and regulatory oversight, resulting in improved supervision efficiency and effectiveness.
- Provision of regulatory support for fintech companies to test product offerings under the CBO Fintech Regulatory Sandbox. The current cohort focuses on "Alternate Modes of Finance," and based on test results, a regulatory framework will be proposed.

**4. Initiatives for the Development of Payment Systems and Services:**
CBO has introduced several initiatives to enhance the payment system and services, including:

- The launch of 24/7 Real-Time Gross Settlement (RTGS) in June 2023.
- The implementation of the International Bank Account Number (IBAN) in Oman in July 2023.
- Card Tokenization was introduced in August 2023.
- The introduction of E-mandate in December 2023.
- Enhancements to Direct Debit in December 2023.

**5. Regarding Central Bank Digital Currency (CBDC)**, the CBO has concluded its research on the need to issue a CBDC. It has assessed technical requirements, operational needs, regulatory considerations, and identified relevant use cases. The CBO is currently conducting a CBDC pilot to verify certain use cases.

**6. Furthermore, the CBO has developed the Fintech Framework and Roadmap,** which focuses on enabling the Fintech ecosystem in Oman. This framework includes policies, collaboration with education and academia, research and development, accelerator and incubator programs, funding and capital investment, and infrastructure development. These strategic pillars aim to support the growth of the Fintech sector in Oman and ensure a conducive environment for innovation and development.

The Central Bank of Oman's regulatory efforts and initiatives reflect its commitment to embracing digital transformation, supporting Fintech innovation, and driving the development of a modern and resilient financial ecosystem in Oman.

**SECTION**

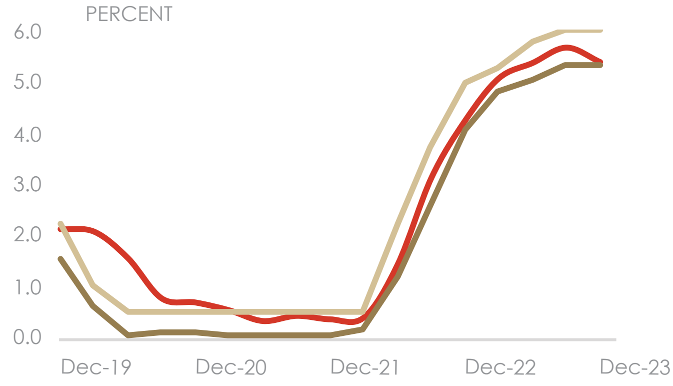
# VULNERABILITIES AND RISKS FOR THE FINANCIAL STABILITY

## OUTLOOK FOR FINANCIAL STABILITY

### Elevated Geopolitical Tensions Exacerbate Uncertainty

The year 2023 has remained fraught with significant challenges, including geopolitical tensions, disruptions in global trade, and some lingering effects of the COVID-19 pandemic. Geopolitical risks have intensified following recent events in the Middle East besides the protracted Russia-Ukraine war, exacerbating uncertainty regarding the economic outlook, particularly in relation to commodity prices, energy markets, and global value chains. These factors have tested the resilience of the financial sector, and any further escalation of geopolitical uncertainty could lead to adverse spillovers, dampen economic activity, elevate inflation, depress asset prices, and increase financial market volatility.

**GRAPH 2.1**
**POLICY AND OVERNIGHT INTERBANK RATES**




Overnight Interest Rates
Effective Fed Fund Rate
Repo Rate

**GRAPH 2.2**
**DME OMAN CRUDE**


### Globally Higher-for-longer Interest Rates Could Impose Significant Stress on the Financial System

Interest rates in the US and other advanced economies have gradually become less accommodative since March 2022 (Graph 2.1). Given the fixed exchange rate of the Omani Rial against the USD, the US policy stance is fully reflected in Oman's policy rates. The ensuing tightening of financial conditions carries implications for the stability of the financial system manifesting as pressures on an array of financial and real assets, an increased materialization of credit risk, and challenges regarding debt affordability by businesses and households.

At present, financial markets do not anticipate any additional increase in the policy rate, but interest rates will likely need to remain elevated to ensure the sustained decline of inflation. Should interest rates remain elevated for a prolonged period beyond current market expectations, it could compound existing strains in the debt-servicing capacities of households and businesses and weaken the economic outlook. The perception or realization of potential losses by banks could exacerbate the tightening of financing conditions, potentially exerting further pressure on economic activity.

### Amid the Uncertainty the Omani Economy Remains Robust and the Financial System is Well-Poised to Support the Economy

Despite formidable headwinds stemming from deteriorating geopolitical conditions, elevated interest rates, and persistent global inflation, the higher oil prices and fiscal discipline have served as a source of fiscal buffer for Oman against these challenges (Graph 2.2). The ongoing fiscal consolidation and structural reforms are expected to improve the sustainability of public expenditure, further supporting financial stability. Initiatives aimed at enhancing the business environment, such as streamlining regulations and promoting private sector development, are likely to attract FDI and stimulate economic activity. Moreover, Oman's non-hydrocarbon activities are poised for growth, driving economic diversification efforts and reducing reliance on oil revenues. The plan to implement Personal Income Tax underscores the government's commitment to fiscal reforms and economic diversification.

**GRAPH 2.3**
**MATURITY OF ASSETS AND LIABILITIES**

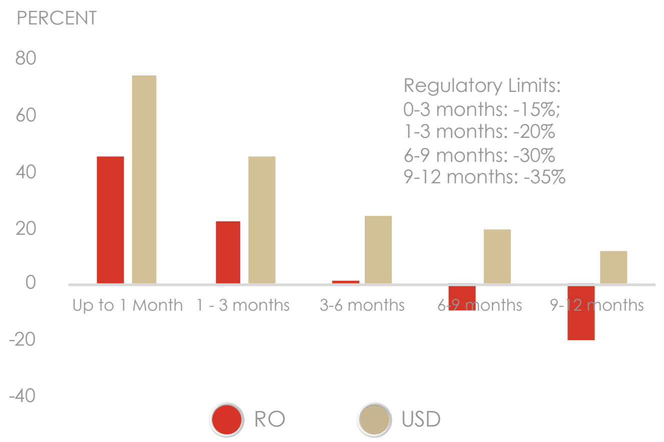



**TABLE 2.1**
**OMAN`S CREDIT RATING UPGRADES**

| | 2020 | 2021 | 2022 | 2023 | 2024 |
|---|---|---|---|---|---|
| **S&P** | B | B+ | BB | BB+ stable | BB+ positive |
| **Fitch** | BB- downgrade | BB- | BB | BB+ stable | BB+ stable |
| **Moody`s** | Ba 3 negative | Ba 3 stable | Ba 3 positive | Ba 1 stable | Ba 1 stable |

The banking sector continues to demonstrate resilience as evidenced by recent stress tests (Section 3) attesting to the ability of the financial system to navigate potential risks. The stress tests show that banks are well-positioned to withstand adverse shocks. Despite some bank failures in the US and Europe that occurred at the beginning of 2023, Oman's banking sector has remained stable as Omani banks must adhere to stringent prudential limits on maturity mismatches between assets and liabilities, thereby mitigating their exposure to fluctuations in interest rates (Graph 2.3). Additionally, Oman has not experienced the correction in the real estate prices witnessed in several advanced economies. Participants of the latest Systemic Risk Survey also showed high confidence in the Omani macro-financial system (Section 1: Box 1.1). On balance, the risks to the outlook for financial stability in Oman are low in the near term, but it remains sensitive to global development.Thus, going forward, the monetary policy stance of the US Fed, geopolitical developments in Europe and the Middle East, and the future trajectory of the OPEC+ agreement will remain pivotal in shaping the macroeconomic and financial stability outcomes in Oman. However, the Omani banking system can leverage its strength to support businesses and households in the event of any unforeseen shocks.

## Oman's Fiscal Performance and Structural Reforms Lead to Consecutive Credit Rating Upgrades

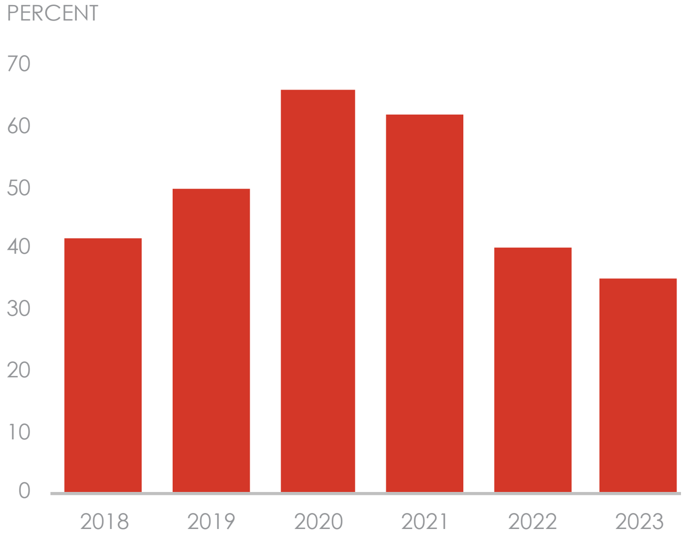
Oman has witnessed three credit rating upgrades since late 2021 from the three major rating agencies. This is attributed to the country's improved fiscal performance, endeavors in economic diversification, and judicious policy implementation. These upgrades underscore the burgeoning confidence of the international community in Oman's economic stewardship and future prospects (Table 2.1).

## DEBT SUSTAINABILITY

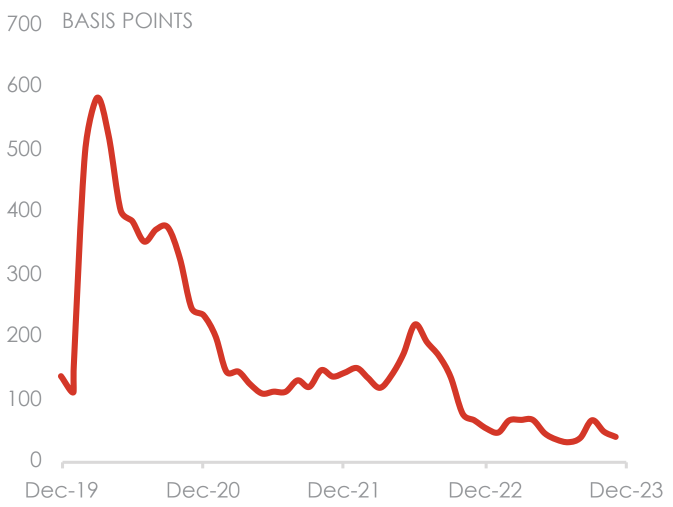
### The Combination of Elevated Oil Prices and Fiscal Consolidation Under a Medium-Term Fiscal Plan Has Eased the Pressure on the Sustainability of Public Debt

Oman's economy experienced severe strain during the pandemic period, as evident from the Composite Financial Stability Indicator that had resulted in a contraction of GDP and an escalating need for borrowing, intensifying pressure on Oman's debt sustainability (Box 1.2).

**GRAPH 2.4**
**PUBLIC SECTOR DEBT TO GDP**




**GRAPH 2.5**
**ONE-YEAR CREDIT DEFAULT SWAP SPREADS**




High levels of public debt pose a substantial risk to financial stability as besides exacerbating the impact of higher interest rates it can amplify any shocks. Many advanced economies are grappling with elevated public debt. In Oman, the post-pandemic economic revival propelled by higher oil prices combined with prudent fiscal management outlined in the medium-term fiscal plan (MTFP) and expedited debt repayments, has enabled the government to markedly curtail its debt burden. This reduction saw debt levels plummet from approximately 65 percent of GDP in 2020 to 35 percent by the end of 2023 (Graph 2.4).

### Declining Credit Default Swap Spreads Bode Well for the Country Risk

Sovereign Credit Default Swaps (CDS)[1] spreads serve as an important indicators of sovereign credit risk, aligning with economic fundamentals and market conditions[2]. The credit default swap (CDS) data pertaining to Omani sovereign bonds showed a significant surge in spreads during 2020. This surge coincided with the period of twin shock marked by the pandemic and low crude oil prices leading to a substantial decline in economic activities, and soaring fiscal deficit and public sector debt. Nevertheless, recently these spreads have experienced a notable decline, indicating a reduction in country-specific risks and a restoration of confidence in the Omani economy (Graph 2.5).

## ASSET VALUATIONS

### Heightened Uncertainty Amplifies Volatility in the Muscat Stock Exchange

During the recent period, the performance of the MSX-30, the main index of the local bourse, has mirrored the intricacies of the economic landscape. During 2023,

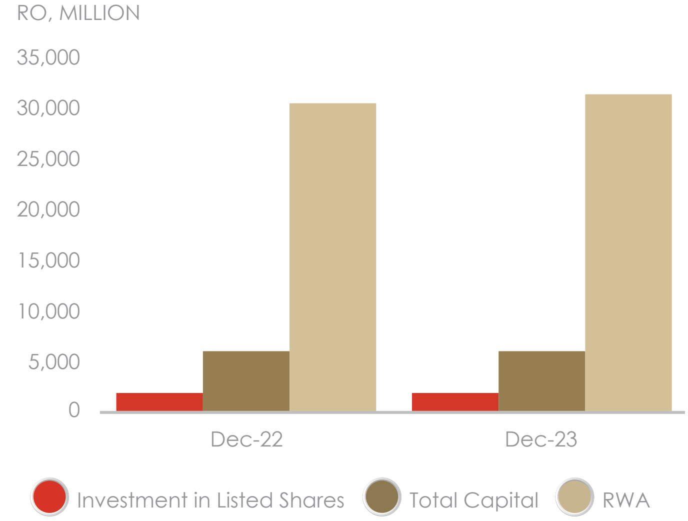
[1] CDS is similar to insurance or protection against credit default. CDS spreads are akin to the premium paid to buy "insurance" against the default of underlying debt.

[2] IMF (2013), "Credit Default Swaps and Financial Stability." Global Financial Stability Report, April 2013

the trading volumes increased by 5.5 percent, however, the index posted a 7.1 percent reflecting cautious investor activity downturn, influenced by heightened global uncertainty amid escalating geopolitical tensions, compounded by a prolonged period of elevated policy rates and a decline in domestic nominal GDP (Graph2.6). The price-to-earnings ratio for the MSX-30 remained low, indicating undervaluation and implying a significant upside potential. Despite similarities in economic structures, regional differences in stock market performance have surfaced during 2023, with most other stock markets in the GCC outperforming Omani equities. Nevertheless, during the first quarter of 2024, the MSX-30 index posted a 3 percent gain. Despite this recovery, uncertainties persist, and the MSX30 remains sensitive to shifts in global and domestic economic conditions and geopolitical dynamics.

**GRAPH 2.6**
**MSX**


**GRAPH 2.7**
**STOCK MARKET EXPOSURE OF BANKING SECTOR**



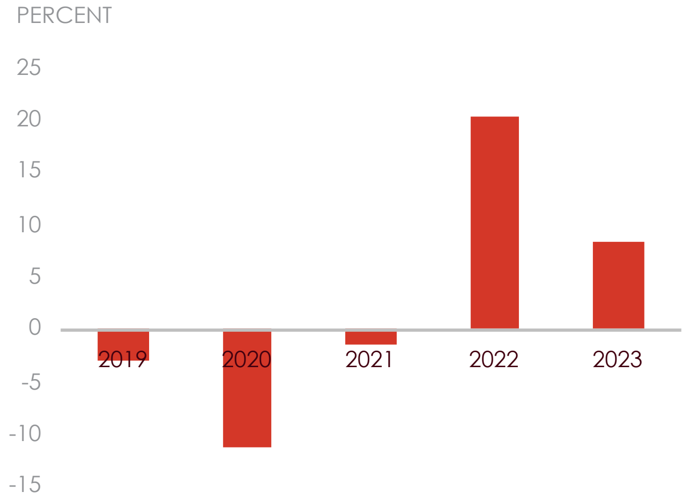

## Modest Equity Exposure Shielded Banks from Market Volatility

The banking sector in Oman maintained conservative equity portfolios. Banks' investment in listed shares was less than RO 300 million in 2023, accounting for less than 1 percent of their total risk-weighted assets or around 4 percent of their regulatory capital (Graph 2.7). Thus, banks' modest equity exposure ensured that a shock in the equity market would not have any direct adverse impact on the financial sector in Oman. Nevertheless, banks are also indirectly exposed to the equity market in the form of lending for the purchase of or lending secured by listed securities. In addition, weak stock market performance may indicate unfavorable market and tighter operating conditions for business, which may impact the quality of the banks' lending portfolio.

## Persistent Inflation Spurs Higher Mortgage Rates, Raising Real Estate Market Concerns in Several Economies

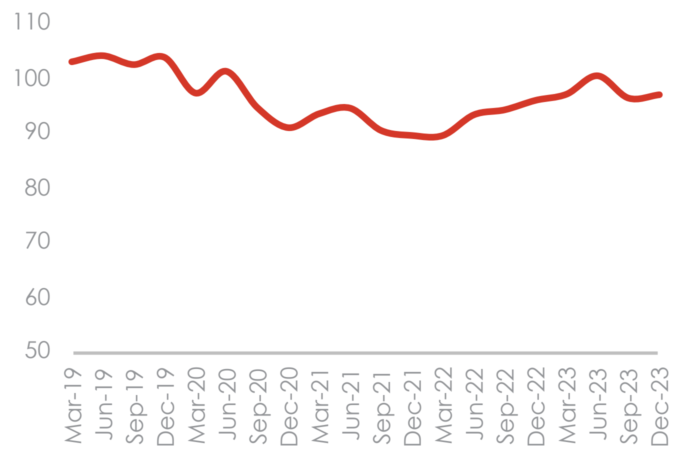
The sustained high policy rates across major advanced economies have precipitated a surge in mortgage rates, subsequently prompting a correction in housing prices. This combined with evolving working and shopping patterns, and subdued demand following the pandemic has notably affected commercial real estate in the United States and Europe, amplifying concerns about financial stability. Moreover, vulnerabilities in the Chinese property market continued to emerge presenting substantial downside risks. The stress in the real estate sector has the potential to propagate adverse effects across other domains. Some risks related to real estate materialized in February 2024,

**GRAPH 2.8**
**CHANGE IN EXPATRIATE POPULATION**



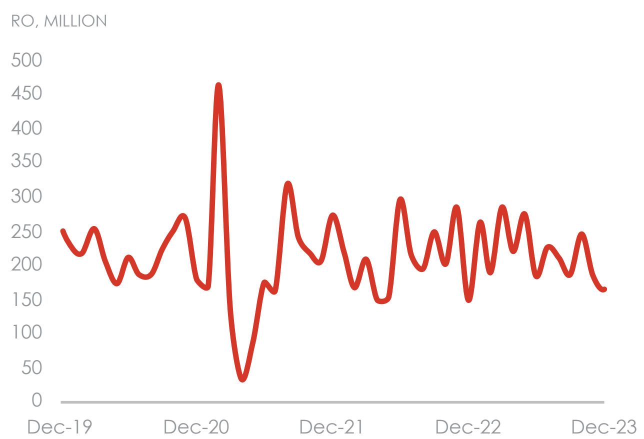

Source: National Center for Statistics and Information (NCSI)

**GRAPH 2.9**
**RESIDENTIAL REAL ESTATE PRICE INDEX**




Source: National Center For Statistics And Information (NCSI)

**GRAPH 2.10**
**VALUE OF PROPERTY TRADED**




SOURCE: MSX.OM

New York Community Bank (NYCB) created hefty provisions due to concerns about its commercial real estate portfolio. The resulting uncertainty caused not just a steep drop in the share price of NYCB, but also a broader loss in the regional banking index (Box 2.1: NYCB).

The Federal Reserve's decision to pause the tightening of monetary policy in June 2023 provided some respite; however, inflation, and looming uncertainties stemming from geopolitical tensions remain a source of concern.

## Oman's Demographics, Including the Growing Domestic Population and Returning Foreign Workforce Supports the Real Estate Market

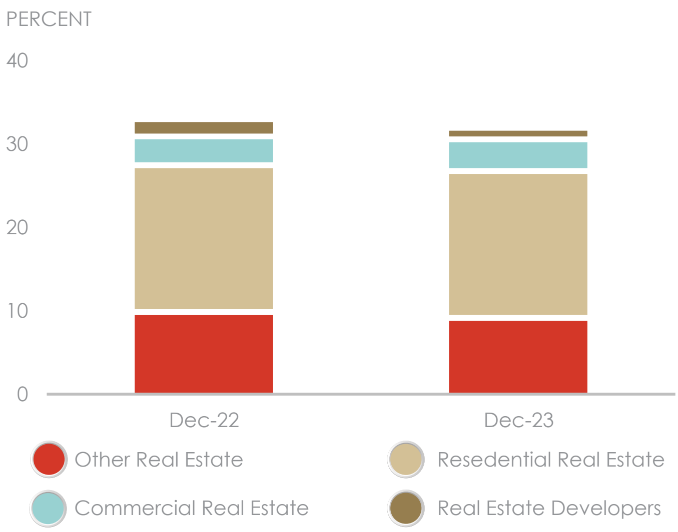
In contrast to trends observed in several advanced nations, Oman's real estate market began to rebound since the end of the COVID-19 Pandemic, buoyed by improving economic conditions. The recent recovery in the population profile, particularly the return of the foreign workforce, following the pandemic has also provided support to the Omani real estate market. The expatriate population, a significant consumer base for rental residential properties, surged by 8.25 percent in 2023 as compared to 2022(Graph 2.8). This increase coupled with a rise in the number of Omanis entering the workforce due to economic recovery, supported demand for real estate. Notably, despite the uptick in policy rates, there have been no indications of tightening lending standards for the real estate sector, with lending rates remaining stable.

As a result of these demographic shifts and economic improvements, the residential real estate index, which had dipped in 2021, saw a noteworthy recovery rising by 8 percent by 2023 (Graph 2.9). Furthermore, property transactions surged in 2023, signaling a growing activity in Oman's domestic real estate market (Graph 2.10).

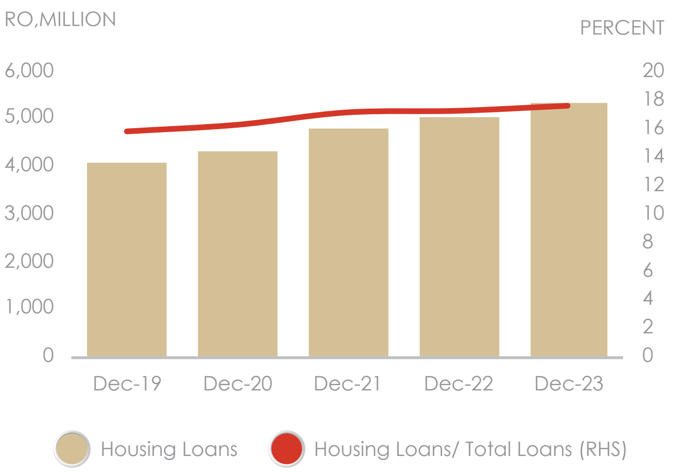
Moreover, CBO has recently broadened the scope of FLCs to encompass additional business activities, such as financing commercial projects and loans to the developers for the development of real estate projects (including the development of residential units). This strategic decision is intended to broaden FLC's activities and is also expected to support the real estate sector in Oman.

Overall, the recovery of the real estate sector in Oman is underpinned by strong fundamentals, and we do not foresee any imminent correction in the real estate prices.

**GRAPH 2.11**
**BANK'S REAL ESTATE FINANCING & EXPOSURE**




**GRAPH 2.12**
**RESIDENTIAL HOUSING LOANS**




## REAL ESTATE EXPOSURE AND MORTGAGE LENDING

### The Bulk of the Real Estate Exposure of Oman Banks Lies in the Safer Primary Residence of the Borrowers

The banking sector's total direct real estate exposure amounts to approximately 22.8 percent of its lending portfolio. Additionally, banks carry an indirect real estate exposure of 9.4 percent of its lending portfolio, where their financing to non-real estate businesses is secured by real estate collateral (Graph 2.11). Within the real estate exposure, residential mortgages account for a significant 17.7 percent of the total credit portfolio (Graph 2.12).

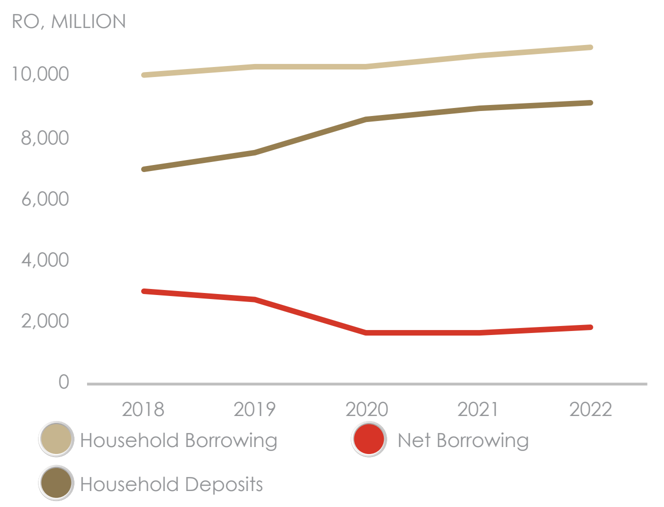
The Residential mortgages are considered relatively safe with over 90 percent of these loans allocated for the primary residences of the borrowers. Moreover, all mortgage loans are fixed-rate loans shielding borrowers from interest rate risks. Banks' exposure to commercial real estate, which is primarily under pressure in several countries, comprised only 3.7 percent of the overall lending portfolio. Following the stress in NYCB due to the commercial real estate portfolio, we conducted a stress test on commercial real estate portfolio of the banks. The results show that the Omani banking sector is resilient to a severe shock to commercial real estate (Box 2.1 NYCB – Commercial Real Estate Exposure in Oman).

## HOUSEHOLD INDEBTEDNESS

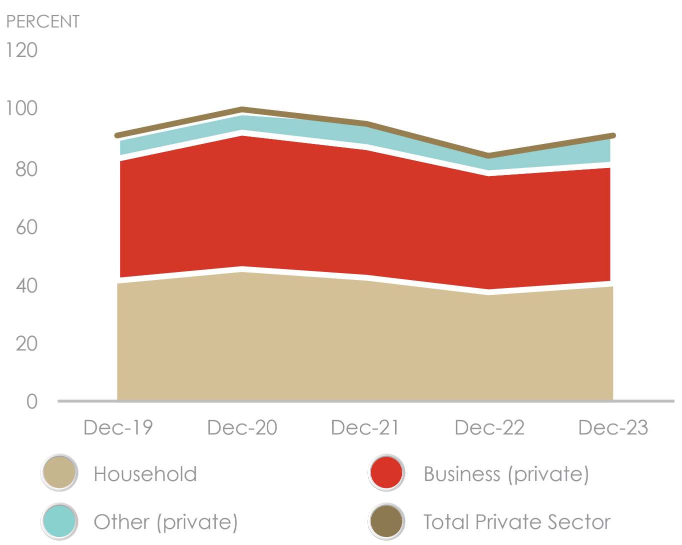
### Net Debt of Households Owed to the Banking Sector Rose As Borrowing Remains Affordable

The banks' lending to the household sector grew at a faster pace than the last year with a growth rate of 4.8 percent (2022: 2.8 percent; 2021: 3.3 percent) reaching RO 11.4 billion. Lending to individuals continues to constitute the largest segment catered by the banks forming around 37.7 percent of the total lending portfolio.

**GRAPH 2.13**
**HOUSEHOLD DEPOSITS AND BORROWING**




**GRAPH 2.14**
**SEGMENT WISE CREDIT TO NON-OIL GDP RATIO**




The banks' appetite for lending to households remained strong, as banks continued to offer loans at less than the personal loan ceiling interest rate of 6 percent. Thus, despite the high policy rate, the borrowing costs for households remained affordable, thereby sustaining their demand for credit. The 2024 edition of the Credit Conditions Survey showed that demand for household credit will stay strong in 2024.

As a result of the faster growth of household loans relative to deposits, the net borrowings of households rose by 5.8 percent in 2023 (Graph 2.13). Moreover, household indebtedness relative to nominal non-oil GDP (2023: 41.1 percent; 2022: 38.1 percent; 2021: 42.9 percent) increased. (Graph 2.14).

### Prudent Measures Mitigated the Risks Associated with Household Debt

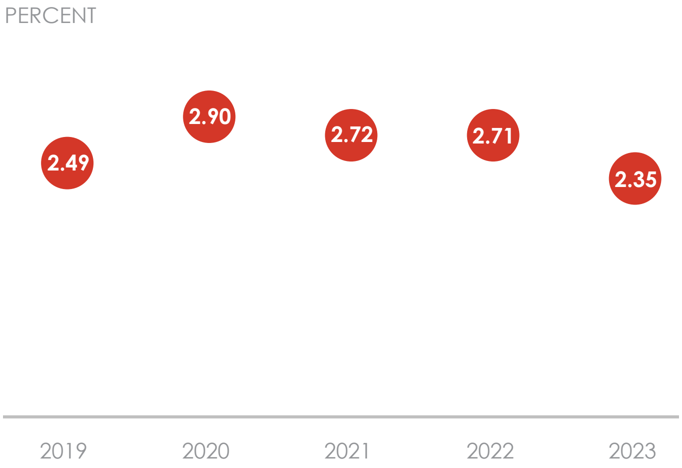
High household indebtedness may pose significant risks to banks and the broader economy. Elevated levels of household debt increase the vulnerability of household to economic shocks, which can lead to higher default rates on loans and mortgages. Moreover, a sharp correction in housing prices can exacerbate these risks, as it can erode the value of collateral underlying mortgage loans.

To mitigate the risks associated with excessive household indebtedness, CBO has implemented prudent measures aimed at preventing debt overhang scenarios. These measures include setting limits on consumer financing that are tied to borrowers repayment capacity, typically measured by income levels. By aligning aggregate loan limits with borrowers' ability to repay, CBO aims to prevent households from taking on debt burdens that exceed their financial means, reducing the likelihood of defaults and financial distress. Furthermore, CBO has imposed a quantitative ceiling on banks' lending to households, thereby curbing the extension of credit beyond prudent levels.

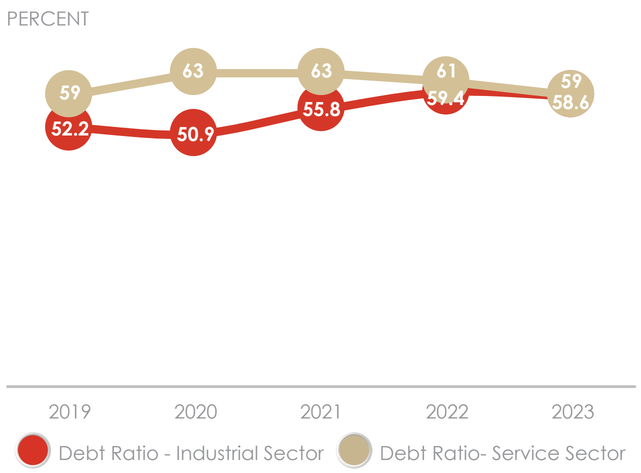
These regulations serve to safeguard both borrowers and lenders against the adverse consequences of overextended household debt, promoting financial stability and resilience within the banking sector. Moreover, as household debt is locked in at a fixed interest rate, the rise in interest rates since early 2022 has not affected the affordability metrics of household debt.

Notwithstanding the growth in households' balance sheets remained solid, with the household debt to non-oil GDP hovering close to the historical average. Moreover, due to the prudent policies of CBO and conservative practices of the banks, most of that debt is owed by households with strong credit histories or considerable home equity, further contributing to the resilience of the sector.

**GRAPH 2.15**
**NPL RATIO OF PERSONAL LOANS**




**GRAPH 2.16**
**DEBT RATIO (LIABILITIES TO TOTAL ASSETS)**




Source: MUSCAT STOCK EXCHANGE (MSX)

### Vulnerabilities Arising from Household Debt Remain Modest

Higher global inflation and interest rates have globally raised concerns about the sustainability of household debt. Households with lower incomes are disproportionately more vulnerable to soaring inflation as they have narrower buffers to maintain their debt servicing capacity in the face of rising costs.

Nevertheless, risks from these developments remain contained in Oman due to moderate inflation expectations, targeted subsidies to protect the more vulnerable strata from inflation, and fixed-rate personal (housing and non-housing) loans. Moreover, prudential regulatory norms and prudent underwriting standards of banks ensured that lending to households remained concentrated among borrowers with better credit profiles while maintaining adequate provisions. As a result, the historically low non-performing loan (NPL[3]) ratio for the household lending portfolio in Oman indicates a high level of credit quality (Graph 2.15).

## CORPORATE INDEBTEDNESS

### Low Corporate Indebtedness Augers Well for Financial Stability

In 2023, the banking sector's lending to private non-financial businesses expanded by 2.3 percent, reaching RO 10.7 billion by year-end. Nevertheless, the leverage (measured as total liabilities to total assets) of non-financial firms listed on MSX remains low signifying that the balance sheets of the non-financial businesses remained solid(Graph 2.16).

Excessive corporate leverage can amplify the impact of economic shocks leading to contagion effects and heightened systemic risks, therefore, a low level of corporate indebtedness augurs well for financial stability.

[3] Throughout the text, NPLs refer to Stage 3 or impaired loans.

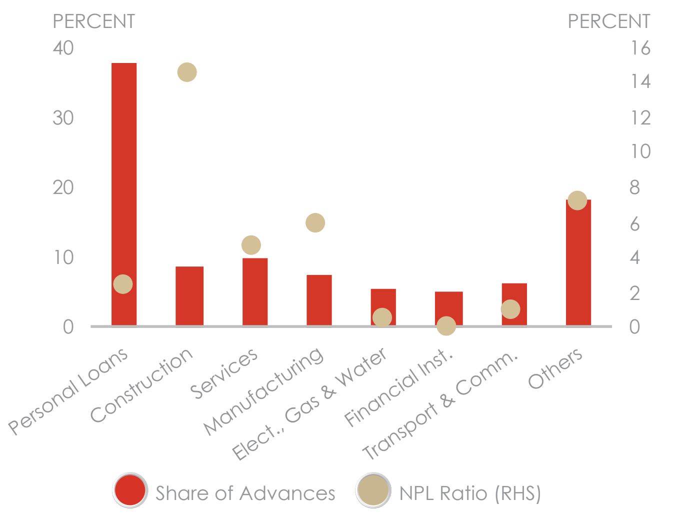
## CREDIT CONCENTRATION

### Concentration in Lending Portfolio Exposes Banks to Sector-specific Risks

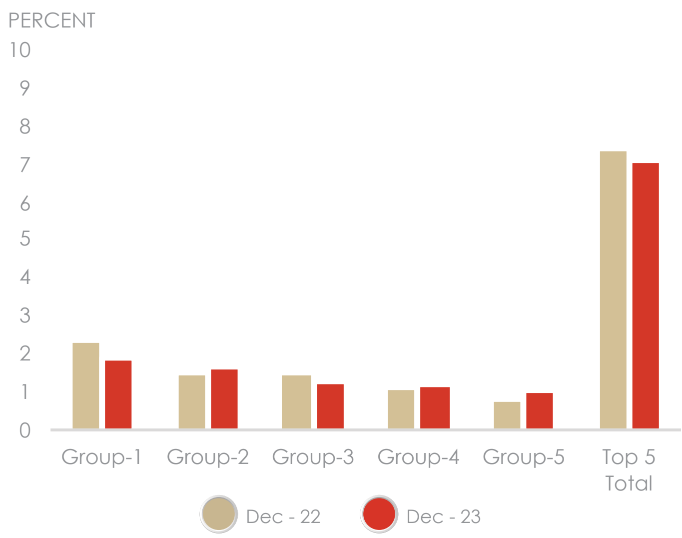
In 2023, personal loans continued to be the leading segment, accounting for about 37.7 percent of the banks' lending portfolio. Following this, credit extended to the service sector constituted around 10 percent of the total credit provided by banks (Graph 2.17).

Personal loans maintained a below-average NPL ratio, standing at 2.4 percent in 2023. The construction sector, ranking third in credit allocation from banks, exhibited the highest NPL ratio, reaching around 14.5 percent. Historically, the construction sector has shown lackluster performance even before the onset of the pandemic. However, with significant upcoming projects in Oman, including Sultan Haitham City, the UAE-Oman railway, and Al Khuwair downtown, among others, there is an expectation for an improvement in asset quality and lending to this sector.

**GRAPH 2.17**
**CONCENTRATION OF LOANS AND NPLs**




**GRAPH 2.18**
**CREDIT CONCENTRATION**




Manufacturing (7.6 percent share) is a priority sector for economic diversification as it is pivotal for job creation and economic development. Despite a decline of 3.3 percent in lending to the manufacturing sector, it is projected to continue growing in line with the objectives outlined in Vision 2040.

As of December 2023, loans extended to the five largest groups of borrowers totaled around RO 2 billion, representing about 7.1 percent of the overall lending portfolio. Prima facie it appears to be a significant concentration, however, these borrowers comprise well-diversified groups, which mitigates the likelihood of simultaneous default across all entities (Graph 2.18).

### Tightening of Lending Standards Define the Landscape of Small Business Credit

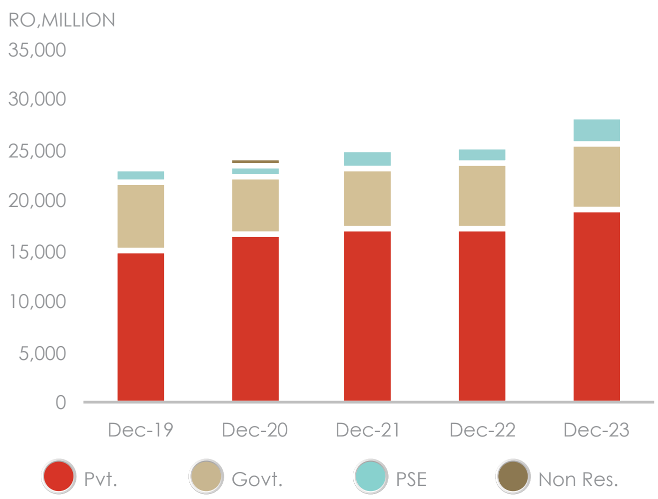
Lending to small and medium enterprises (SMEs) increased by 2.9 percent during 2023. Nevertheless, the total lending by the banking sector to SMEs remained a meager 2.9 percent of the total credit of the banking sector. Credit availability appeared to tighten for SMEs during 2023. The 2024 edition of the Credit Conditions Survey showed that the survey participants believe further tightening of lending standards for SMEs in 2024, which could be due to the deterioration of their credit quality.

## FUNDING CONCENTRATION

### Savings Surged with Attractive Deposit Rates for Term Deposits

In 2023, private sector deposits, constituting approximately 66 percent of the total deposits, experienced a notable increase of 10.6 percent. This growth in private sector deposits is attributed to increased lending to the sector and higher deposit rates, particularly available for term deposits.

**GRAPH 2.19**
**STRUCTURE OF DEPOSITS**



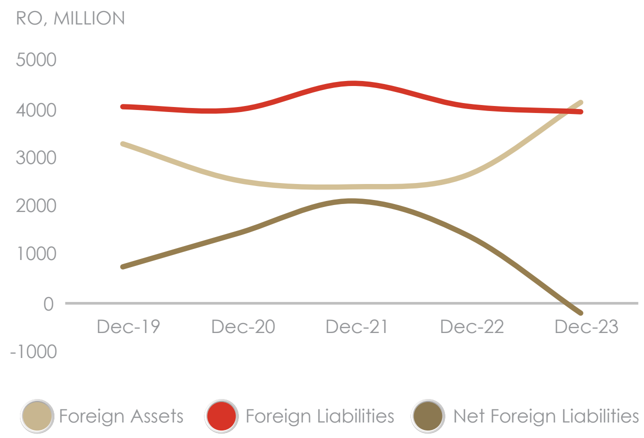

Deposits from the public sector entities (PSEs) substantially increased by 49 percent largely due to better performance of public sector enterprises. (Graph 2.19).

Government and PSEs deposit concentration continues to be high and is currently close to the pre-pandemic levels (December 23: Government proper 23 percent of total deposits; 32 percent including PSE).

### Banks' Reliance on Wholesale Funding Remained Low as Net Non-resident Liabilities of the Banking Sector Further Decline

Non-resident funding continues to represent a relatively small portion of the banks' overall balance sheets. This indicates that the banks rely less on external wholesale funding and their balance sheets are primarily funded by customer deposits. In 2023, the net foreign liabilities of banks turned negative for the first time since 2016. This decrease can primarily be attributed to (i) a rise in banks' investments in foreign T-bills due to their excess FX liquidity and attractive yields on foreign T-bills, and (ii) a decline in borrowing from abroad as it became expensive due to the tightening of funding conditions in overseas markets (Graph 2.20).

**GRAPH 2.20**
**NON-RESIDENT ASSETS AND LIABILITIES**



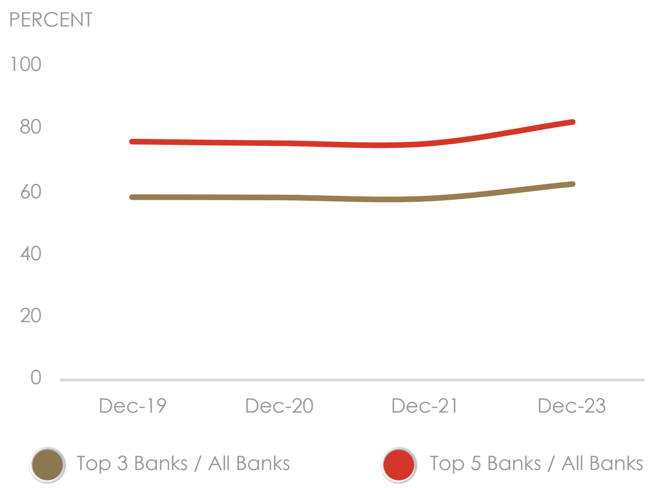
## MARKET CONCENTRATION

### Banking Sector Concentration Remained Moderately High – Closer Regulatory Watch Helped Deal with the Systemically Significant Banks

The Omani banking sector continued to exhibit a moderate level of concentration, as evidenced by the Herfindahl-Hirschman Index, which suggests that a few banks hold a significant portion of the market share. Another measure of concentration in the banking sector is the share of the largest few banks in terms of total banking sector assets. In 2023, the largest bank accounted for approximately 34 percent of the sector's assets, indicating its substantial size and influence within the industry. Furthermore, the combined assets of the top five banks constituted around 82 percent of the total banking sector assets, while the top three banks accounted for approximately 62 percent. The rise in the concentration of the banking sector as compared to the previous years is largely due to the merger of two banks (Graph 2.21).

The higher concentration observed in Oman's banking sector is not unexpected, given the relatively small size of the market.

**GRAPH 2.21**
**BANKING SECTOR CONCENTRATION - BY TOTAL ASSETS**




It is important to note that this concentration is primarily present in sound and robust institutions, which helps mitigate some of its potential adverse consequences.

To address the risks associated with the presence of "too big to fail" institutions, the Central Bank of Oman (CBO) has implemented guidelines to identify, supervise, and regulate Domestic Systemically Important Banks (D-SIBs). The purpose of these guidelines is to ensure closer monitoring and supervision of identified D-SIBs, given their systemic importance.

D-SIBs in Oman are subject to additional regulatory requirements, including a systemic risk surcharge of CET1 capital amounting to one percent of risk-weighted assets. This surcharge serves as a buffer to enhance their resilience and ability to withstand potential shocks. D-SIBs are also subjected to more intensive stress testing regimes to assess their resilience under adverse scenarios.

Furthermore, D-SIBs are required to develop recovery plans, which enable them to undertake self-propelled recovery efforts in case of financial distress. Moreover, CBO also prepares and maintains detailed resolution plans for the D-SIBs, with an aim to allow it to resolve D-SIBs in an orderly manner if circumstances require intervention while minimizing disruptions and costs to the national exchequer and safeguarding financial stability.

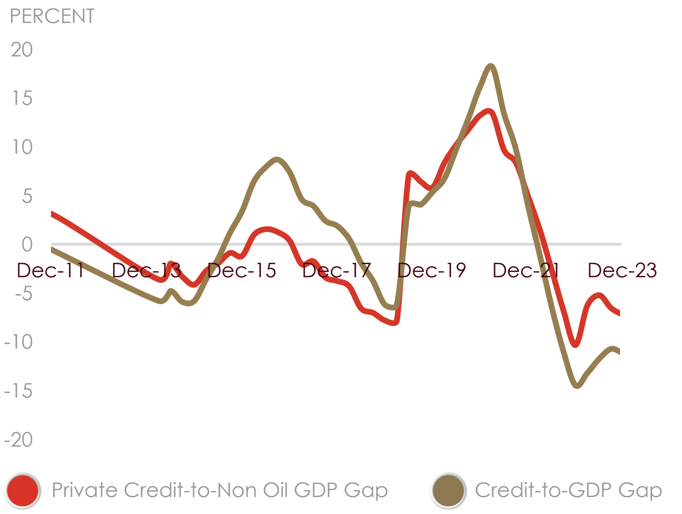
By implementing these measures, CBO aims to mitigate the potential risks associated with concentrated banking institutions, ensuring that they are adequately supervised, and prepared for contingencies, and their failure is managed in a manner that minimizes systemic disruptions and preserves financial stability.

## BUILD-UP OF SYSTEMIC RISKS

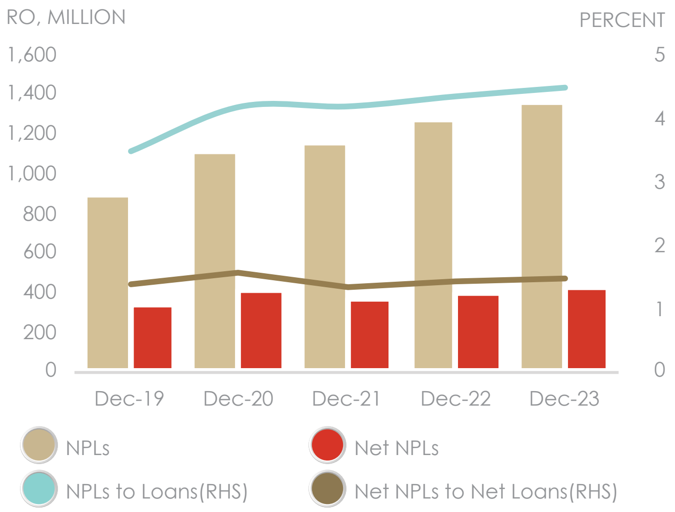
### Despite Some Pick-up in Private Sector Credit Growth, There Are No Signs of Excessive Risk-Taking

The Private Sector Credit-to-GDP Gap (Private Sector Credit-to-GDP Ratio minus the Trend of Private Sector Credit-to-GDP ratio) is a key indicator in determining the excessive credit growth and Countercyclical Capital Buffers (CCyB) in Oman. The growth in GDP in 2021 relative to the growth in credit has led to the indicator reaching negative territory, indicating that credit expansion did not match the pace of GDP growth. Despite a contraction in nominal GDP in 2023, the gap remained negative because of moderate growth in private-sector credit (Graph 2.22). The gap suggests that there are no indications of excessive credit expansion or widespread risks stemming from credit

**GRAPH 2.22**
**PRIVATE CREDIT GAP**




**GRAPH 2.23**
**TRENDS IN NON-PERFORMING (STAGE 3) LOANS**




expansion. Consequently, CBO maintained the (CCyB) requirements at zero percent throughout 2023.

### Bank Lending to Finance & Leasing Companies Increased but Constituted a Small Portion of the Banking Sector Credit

Bank lending to non-bank financial institutions (NBFIs) provides insight into the leverage employed by these entities and their interconnectedness within the broader financial system. Following a decline during the COVID-19 pandemic, lending to Finance & Leasing Companies (FLCs) has rebounded since 2022, rising by 25.7 percent over the last two years (2022 and 2023). Despite this growth, such lending still represents a small proportion (2.1 percent) of banks' total lending portfolio. Similarly, lending to insurance companies and pension funds remains negligible, accounting for just 0.24 percent and 0.08 percent of total credit, respectively. Although tightened financial conditions may expose vulnerabilities in the NBFIs, the systemic risk posed by potential contagion from it remains limited.

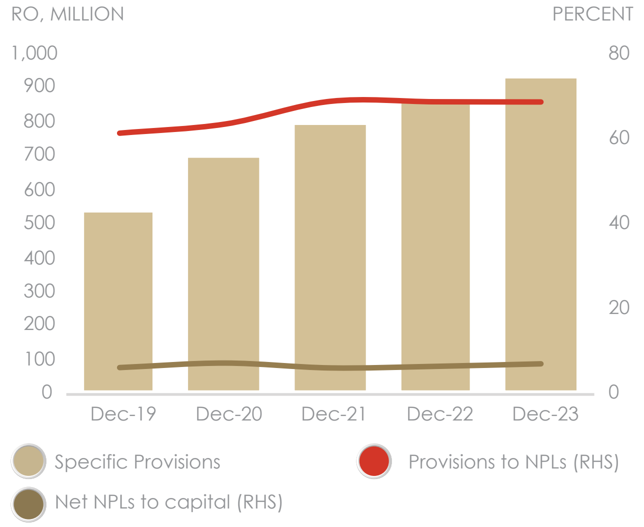
## CREDIT RISK

### Asset Quality of the Banking Sector Remains Strong

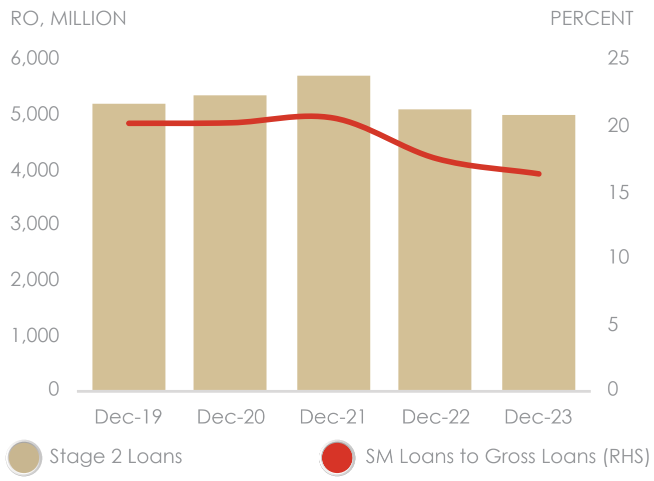
Credit risk remained a crucial component in the risk profile of the banking sector with the credit risk-weighted assets forming around 91percent of the total risk-weighted assets. Asset quality remained well-contained with a low NPL ratio and adequate provision coverage.

At the close of 2023, the stock gross NPLs amounted to RO 1.4 billion, up from RO 1.3 billion in 2022. Thus, the NPLs were 4.5 percent of banks' gross loans in December 2023 compared to 4.4 percent in the previous year (Graph 2.23). The asset quality of the Islamic banking financing portfolio also remained robust, with an NPF ratio of 2.8 percent at the end of December 2023.

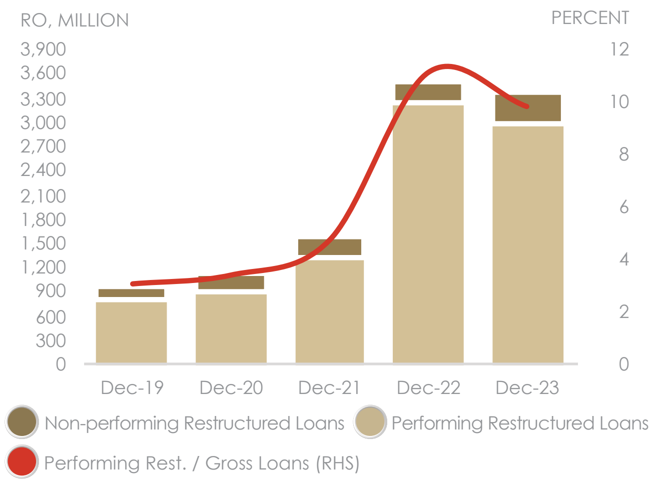
**GRAPH 2.24**
**PROVISIONS AGAINST NPLs**




**GRAPH 2.25**
**STAGE 2 LOANS**




**GRAPH 2.26**
**RESTRUCTURED LOANS**




The NPLs are adequately covered by provisions with a Stage 3 (NPL) coverage ratio of 69.7 percent, which increased to 117.4 percent when including provisions for Stage 1 and Stage 2 loans (Graph 2.24). Thus, NPLs net of provisions of the banking sector amounted to RO 413.9 million or 1.4 percent of the net loans at the end of 2023, underscoring sufficient coverage against potential credit losses.

## A Decline in Stage 2 Loans Indicates an Improvement in Asset Quality

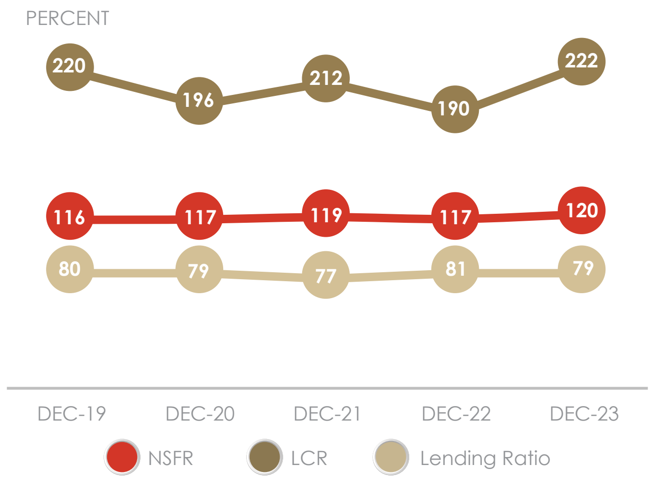
Stage 2 loans refer to the loans "that have experienced a significant increase in credit risk since initial recognition but yet does not showcase impairment", thus they are not classified as NPLs or Stage 3. These loans require closer monitoring and higher provisions compared to Stage 1 loans. Restructured loans, on the other hand, are loans that have been modified to provide some concession to the borrower facing financial difficulties, potentially indicating higher credit risk. Both Stage 2 and restructured loans serve as early warning indicators of potential credit issues, highlighting the need for banks' to maintain strong risk management practices and adequate provisions to mitigate future credit losses.

The improvement in operating conditions since the subsidence of the pandemic has led to an improvement in the banks' Stage 2 loans with a drop of RO 728 million from the year 2021 to 2023(Graph 2.25).

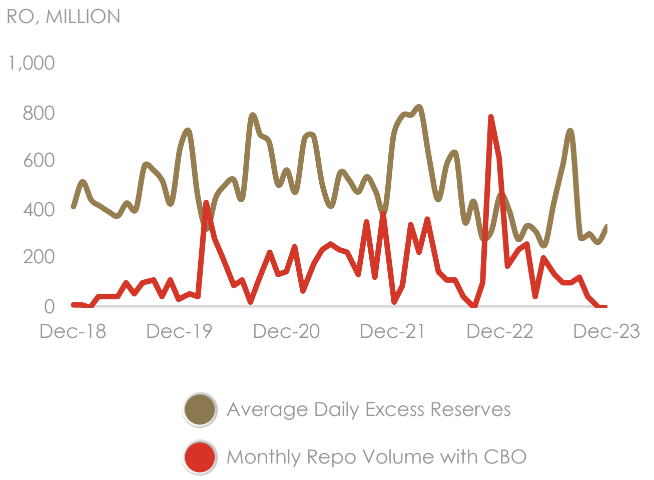
Similarly, the total restructured loans in 2023 also declined by 4 percent reaching RO 3.4 billion (2022: RO 3.5 billion) with 92 percent in Stage 1 or 2 categories (Graph 2.26). The drop in both Stage 2 and restructured loans is an indication of improved asset quality of the banking sector.

Presently, there are no visible signs of credit risks materializing for Stage 2 loans or restructured loans. Moreover, the stress tests indicate that banks remain resilient to a battery of rigorous shocks to their credit portfolio (Section 3: Resilience of the Banking System). Nevertheless, the large volume of Stage 2 and restructured loans warrant vigilant scrutiny and concerted efforts to monitor and manage these loans effectively.

**GRAPH 2.27**
**PRUDENTIAL LIQUIDITY INDICATORS**




**GRAPH 2.28**
**EXCESS RESERVES AND REPO VOLUMES**




## LIQUIDITY RISK

### Banking System Continued to Hold Large Liquidity Buffers and Systemic Liquidity Remained Ample Amid Monetary Policy Tightening

The banking sector has maintained a high level of liquidity during 2023. Banks' prudential liquidity measures remained robust. The lending ratio of banks stood at 79.2 percent at the end of the year 2023, well below the ceiling of 87.5 percent Both LCR (222 percent) and NSFR (120 percent) exceeded the regulatory requirements (100 percent) during 2023 (Graph 2.27). This indicates that banks have maintained satisfactory levels of liquidity to meet their obligations.

Liquidity stress tests also highlight the resilience of the banks against assumed deposit run-off and higher haircuts for liquid assets (Section 3: Resilience of the Banking System).

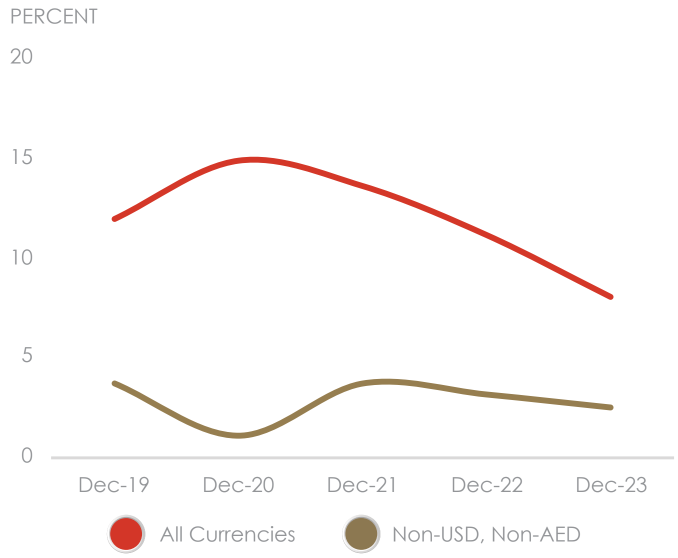
The average daily excess cash reserves in the banking system were RO 374 million in 2023 down from RO 542 million in 2022 in line with the tighter monetary policy. The average daily excess reserves, net of liquidity facilities from CBO, were RO 291 million during 2023 compared to RO 360 million in 2022. In 2023, there was a large reduction in the utilization of CBO's liquidity facilities. The total value of Repos, representing secured borrowing by banks from the CBO, amounted to RO 1.4 billion in 2023, down from RO 3 billion in 2022 (Graph 2.28).

## MARKET RISK

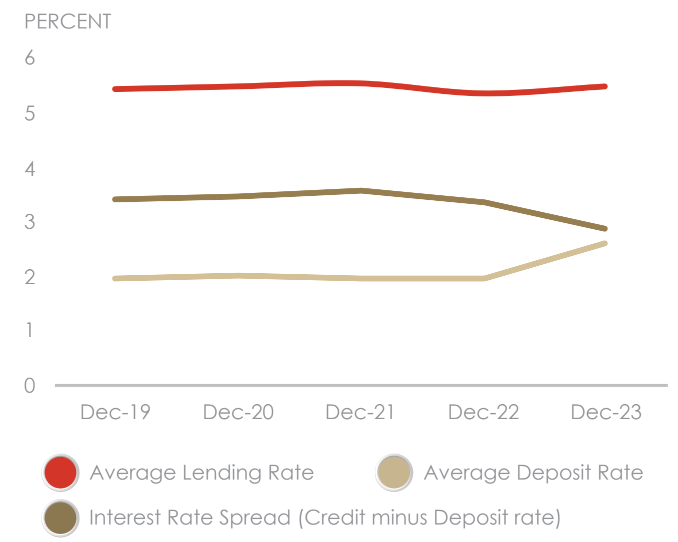
### Low Foreign Exchange Exposure Bodes Well for the Stability of the Banking Sector

According to regulations stipulated by the Central Bank of Oman, banks are permitted to maintain foreign exchange exposure of up to 40 percent of their tier 1 capital. However, banks in Oman have consistently maintained their FX exposures significantly below this threshold. Historically, banks' FX exposures have stayed below 20 percent of their tier 1 capital (Graph 2.29).

**GRAPH 2.29**
**FOREX EXPOSURE TO TIER-1 CAPITAL**




**GRAPH 2.30**
**CREDIT AND DEPOSIT RATES (RO PORTFOLIO)**




The FX exposure to Tier 1 capital at the end of 2023 was about 8.6 percent, (2022: 10.8 percent). Since the Omani Rial (and currencies of most other GCC countries) are pegged to the USD, exposures in USD (and other currencies pegged to USD) do not entail any FX risk . The effective FX exposure (exposure in non-USD and other non-pegged currencies) remained even much lower at about 2.2 percent of their Tier 1 capital. This conservative approach to FX exposure highlights the prudent risk management practices adopted by banks in Oman.

### Monetary Policy Remained Restrictive Throughout the Year. Pass-through to Retail Rates in Oman Remained Limited

Between March 2022 and July 2023, the US Federal Reserve has incrementally raised the policy rates (Fed Fund Target Range) by 5.5 percentage points across 11 successive rate revisions. Following this, CBO has also gradually raised its repo rate from 0.5 percent in March 2022 to 6 percent in July 2023. The overnight Rial Omani domestic interbank lending rate increased to 5.42 percent in December 2023 from 4.27 percent a year ago.

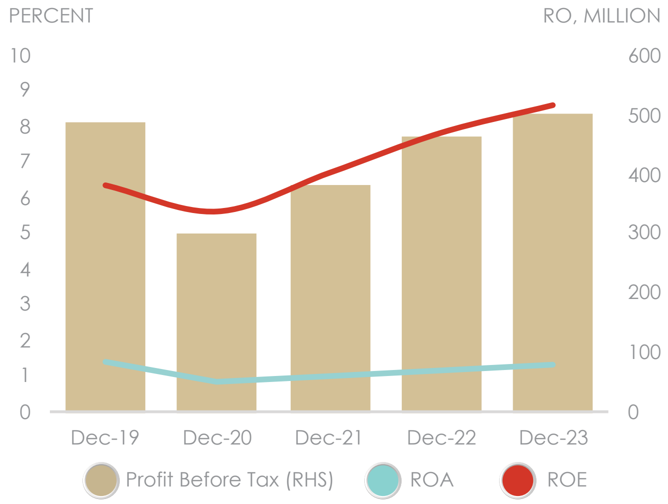
However, in Oman, the interest rate pass-through is not complete. Thus, so far, the increase in policy and interbank rates has not materially affected average retail interest rates. The weighted average interest rate on RO deposit (Dec-23: 2.64 percent; Dec-22: 1.99 percent) and RO lending (Dec-2023: 5.51 percent; Dec-2022: 5.38 percent) slightly inched up (Graph 2.30). The policy rates are expected to remain at these levels during the first half of 2024. Going forward, if the monetary policy remains tight, there could be pressure on retail rates, which may dampen demand for credit from the private sector.

## BUFFERS – PROFITABILITY AND SOLVENCY

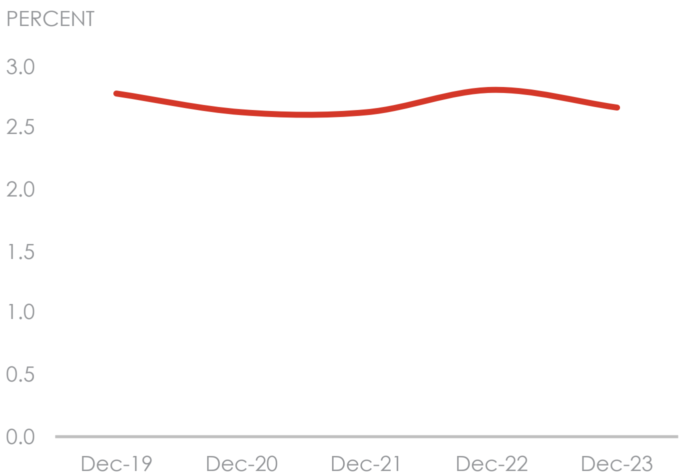
### Amid Healthy Operation Conditions, Banks Witnessed Notable Improvements in their Profitability Metrics

In 2023, the banking sector exhibited strong financial performance, as evidenced by pre-tax profits rising to RO 502 million, marking an increase from RO 464 million in the previous year (Graph 2.31). The ROA and ROE of banks also remained in line with the historical trends. While banks maintained their Net Interest Margin, this increase can be primarily attributed to the increase in both 'net foreign exchange income' and 'other income (Graph 2.32).

**GRAPH 2.31**
**PROFITABILITY OF THE BANKING SECTOR**




**GRAPH 2.32**
**NET INTEREST MARGIN**




### Large Capital Buffers by Banks Highlight their Ability to Absorb Unexpected Losses

The banking sector in Oman displayed robust capitalization, boasting common equity tier-1 capital ratio (CET1) of approximately 14.2 percent at the end of 2023, which itself is sufficient to fulfill the total regulatory capital requirement of 13.5 percent. This underscores the strength of banks' capital buffers. Additionally, the overall capital adequacy of banks, measured by the capital-to-risk weighted assets ratio (CRAR), averaged at 19.0 percent in December 2023. The strong capital position of the banking sector further instills confidence in its resilience to weather any adverse shocks.There is also a time lag before credit risks can be observed in the data. It is therefore important for banks to take not only the increased risks, but also their resilience, into account going forward in designing their capital policies

The stress testing exercise (Section 3: Resilience of the Banking Sector) shows that the banking system remains resilient to various stress scenarios. Even when severe credit and market shocks are applied, domestic banks remain solvent with a comfortable level of system-wide CRAR that exceeds regulatory requirements.

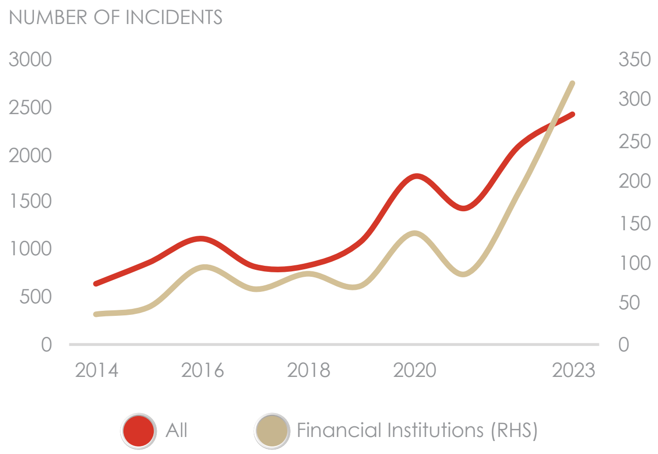
## EMERGING RISKS TO FINANCIAL STABILITY

### Growing Cyber Risks Globally Pose Risks for Financial Stability

With the increasing use of technology, the frequency of cyber-attacks is also on the rise. Between 2014 and 2023, cyber events increased by 4 times, whereas cyber-attacks in the 'finance and insurance' sector increased by nearly 9 times during this period. In 2023, the globally reported cyber-attacks reached a new peak with a 16 percent increase during the year, whereas, the reported cyber incidents in the 'finance and insurance' sector surged by 70 percent during 2023 (Graph 2.33).

The disproportionate increase in cyber-attacks on the financial sector highlights its attractiveness as a prime target for cybercriminals due to the potential for substantial gains. The use of outsourcing arrangements in financial institutions increases their vulnerability by creating additional entry points for cyber events. Although Oman has not faced significant disruptions from cyber risks recently, financial institutions have been victims in other jurisdictions, as such the Omani financial sector also remains vulnerable to cyber-attacks. Consequently, cybersecurity continues to be a top strategic priority for the Central Bank of Oman (CBO). Despite the increased demands on payment and settlement systems (PSS) since the pandemic, Oman's PSS infrastructure has remained resilient and robust (Box 2.3 gives an overview of Omani PSS).

**GRAPH 2.33**
**GLOBAL CYBER EVENTS**




SOURCE: CISSM, University of Maryland

The CBO is actively monitoring developments in various emerging areas and has established task forces dedicated to studying Central Bank Digital Currencies (CBDCs) and other digital innovations. This proactive approach allows the CBO to equip itself with the expertise required to navigate the evolving landscape of digital finance and stay prepared to take appropriate action when necessary.

### Risks Associated with Climate Change Pose Challenges for Financial Stability and its Assessment

The effects of climate change are becoming increasingly apparent as the materialization of climate risks becomes more pronounced and frequent in Oman and other countries. Climate change risks also pose significant concerns to the financial system, giving rise to both micro and macroprudential risks. The increase in extreme weather events underscores the urgent need to accelerate comprehensive climate risk management to protect economic stability and ensure sustainable growth. The impacts of climate change, such as weather events, can have profound implications for individual financial institutions (micro-prudential risk) as well as the stability of the entire financial system (macroprudential risk). These risks include physical risks (direct impacts from climate-related events), transition risks (risks associated with the transition to a low-carbon or green economy), and liability risks (legal or financial consequences arising from climate-related damages). It is crucial for financial regulators, policymakers, and institutions to proactively consider, manage and mitigate these risks to safeguard the stability and resilience of the financial system in the face of ongoing climate change. Moreover, financial institutions, especially in hydrocarbon-dependent countries like Oman, face an additional challenge in addressing the implications of transitioning to a greener and low-carbon economy. The shift towards reducing carbon footprints requires significant changes in the structure of the economy, which can have profound implications for the operations, investments, and overall business strategies of these institutions. This transition may involve a fundamental restructuring of industries, diversification of revenues for the government and businesses, and the adoption of sustainable practices. Financial institutions need to actively assess and manage the risks and opportunities associated with this transition to ensure long-term viability and resilience in a changing economic landscape.

Assessment of climate risks remains a challenge because of the difficult-to-predict shocks and significantly long-time horizon spanning over decades for modeling and analysis of transition risks. CBO is working on expanding its capacity to formally incorporate these risks in its assessment of financial stability. As part of national efforts to tackle climate risks, CBO is actively involved in fulfilling its responsibilities. It has advised banks and financial leasing companies (FLCs) to refine their risk management policies and practices in line with the Basel consultative paper on 'Principles for the effective management and supervision of Climate-related financial risks'.

Furthermore, CBO has prepared a preliminary roadmap aimed at fostering sustainable and green financing besides other best ESG practices within the Omani financial system. This roadmap will be implemented to promote environmentally friendly financial practices.

## Box 2.1: Islamic Banking Sector in Oman

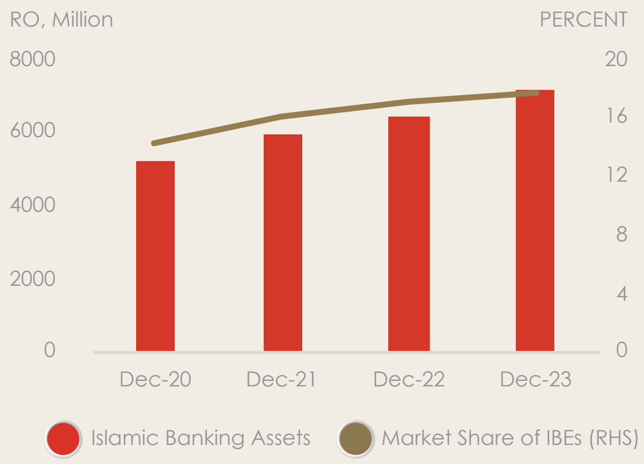
In the Sultanate of Oman, the Islamic banking sector comprises two standalone Islamic banks and five Islamic banking windows. This sector has shown notable growth since its inception in 2012. The significance of Islamic banking is on the rise as it progressively gains a larger market share. By December 2023, Islamic banking assets constituted 17.6 percent of the overall banking sector assets, up from 16.5 percent in December 2022 (Graph 2.1.1).

With a growth of 10.7 percent during the year, total Islamic banking assets reached to RO 7.1 billion at the end of 2023. This expansion of total assets is predominantly propelled by financing activities, which grew by 10 percent during 2023. Similarly, on the funding side, total deposits grew by 12 percent in 2023 (Graph 2.1.2).

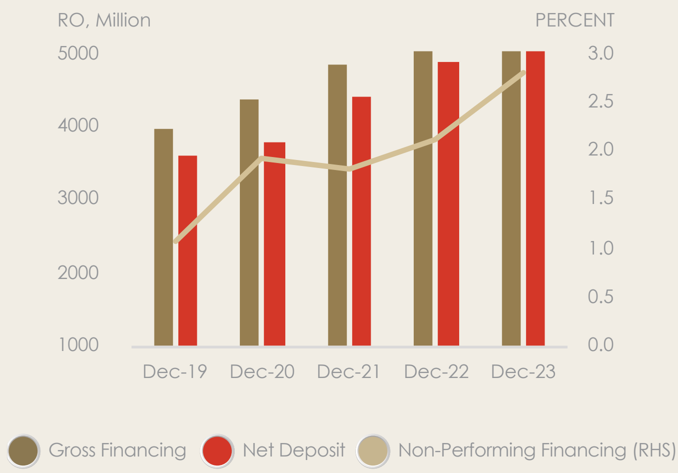
This significant growth in financing activities has led to a marginal rise in the financing-to-deposit ratio, which decreased to 108.9 percent at the end of December 2023, compared to 111.4 percent in the preceding year. Furthermore, the sector maintains robust solvency, with a capital adequacy ratio of 15.8 percent as of December 2023, exceeding the regulatory requirement of 13.5 percent.

Credit Risk, as gauged by asset quality indicators, remains well managed despite an increase in the non-performing financing (NPF) ratio, which rose to 2.8 percent in December 2023 from 2.1 percent in 2022 (Graph 2.1.2). The corporate sector drove the majority of financing flows, contributing 61.7 percent as of December 2023. The household/retail sector accounted for 35.3 percent (2022: 36.5 percent), followed by small and medium enterprises at 2.9 percent.

**GRAPH 2.1.1**
**ISLAMIC BANKING ASSET GROWTH & MARKET SHARE**




**GRAPH 2.1.2**
**GROWTH IN DEPOSITS,FINANCING AND NPF**

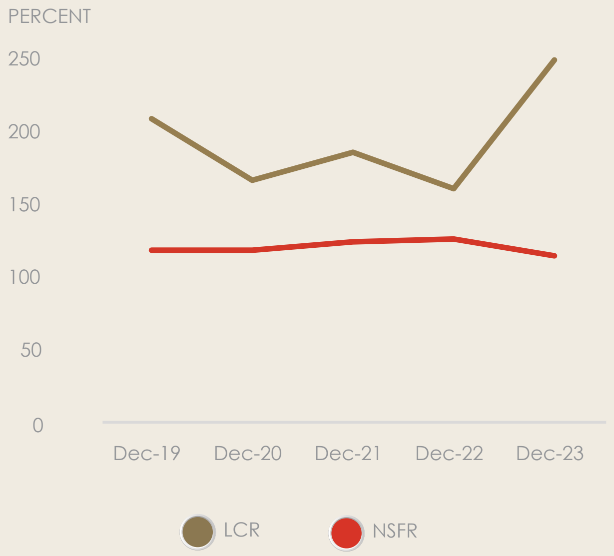


In terms of the mode of financing, the participatory mode, consisting of diminishing Musharaka and Ijara, continued to dominate the flow of financing, contributing 55.0 percent and 17.1 percent, respectively. The share of Wakala Bil Istithmar was 15.3 percent, followed by Murabaha at 10.1 percent.

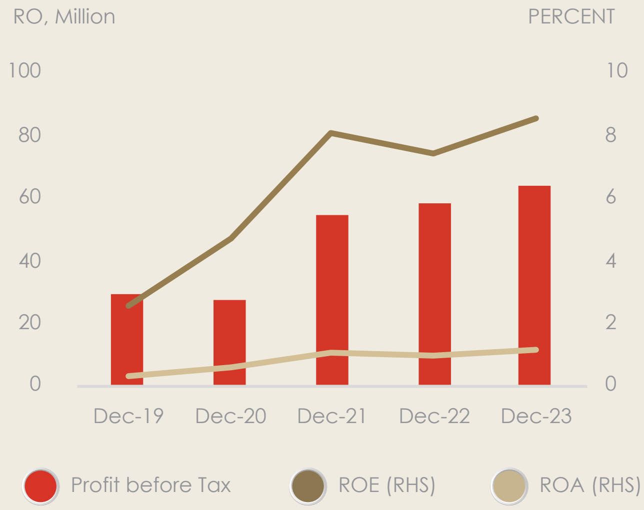
The net profits of the sector witnessed a notable growth of 9.2 percent over the year. Moreover, the Return on Assets (ROA) and Return on Equity (ROE) of the sector improved in 2023, which stood at 1.1 percent (2022: 0.97 percent) and 8.5 percent (2022: 7.43 percent), respectively (Graph 2.1.4). The prudential liquidity indicators signify a robust liquidity position in the sector. As of December 2023, the Liquidity Coverage Ratio (LCR) stood at 248.60 percent (2022: 160.1 percent), well above the regulatory requirement of 100 percent. The Net Stable Funding Ratio (NSFR) slightly dropped to 114.6 percent, compared to 125.81 percent in 2022, but remained comfortably above the regulatory threshold of 100 percent (Graph 2.1.3).

Overall, the Islamic banking sector, though starting with a modest market share, has shown significant growth and made substantial contributions to new financing and deposit growth in the banking market since its inception.

**GRAPH 2.1.3**
**ISLAMIC BANKING LIQUIDITY INDICATORS**




**GRAPH 2.1.4**
**PROFITABILITY OF IBES**



## Box 2.2: Overview of Payment and Settlements Activities

### Recent Advancements in Oman's Payment System Infrastructure

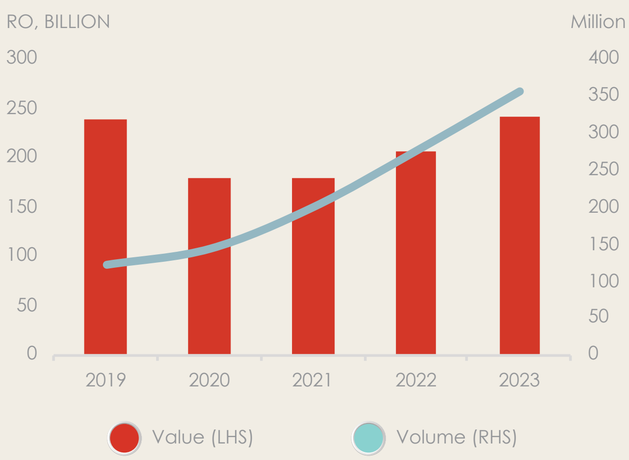
The issuance of Royal Decree No. 6/2023 marked a significant development in Oman's payment systems landscape where it ratified the agreement on the system for linking payment systems between the countries of the Gulf Cooperation Council (GCC). This agreement paves the way for seamless cross-border payments within the GCC, fostering regional financial integration and economic cooperation.

The Central Bank of Oman (CBO) is diligently advancing various initiatives to ensure a robust and modern payment infrastructure in line with global developments. Notably, the CBO has upgraded the Real-Time Gross Settlement (RTGS) and Automated Clearing House (ACH) systems to comply with the latest technological standards. The introduction of the RTGS 24/7 system - being the first GCC country to implement a 24/7 RTGS system - enables financial transactions to be processed and settled at any time, including outside of regular banking hours to enable seamless and uninterrupted electronic funds transfers. This upgrade enhanced the efficiency and security of interbank settlements, as well as facilitated faster and more reliable transactions, and contributed to improved liquidity management for all participants.

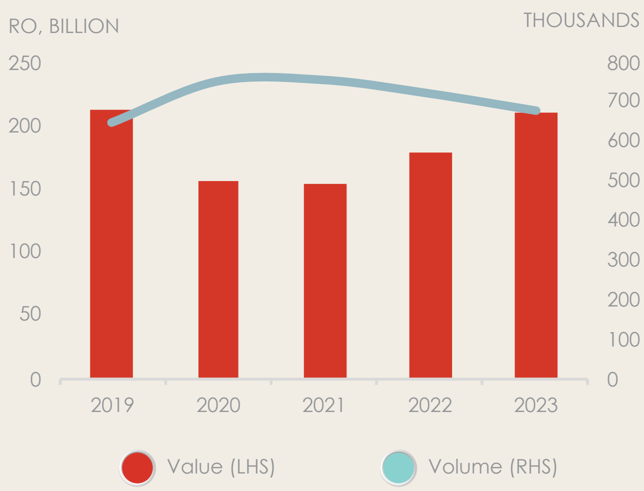
Additionally, CBO is working on enhancing the wage protection system (WPS) by introducing new features and enabling the Ministry of Labor to closely monitor wages in the private sector. Banks have also been directed to comply with the rules and regulations governing the wage protection system.

CBO is committed to promoting the use of electronic payment methods; by launching two key initiatives: the implementation of International Bank Account Numbers (IBAN) and the issuance guidelines for Card Tokenization services. The first initiative facilitates communication through the use of the universally accepted IBAN, allowing for seamless and accurate international cross-border transactions. The second initiative enables domestic and international electronic payment applications (Apple Pay, Samsun Pay, etc.) on smart devices to activate their services in the Sultanate of Oman.

GRAPH 2.2.1
AGGREGATE VALUES & VOLUMES




GRAPH 2.2.2
RTGS VALUES & VOLUMES (CBO OPERATED)



## Insights into Payment Activities During 2023

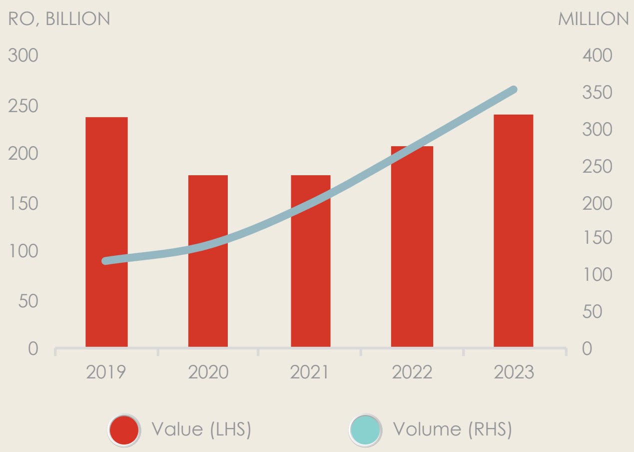
The number of transactions handled within the Payment and Settlement Systems (PSS) has shown a steady increase, with a growth rate of 22.5 percent in 2023. During the year, the system processed a total of 355.9 million transactions, compared to 275.9 million transactions in 2022. Likewise, the total value of transactions conducted through the system experienced a 13.9 percent growth from the previous year. In 2023, the aggregate value reached RO 240.1 billion, compared to RO 206.6 billion in the previous year (Graph 2.2.1).
During 2023, there was a slight decline of 6.36 percent in the number of bank transfers made through the RTGS system. However, the value of these transfers experienced a notable increase of 14.5 percent compared to 2022, rising from RO 179.3 billion to RO 209.9 billion. On average, the daily value of these transfers amounted to approximately RO 575 million (Graph 2.2.2).

## E-Payments

The total volume of retail transactions has experienced a significant exponential growth of 22.5 percent compared to the previous year. In 2023, the number of transactions reached 355.2 million, up from 274.4 million in 2022. Additionally, the value of transactions conducted through retail systems increased by 9.70 percent, reaching a total value of RO 30.2 billion (Graph 2.2.3).

The significant growth in the volume of transactions processed through retail payment systems since 2021 can be attributed to several factors. A key driver behind this growth is the wider adoption of E-payment methods and the increasing shift away from cash usage. As people increasingly embrace digital transactions, E-payment services have become more prevalent, especially during the pandemic when safer and faster online payments were in high demand.

**GRAPH 2.2.3**
**RETAIL PAYMENT SYSTEMS VALUES & VOLUMES**



The progress made in terms of the reach and utilization of these payment systems has been remarkable. Notably, the volume and value of transactions conducted through the Automated Clearing House (ACH) have seen an 18 percent increase. Similarly, the usage of OmanNet, another electronic payment system, has risen by nearly 30 percent in terms of transactions and around 10 percent in terms of value.

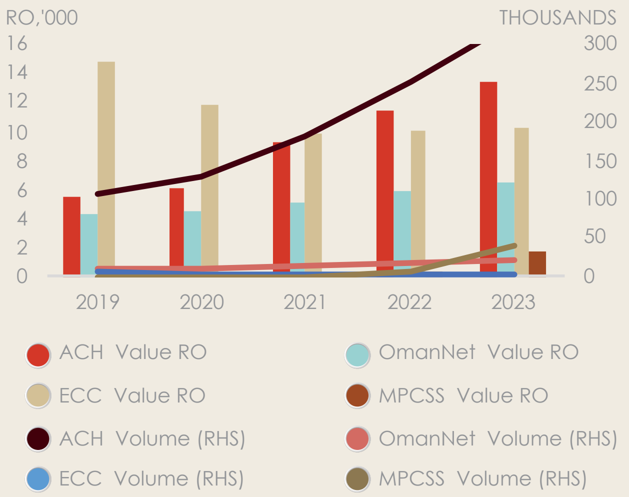
In contrast, traditional paper-based payment methods like cheques have experienced a decline below the 5-year average, indicating a shift towards digital alternatives. This decline reflects the ongoing transition from paper-based transactions to more efficient and convenient digital payment options.
Furthermore, mobile payment usage has witnessed a substantial surge, with transactions increasing by 726 percent and value increasing by 507 percent in 2023. The convenience and accessibility offered by mobile payment solutions have contributed to this remarkable growth.

Overall, the expansion of e-payment services, the decline in cheque usage, and the significant increase in mobile payment transactions and values have collectively driven the exponential growth in the volume of transactions processed through retail payment systems during the last three years (Graph 2.2.4). In 2023, there was a significant increase of 30.2 percent in the volume of E-Payment transactions, totaling 328.3 million transactions. This growth can primarily be attributed to point-of-sale (POS) transactions, which experienced a substantial increase of 40.5 percent. Additionally, transactions conducted through e-commerce platforms saw a growth of 17.2 percent. On the other hand, ATM transaction volume declined by 2.2 percent. This can be attributed to avoiding unnecessary cash usage as more people opt for cashless payment methods (Graph 2.2.5).

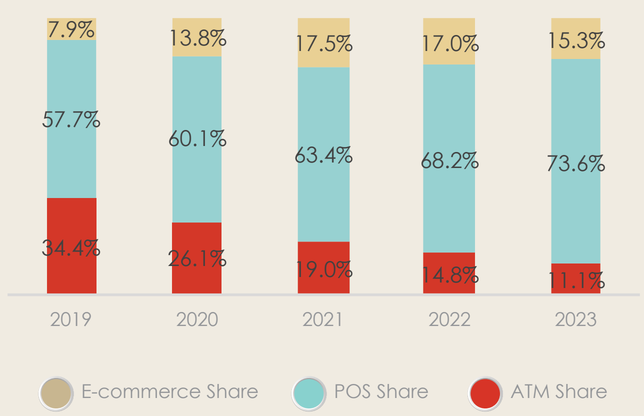
## Transactions in Cheques

The increasing adoption of electronic alternative payments has resulted in a significant decline in the use of cheques for payments since 2018. The number of cheque payments has decreased notably, going from approximately 4.7 million in 2018 to 3.7 million in 2023. This decrease clearly indicates the ongoing transition from paper-based payments to digital payment methods (Graph 2.2.6).

**GRAPH 2.2.4**
**RETAIL PAYMENT SYSTEMS VALUES & VOLUMES**




**GRAPH 2.2.5**
**OMANNET LOCAL TRANSACTION VOLUME**



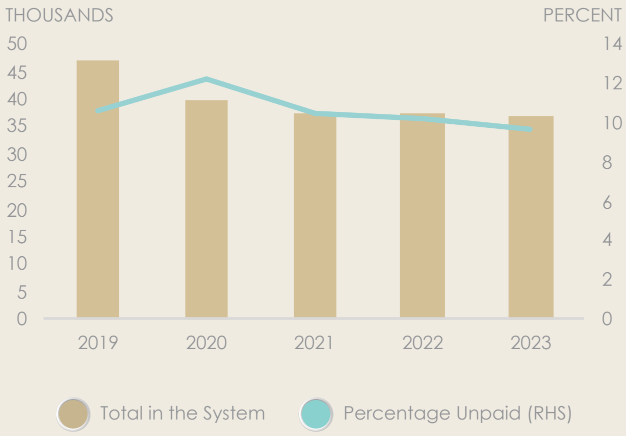
As a result, the volume of unpaid cheques within the system also declined from 387 thousand in 2022 to 362 thousand in 2023. This decrease represents a 9.8 percent reduction in the proportion of unpaid cheques to the total number of cheques presented in the system during 2023.

The majority of unpaid cheques, in terms of volume, are returned due to financial reasons rather than technical reasons. Specifically, "Insufficient Funds" remains the leading cause behind unpaid cheques, with a total volume of 291,444, accounting for 80.5 percent of all unpaid cheques. This is followed by "Account Closed / Frozen / Transferred", totaling 31,614 cheques (8.73 percent) (Graph 2.2.7).

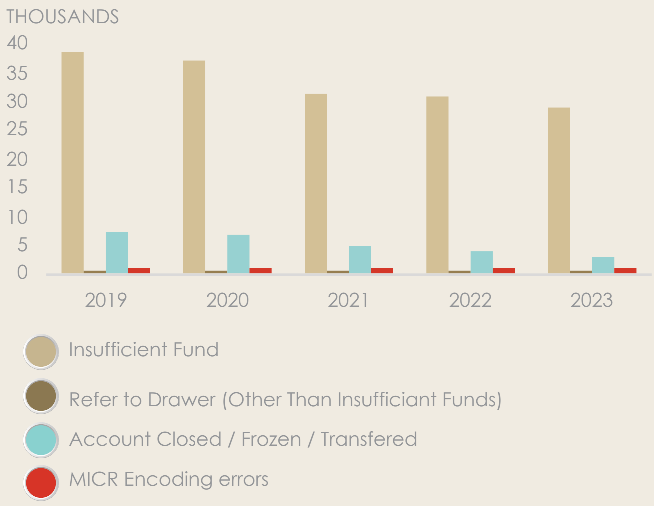
It's important to note that a bounced cheque or having an unpaid cheque is considered a serious offense in Oman and may result in legal consequences, including fines and imprisonment. In some countries, partial fulfillment of cheques has been introduced as an alternative measure. Under this system, if the full amount specified on the cheque is not available in the writer's account, banks are required to cash a partial amount equal to the available funds, unless the cheque bearer rejects the option for partial payment.

Worth mentioning, CBO is working jointly with other government entities on introducing regulations to allow for the partial fulfillment of cheques. This is done to provide more flexibility for both businesses and individuals when managing their cash flow and account balances. Previously, cheques in Oman had to be paid in full upon presentment. The new rules will permit banks to accept and process cheques even if the payer's account does not have sufficient funds to cover the full amount. The bank will then debit the available balance from the account and the payee can choose whether to accept the partial payment or reject the cheque entirely. CBO aims that the partial fulfillment option will reduce the number of cheque defaults and provide a more efficient payment system overall.

**GRAPH 2.2.6**
**TOTAL CHEQUES PRESENTED FOR CLEARING AND percentAGE OF UNPAID CHEQUES**




**GRAPH 2.2.7**
**REASONS FOR UNPAID CHEQUES**



## Box 2.3: Credit Conditions Survey

The Credit Conditions Survey was initiated by the CBO in June 2022 to improve its understanding of the existing credit conditions in Oman. This initiative aligns with the CBO's overall objectives in assessing and maintaining financial stability. The survey targets senior credit officers from all banks and Finance & Leasing Companies (FLCs) operating in Oman, seeking to assess loan demand, credit availability, changes in lending standards for 2023, and expectations for 2024. It covers lending to households, corporates, small and medium-sized enterprises (SMEs) and includes questions on factors influencing changes in credit demand or supply.

The survey results are reported as a net balance, represented as a percentage. A positive score indicates an observed or expected increase in credit demand or availability, or a relaxation of lending standards, while a negative score indicates the opposite. For instance, the net percentage balance for loan demand is calculated as follows: ( percent Reporting "Increased Significantly" + 0.5 x percent Reporting "Increased Somewhat") - ( percent "Decreased Significantly" + 0.5 x percent Reporting "Decreased Somewhat"). Similar computations apply to other indicators.

This section presents the findings of the third iteration of the Credit Conditions Survey conducted in December 2023. It's important to note that the results solely reflect the responses of survey participants and may not necessarily reflect the CBO's perspective on credit conditions in the economy.

### Lending to Households

Based on the findings of the Credit Conditions Survey (CCS) 2024, there was a notable rise in the demand for loans from households. The most significant increase was observed in secured loans, particularly for mortgage lending and auto financing, as well as other unsecured loans. It is worth mentioning that these types of loans have lower barriers to entry, involve fewer administrative procedures, and tend to receive quicker approvals compared to mortgage lending. This trend is particularly notable as more nationals enter the workforce (Graph 2.3.1).

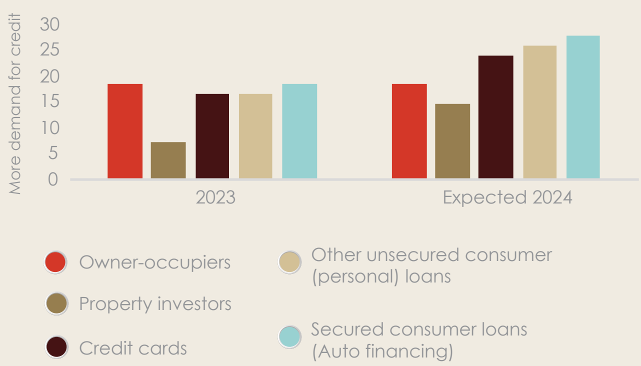
Anticipated for 2024, there is a projected surge in demand for household lending across all categories. The most substantial increase is expected in auto loans and personal loans. It is foreseen that these loans will experience heightened demand, driven by economic expansion and increased consumer confidence. During such periods, individuals typically have higher disposable income and a greater willingness to make significant purchases. Borrowing by households serves as a financial resource to facilitate these expenditures, whether it involves purchasing a vehicle, renovating a home, or financing a vacation.

Credit availability refers to the level of ease with which borrowers can access loans to finance their purchases. This accessibility can be influenced by several factors, including economic conditions, competition among lenders, lending policies, and risk pricing and fees as well as the range of mortgage products available.

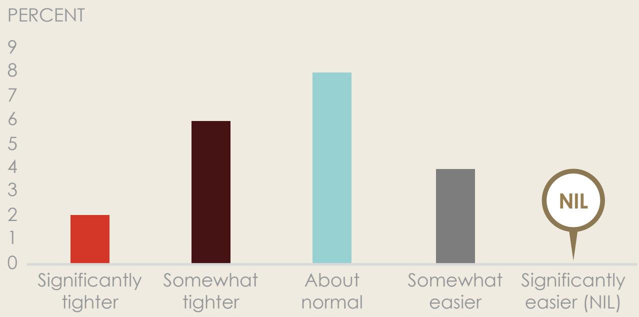
Survey respondents indicated that in 2023, credit availability for the household sector was considered to be consistent with the preceding three years (Graph 2.3.2). When examining the overall credit availability for various segments of household lending, such as personal loans and residential mortgages, survey respondents noted a marginal increase in availability. Nevertheless, it is important to highlight that, according to survey participants, pricing or non-pricing terms for residential mortgage loans did not become lenient in 2023. This cautious approach by banks is in line with the elevated policy rates. Similarly, while the participants anticipate easing of non-price terms for both mortgage and other lending to households, they expect loan pricing to ease for mortgage loans while remaining tightened for other lending to individuals (Graph 2.3.3).

Survey results highlighted that lending policies and credit terms were stricter for owner-occupied residential mortgages in 2023. This included requirements for higher credit scores, lower debt-to-income ratios, or more rigorous documentation criteria (Graph 2.3.4).

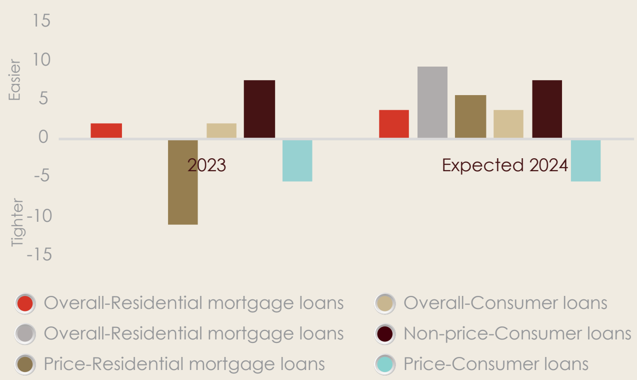
**GRAPH 2.3.1**
**DEMAND FOR CREDIT - HOUSEHOLDS**




**GRAPH 2.3.2**
**CREDIT AVAILABILITY FOR HOUSEHOLD SECTOR COMPARED TO LAST THREE YEARS**




**GRAPH 2.3.3**
**CREDIT AVAILABILITY- HOUSEHOLDS**




**GRAPH 2.3.4**
**LENDING POLICIES AND CREDIT TERMS-HOUSEHOLDS (OWNER-OCCUPIERS)**

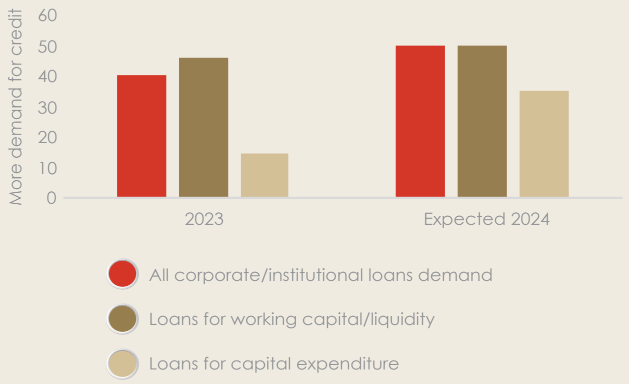
## Corporate/Institutional Lending

The survey findings indicate a robust demand for corporate lending in 2023, driven by both an increase in loans for working capital and capital expenditure. This strong appetite for corporate credit is projected to continue in 2024 (Graph 2.3.5).

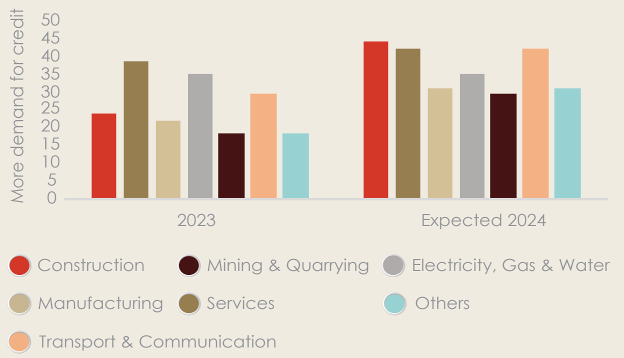
When examining the demand by sector, survey respondents observed an elevated demand for corporate loans across all economic activities and industries in 2023. The notable demand in the services sector suggests that businesses within this sector are likely to expand their operations and invest in new projects. These expansions necessitate additional capital, which can be obtained through corporate loans. Additionally, strong demand for corporate loans was also observed in the electricity, gas & water, and transport & communication sectors in 2023. Looking ahead to 2024, a further increase in credit appetite and demand for business loans is expected across all economic activities, particularly in construction, services and transport & communications. Despite the underperformance of the construction sector, survey respondents anticipate a significant rebound in credit demand for this sector in 2024, surpassing the expectations for any other sector (Graph 2.3.6).

Survey respondents believe that credit availability for the corporate sector was somewhat tightened in 2023 compared to the previous three years (Graph 2.3.7). Both pricing and non-pricing terms were tightened as banks have been cautious in their lending practices. As interest rates are expected to remain elevated and so far, pass-through from policy rates to lending rates has been incomplete, it is anticipated that there will be some tightening in pricing for corporate lending in 2024, while non-price terms are expected to ease (Graph 2.3.8).

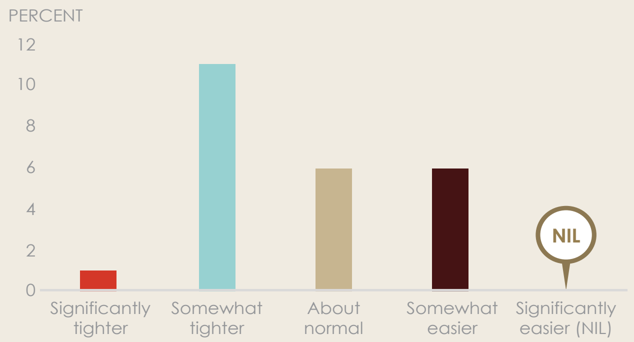
### GRAPH 2.3.5
### DEMAND FOR CREDIT - CORPORATE LENDING



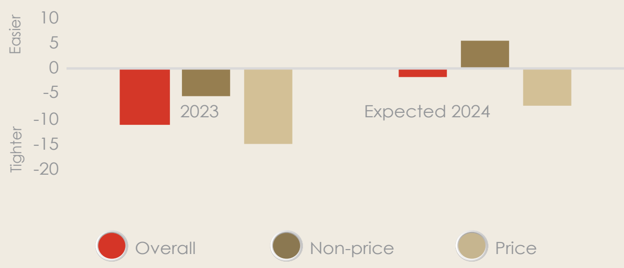

### GRAPH 2.3.6
### DEMAND FOR CREDIT BY ECONOMIC ACTIVITIES




### GRAPH 2.3.7
### CREDIT AVAILABILITY FOR CORPORATE SECTOR COMPARED TO LAST THREE YEARS




### GRAPH 2.3.8
### CREDIT AVAILABILITY- CORPORATE LENDING



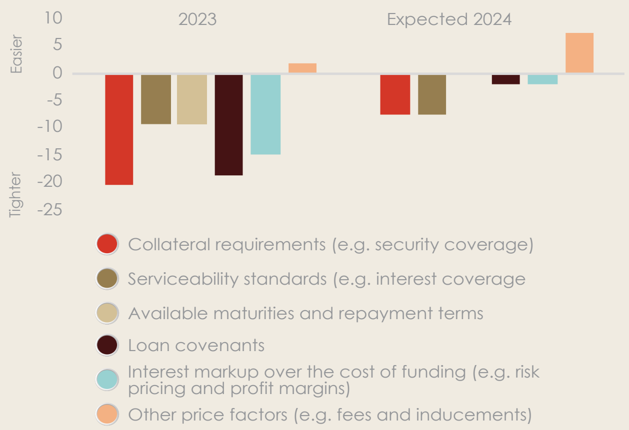
Moreover, an overwhelming majority of survey participants indicated that their lending standards for corporate borrowers remained rigorous throughout 2023. The majority of respondents anticipate that these lending standards for corporate credit will continue to be tightened in 2024, particularly concerning collateral requirements, serviceability standards, loan covenants, and risk pricing. However, it is worth noting that respondents expect some easing in terms of fees (Graph 2.3.9).

## SMEs Lending

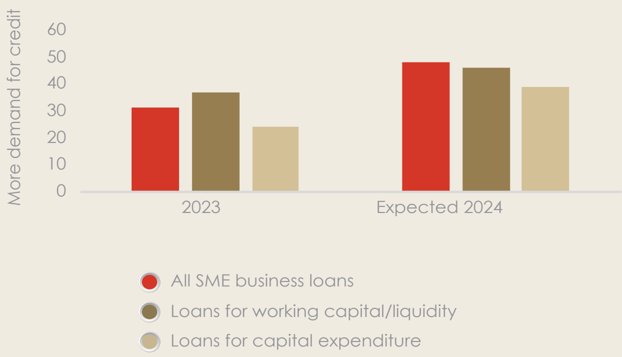
According to the survey participants, there was a significant increase in the overall demand for loans from small and medium-sized enterprises (SMEs) in 2023, encompassing both working capital and capital expenditure financing (Graph 2.3.10). Respondents anticipate a strong demand for all types of loans from SMEs, particularly capital expenditure loans in 2024. This reflects the impact of government initiatives aimed at fostering SMEs growth and increased optimism among SMEs about the economic prospects.

Survey respondents expressed the opinion that credit availability for the SMEs sector in 2023 was relatively stable, similar to the previous three years (Graph 2.3.11). However, respondents noted the presence of tighter non-price factors, such as lending policies, as well as price factors including markup, risk pricing, and fees. Nevertheless, there is an expectation that overall credit availability for SMEs will improve in 2024, particularly in terms of more favorable lending policies (Graph 2.3.12). The respondents anticipate that some lending policies like repayment terms and fees may ease in 2024, while other credit terms for SMEs will continue to be tightened in 2024. This tightening is expected to be primarily focused on serviceability standards, loan covenants, and risk pricing (Graph 2.3.13).

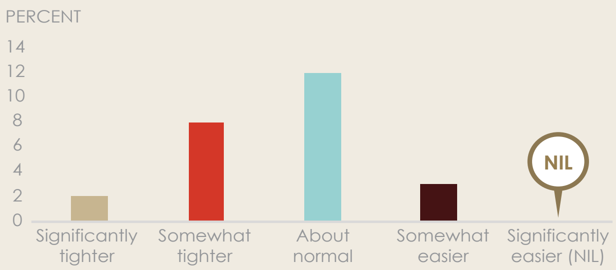
**GRAPH 2.3.9**
**LENDING POLICIES AND CREDIT-CORPORATE LENDING**



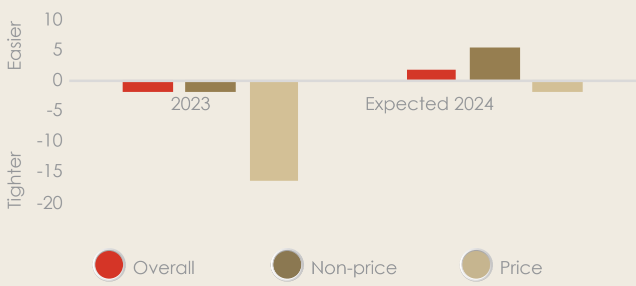

**GRAPH 2.3.10**
**DEMAND FOR CREDIT - SME LENDING**




**GRAPH 2.3.11**
**CREDIT AVAILABILITY FOR SME SECTOR COMPARED TO LAST THREE YEARS**




**GRAPH 2.3.12**
**CREDIT AVAILABILITY- SME LENDING**



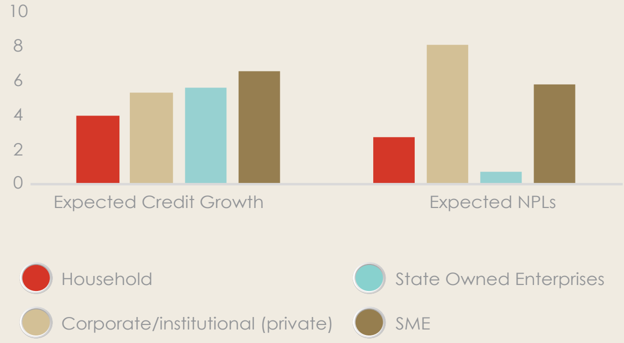
## Lending Conditions, Expectations, and Loan Performance

The participants were presented with a series of comprehensive questions encompassing various aspects, including their views on economy-wide lending growth and Non-Performing Loans (NPLs) in 2023 and 2024 across different sectors. They were also asked about the impact of different factors on credit conditions, the reasons behind loan rejections, and the key drivers influencing credit availability. According to survey respondents, the highest projected lending growth in 2024 is expected to be in the SMEs sector, approximately at 6.6 percent. This is followed by lending to state-owned enterprises at 5.6 percent, the corporate sector at 5.3 percent, and the household sector at 4.0 percent. Regarding Non-Performing Loans (NPLs), respondents anticipate an increase in NPLs in 2024 across all segments, with the highest increase in private businesses while NPLs for the SME segment are expected to decline (Graph 2.3.14).

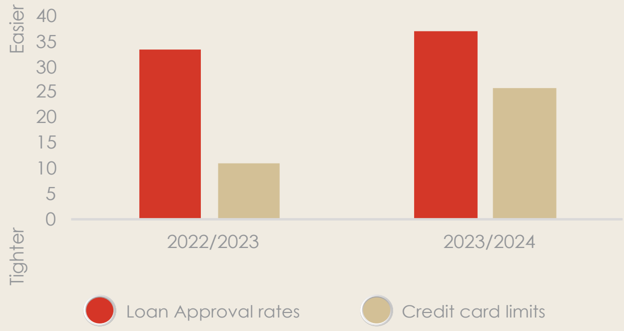
The respondents perceive a slight increase in the loan approval rate in 2023, and this is expected to continue in 2024. Furthermore, credit card limits experienced a slight increase in 2023; and respondents expect further increases in credit card limits in 2024 (Graph 2.3.15).

**GRAPH 2.3.13**
**LENDING POLICIES AND CREDIT TERMS-SME LENDING**


**GRAPH 2.3.14**
**ECONOMY-WIDE LENDING GROWTH EXPECTATION IN 2024**



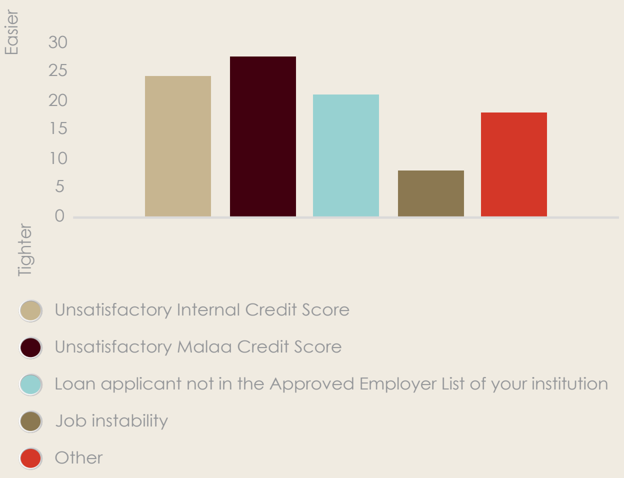

**GRAPH 2.3.15**
**CHANGES IN CREDIT CONDITIONS**



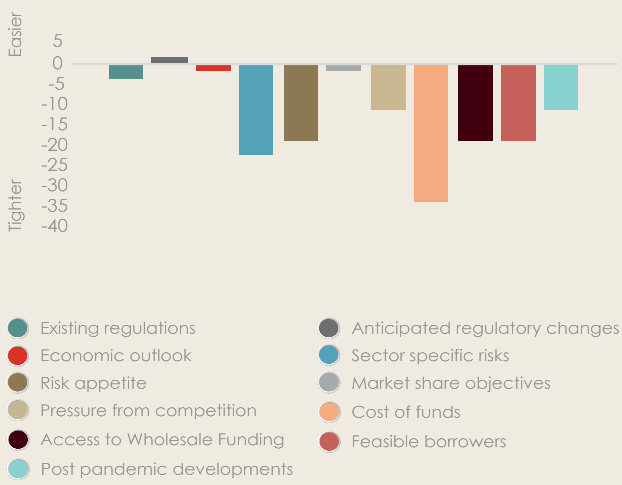
In the survey, participants were questioned regarding the factors contributing to the rejection of loan applications in 2023. The leading reason identified by respondents was a low credit score, specifically an 'unsatisfactory Mala'a credit score,' accounting for 27.9 percent of the rejections. Following closely was an 'unsatisfactory internal credit score for the applicant' at 24.6 percent. Other reasons included the loan applicant not being on the approved employer list of the borrower institution, which constituted 21.3 percent of the rejections, and job instability, which accounted for 8 percent of the rejections (Graph 2.3.16).

The survey revealed various factors that played a role in the tightening of credit availability. Among these determinants, the cost of funds and sector-specific risks were identified as the most significant contributors. On the other hand, anticipated regulatory changes had a relatively minor impact on credit availability (Graph 2.3.17).

**GRAPH 2.3.16**
**REASONS BEHIND THE REJECTION OF LOAN APPLICATIONS**




**GRAPH 2.3.17**
**DRIVERS OF CREDIT TIGHTENING DURING 2023**



## Box 2.4: Assessing Commercial Real Estate Risks in Oman Amid Global Real Estate Vulnerabilities

### Introduction

Real Estate, particularly commercial real estate, in several countries is under stress. For example, the Chinese property market is expected to decline by 6 percent with sales declining by 10 to 15 percent from 2003[1]. Similarly, in the US, commercial real estate prices have declined by 11 percent since the US Fed began increasing policy rates in March 2022[2]. Given the falling prices and significant downside risks associated with commercial real estate, banks with higher exposure to this sector are particularly vulnerable to any negative developments in the market.

### Stress in the US Regional Banks – the Case of New York Community Bancorp

In early 2024, such risks came to the surface when New York Community Bancorp (NYCB) – which is a mid-sized regional bank with an asset base of about $119 billion and garnered attention after it acquired assets of the failed Signature Bank in 2023 – reported its Q4-2023 and full-year FY-2023 financial results on January 31, 2024.

For FY-2023, the bank witnessed a 280 percent increase in earnings, reaching $2.37 billion, inclusive of a bargain purchase gain of $2.15 billion. This performance marked a significant uptick from the $650 million reported in FY-2022, despite an increase in loan loss provisions to $833 million from $133 million during the previous year. Notwithstanding the remarkable full year results, due to a sharp increase in provisions on account of its commercial real estate portfolio, the Q4-2023 witnessed a loss of $252 million as compared to a profit of $172 million in Q4-2022 as the bank created loan loss provisions of $552 million in Q4-2023 to build reserve levels in line with the peer banks. Furthermore, as part of its strategy to fortify capital in its Category IV large bank status, NYCB opted to reduce the quarterly common dividend to 5 cents per common share from 17 cents in the previous quarter.

### Market/ Rating Agencies Reaction

**Major Sell-Off & Share Price Crash**

- A significant downturn in dividends coupled with an upswing in loan loss provisions, particularly attributed to commercial real estate, triggered a negative response from the market. Apprehensions regarding the asset quality intensified, leading to a substantial sell-off. Consequently, the price of NYCB's shares plummeted by almost 67 percent within the span of a week (between 31-Jan-2024 and 7-Feb-2024).

**Rating Downgrades**

- Key credit rating agencies also cut the credit rating of NYCB with Moody's downgrading it to the junk (Ba2) rating and warned of more downgrades. The repercussions extended beyond the stock market as major credit rating agencies downgraded NYCB's credit rating.

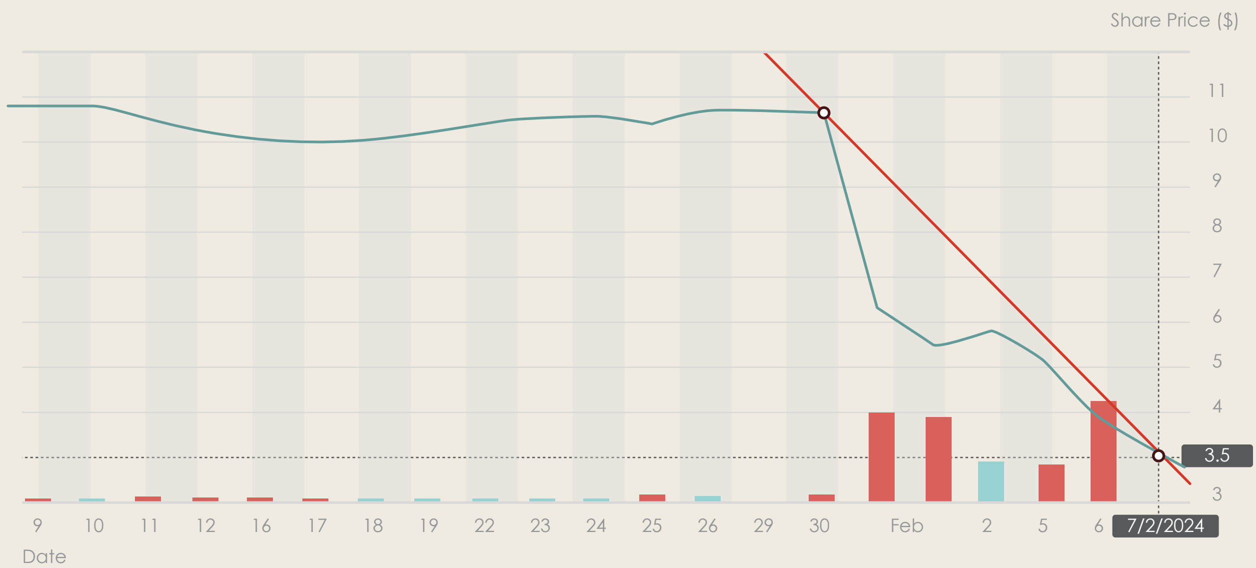
[1] S&P Global Ratings. (2024, May 7). China property watch: Searching for a bottom. S&P Global. https://www.spglobal.com/ratings/en/research/articles/240507-china-property-watch-searching-for-a-bottom-13084773

[2] Deghi, A., Natalucci, F., & Qureshi, M. S. (2024, January 17). U.S. commercial real estate remains a risk despite investor hopes for soft landing. IMF Blog. https://www.imf.org/en/Blogs/Articles/2024/01/17/us-commercial-real-estate-remains-a-risk-despite-investor-hopes-for-soft-landing

### Spill-over of Stress to Other Regional Banks

- The stress emanating from NYCB's situation reverberated across the sector, impacting other regional banks. Share prices of Western Alliance Bancorp and Comerica also witnessed declines. Additionally, the regional banking index (KBW) recorded a decrease of approximately 6 percent during the same week (31-Jan-2024 to 7-Feb-2024). The interconnectivity of these events underscored the broader implications of NYCB's challenges on the stability and performance of the regional banking sector.

**GRAPH 2.4.1**
**SHARE PRICE OF NYCB AFTER Q4-2023 RESULTS**




Source: New York Community Bancorp, Inc. (NYCB) Stock Price, News, Quote & History (2024) Yahoo! Finance.

## Risks Emanating from Real Estate in Oman

- Over the past two years, Oman has witnessed an improvement in real estate prices, rebounding from the lows (in Q4-2021) experienced during the COVID-19 pandemic. According to the latest available data from the National Center for Statistics and Information (NCSI), the residential real estate price index has shown a notable increase of 8.1 percent since Q4-2021.

- Considering the likely trajectory of the economy and the prevailing direction of interest rates, there is an optimistic outlook, and we do not foresee a decline in real estate prices in Oman in the near term.

### Stress Testing the Commercial Real Estate Exposures

- Recognizing the global trend of softening in the commercial real estate market, an assessment of the impact of any softening in commercial real estate on the banks has been undertaken. This evaluation involves stress-testing the domestic banks' commercial real estate exposures to ensure preparedness for any potential challenges arising from broader global dynamics impacting the real estate sector. This proactive approach aligns with CBO's commitment to unveil any potential vulnerabilities and test resilience, taking into consideration both local and global market conditions.

**Key Assumptions**

- In our stress-testing scenarios, it is assumed that commercial real estate prices will decline by varying degrees: 10 percent, 15 percent, or 20 percent[3]. As part of these scenarios, we make the following additional assumptions:
- **Revenue Generation from Other Sources**
  It is assumed that banks will continue to generate revenues from other sources. This serves as the first line of defense, providing a buffer against the potential impact of the decline in real estate prices on the capital of the banks.

- **Full Provision for Decline in Real Estate Prices**
  It is also assumed that the banks will fully provide for the decline in real estate prices. This provision is made without considering the existing cushion in the collateral value, indicating a conservative approach in stress testing in assessing the ability of banks to navigate potential challenges arising from fluctuations in the real estate market.

### Results and Key Takeaways

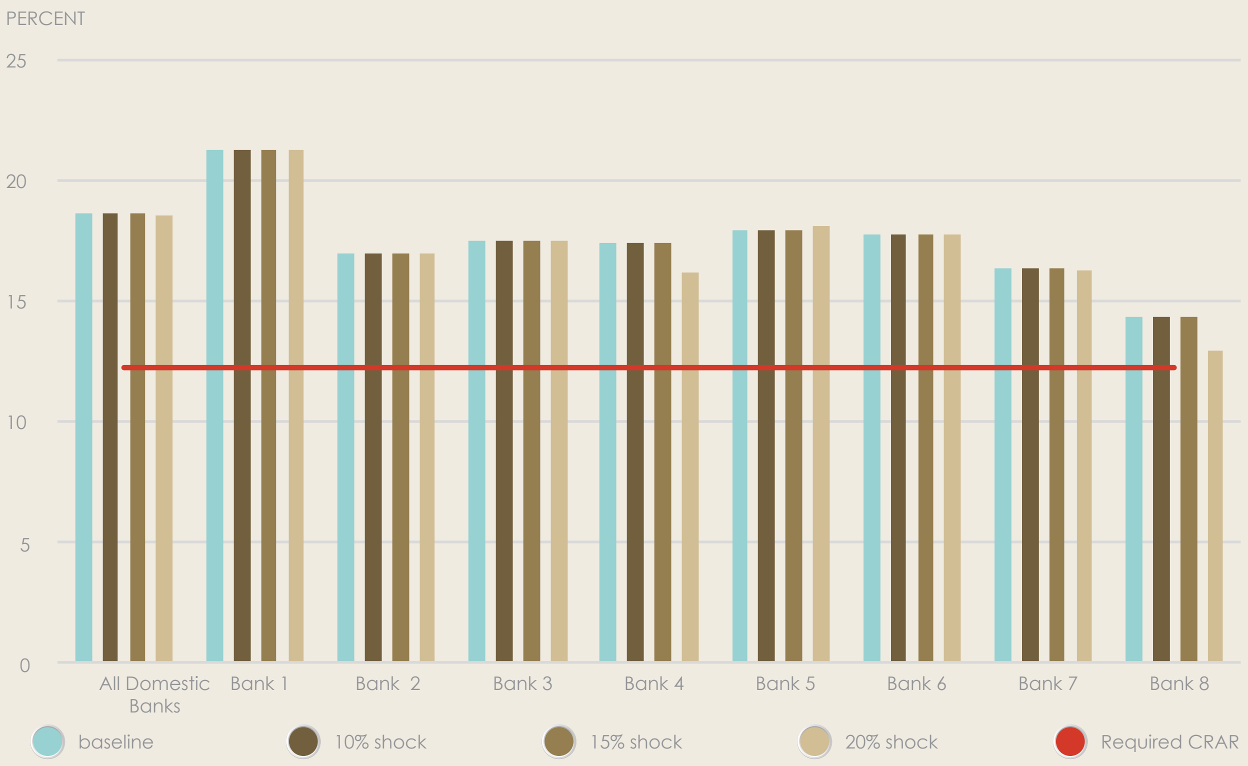
- The stress test results, as depicted in the following graphs, indicate that all banks would be resilient enough to absorb a decline in commercial real estate ranging from 10 percent to 20 percent without breaching the regulatory capital requirement of 13.5 percent. This suggests robustness of the banks in the face of severe stress scenarios specific to the commercial real estate (Graph 2.4.2).

- Nevertheless, the stress in the commercial real estate and its impact on some banks globally underscore the importance of paying due attention to credit concentrations as high exposures to certain sectors may expose banks to the performance of that sector. Moreover, the recent stress episodes in the US banking sector in 2023 and 2024 highlight the need for thoughtful preparation for potential distress scenarios. While each distress situation may have unique aspects, it is imperative for banks and regulators to be prepared and have well-defined plans to address potential distress scenarios. The CBO has made commendable progress in this regard by developing a resolution plan for the identified D-SIB (Bank Muscat), prompt corrective action framework for other banks.

[3] We have a short history of the real estate price index starting from 2018. Within this available time series, the residential real estate price index reached its highest in Q2-2018 at 107.2. Conversely, the lowest point was documented in Q4-2021, standing at 89.7. This indicates a maximum decline of 16.2 percent in the residential real estate price index within the available dataset. The data on commercial real estate prices is not available in Oman.

- It’s essential to emphasize that stress test scenarios do not reflect our expectations about the trajectory of real estate prices, they are only designed to assess resilience under extreme yet plausible events. Nonetheless, these stress test results could guide the assessment of individual banks, their risk management strategies and capital planning. Moreover, these results may be taken into account while settling the policies regarding real estate exposure limits.

**GRAPH 2.4.2**
**COMMERCIAL REAL ESTATE EXPOSURE - CRAR UNDER BASELINE AND STRESSED SCENARIOS**



## Appendix 1

| Select Banking and Market Indicators<br>Values in RO million | | | | | | | |
|---|---|---|---|---|---|---|---|
| | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 | 2023 |
| **Balance Sheet Items** | | | | | | | |
| Cash and CBO Deposits | 2,482.5 | 2,923.2 | 2,377.1 | 1,874.4 | 2,526.1 | 1,907.6 | 2,118.1 |
| Credit to Government | 34.6 | 39.5 | 136.9 | 477.8 | 620.4 | 844.6 | 516.4 |
| Credit to Public enterprises | 2,213.4 | 2,640.8 | 2,710.9 | 3,128.6 | 3,642.2 | 3,753.3 | 4,149.7 |
| Credit to Private Sector | 21,018.2 | 22,049.8 | 22,673.4 | 22,912.6 | 23,435.7 | 24,422.9 | 25,566.5 |
| Credit to Non-Residents | 278.3 | 327.5 | 309.2 | 157.1 | 150.1 | 202.4 | 241.7 |
| Loans and Advances (Net) | 22,810.0 | 24,252.9 | 24,955.6 | 25,577.6 | 26,594.2 | 27,783.4 | 28,858.8 |
| Growth Rate | 6.4% | 6.3% | 2.9% | 2.5% | 4.0% | 4.5% | 3.9% |
| Investment in Govt. Bonds and T-Bill | 2,458.0 | 2,813.6 | 3,185.6 | 3,652.2 | 4,274.4 | 3,722.7 | 4,203.9 |
| Total Investments | 3,108.5 | 3,447.5 | 3,952.3 | 4,762.8 | 5,359.6 | 3,722.7 | 4,203.9 |
| Total Assets | 31,488.6 | 33,958.6 | 35,221.0 | 35,814.1 | 38,521.9 | 38,817.1 | 41,825.6 |
| Growth Rate | 5.4% | 7.8% | 3.7% | 1.7% | 7.6% | 0.8% | 7.8% |
| Private Sector Deposits | 13,943.5 | 14,316.3 | 15,200.7 | 16,806.1 | 17,300.1 | 17,359.9 | 19,203.7 |
| Government Deposits | 6,363.9 | 6,423,57 | 6,646.4 | 5,601.5 | 6,106.0 | 6,366.0 | 6,580.6 |
| PSE Deposits | 982.6 | 1,936.3 | 1,433.4 | 1,277.3 | 1,680.0 | 1,732.5 | 2,586.9 |
| Non-resident Deposits | 279.9 | 359.9 | 376.8 | 480.6 | 524.4 | 443.4 | 729.4 |
| Total Deposits | 21,569.9 | 23,255.3 | 23,657.3 | 24,165.5 | 25,610.4 | 25,901.9 | 29,100.7 |
| Growth Rate | 5.6% | 7.8% | 1.7% | 2.1% | 6.0% | 1.1% | 12.3% |
| **Asset Quality** | | | | | | | |
| ECL (Stages 2 & 1) | 321.6 | 360.3 | 322.6 | 385.2 | 447.9 | 566.1 | 651.5 |
| ECL (Stage 3) | 287.2 | 448.8 | 544.3 | 704.0 | 799.7 | 870.8 | 936.7 |
| Gross NPL Ratio | 1.9% | 2.7% | 3.5% | 4.2% | 4.2% | 4.4% | 4.5% |
| Net NPL to Net Loans | 0.7% | 1.0% | 1.4% | 1.6% | 1.4% | 1.4% | 1.4% |
| Stage 3 or Specific Provisions to NPLs Ratio | 65.2% | 65.7% | 61.2% | 63.4% | 68.8% | 68.7% | 69.7% |
| Restructured loans to Gross Loans | 1.6% | 2.3% | 3.8% | 4.3% | 5.8% | 12.1% | 11.1% |
| Stage 2 loans to Gross Loans | 7.5% | 20.0% | 20.2% | 20.2% | 20.5% | 17.6% | 16.42% |
| **Solvency** | | | | | | | |
| Total Regulatory Capital | 5,011.5 | 5,230.8 | 5,469.8 | 5,538.5 | 5,814.4 | 6,011.7 | 5,958.9 |
| Tier 1 Capital | 4,554.3 | 4,852.1 | 5,165.1 | 5,216.0 | 5,524.5 | 5,758.3 | 5,689.0 |
| CET1 Ratio | 13.9% | 13.9% | 14.3% | 14.7% | 15.5% | 15.0% | 14.2% |
| CRAR | 17.4% | 17.9% | 18.5% | 18.8% | 19.4% | 19.7% | 19.0% |
| **Liquidity** | | | | | | | |
| LCR | 216.0% | 254.0% | 220.0% | 196.0% | 212.1% | 190.2% | 221.8% |
| NSFR | 116.0% | 115.0% | 116.0% | 117.0% | 118.6% | 117.1% | 120.3% |
| Credit-to-Deposit Ratio | 109.2% | 107.8% | 109.2% | 110.4% | 108.7% | 112.8% | 104.7% |
| Lending Ratio | 79.9% | 78.6% | 79.6% | 79.7% | 76.9% | 80.7% | 79.2% |
| **Profitability** | | | | | | | |
| ROA | 1.5% | 1.6% | 1.4% | 0.9% | 1.1% | 1.2% | 1.3% |
| ROE | 9.8% | 10.6% | 9.4% | 5.7% | 6.8% | 7.9% | 8.6% |
| NIM | 2.5% | 2.7% | 2.7% | 2.5% | 2.6% | 2.8% | 2.7% |
| Profit before Tax | 451.8 | 514.1 | 487.6 | 303.2 | 382.4 | 464.0 | 502.0 |
| **Market Indicators** | | | | | | | |
| Repo Rate | 2.0% | 2.9% | 2.2% | 0.5% | 0.5% | 4.8% | 6.0% |
| Overnight Interest Rate | 1.2% | 2.1% | 2.1% | 0.7% | 0.4% | 3.9% | 5.4% |
| RO Average Lending Rate | 5.2% | 5.3% | 5.5% | 5.5% | 5.6% | 5.4% | 5.5% |
| RO Average Deposit Rate | 1.7% | 1.9% | 2.0% | 2.0% | 2.0% | 2.0% | 2.6% |
| MSM Price Index | 5,099 | 4,324 | 3,981 | 3,659 | 4,130 | 4,857 | 4,485 |
| Change in MSM Index | -11.8% | -15.2% | -7.9% | -8.1% | 12.9% | 17.6% | -7.7% |

## Appendix 2

| Payment System Indicators<br>Volume in million, Values in RO million | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | | **2016** | **2017** | **2018** | **2019** | **2020** | **2021** | **2022** | **2023** |
| **ACH** | Volume | 4.783 | 5.179 | 7.240 | 8.650 | 10.453 | 14.548 | 18.506 | 21.887 |
| | Value | 3,146 | 3,358 | 4,679 | 5,553 | 6,030 | 9,178 | 11,460 | 13,509 |
| **ECC** | Volume | 4.383 | 4.642 | 4.697 | 4.565 | 3.910 | 3.780 | 3.745 | 3.714 |
| | Value | 18,196 | 16,680 | 15,548 | 14,827 | 11,771 | 9,796 | 9,969 | 10,293 |
| **OmanNet** | Volume | 45.263 | 59.201 | 82.437 | 99.691 | 128.757 | 180.821 | 252.929 | 329.579 |
| | Value | 2,945 | 3,323 | 3,720 | 3,960 | 4,547 | 5,167 | 5,865 | 6,423 |
| **Total Retail** | Volume | 54.429 | 69.022 | 94.373 | 112.907 | 143.121 | 199.149 | 274.400 | 355.181 |
| | Value | 24,287 | 23,361 | 23,947 | 24,340 | 22,348 | 24,143 | 27,293 | 30,225 |
| | | | | | | | | | |
| **RTGS** | Volume | 0.496 | 0.579 | 0.597 | 0.650 | 0.754 | 0.757 | 0.723 | 0.680 |
| | Value | 152,275 | 158,811 | 178,907 | 212,157 | 155,542 | 154,649 | 179,347 | 209,867 |
| **Total Cheques** | Volume | 4.441 | 4.642 | 4.697 | 4.714 | 3.975 | 3.780 | 3.762 | 3.713 |
| **Bounced Cheques** | Volume | 0.362 | 0.427 | 0.469 | 0.379 | 0.486 | 0.399 | 0.387 | 0.362 |
| | Value | 704 | 1,519 | 856 | 1,367 | 547 | 656 | 710 | 489 |

**SECTION**

# RESILIENCE OF THE OMANI BANKING SYSTEM

## Solvency Stress Testing

The Central Bank of Oman (CBO) employs a sophisticated array of stress tests to evaluate the resilience of the Omani banking system against potential adverse financial and macroeconomic conditions. This rigorous testing framework includes macro scenario-based stress testing, hypothetical stress scenarios, and reverse stress testing, providing a thorough assessment of the sector's capacity to withstand economic shocks over a specified time horizon.

Macro stress testing is a coherent tail-risk approach designed to simulate the impact of hypothetical macroeconomic deteriorations on the banking sector. The hypothetical stress scenarios foresee severe, yet plausible economic downturns, while reverse stress testing identifies the threshold at which banks would breach regulatory capital requirements due to increased non-performing loans (NPLs).

Under the baseline scenario, which assumes business as usual, the solvency of the Omani banking sector remains robust, consistently exceeding the domestic regulatory benchmark of 13.5 percent over a three-year horizon. When subjected to more adverse scenarios, the stress test results reveal that the sector can comfortably maintain its solvency, even in the face of severe macroeconomic downturns, including significant declines in global oil prices and resultant economic strain in Oman. The reverse stress testing analysis indicates that the banking sector can withstand an 8.5 percent increase in NPLs before breaching the CBO's Capital to Risk-weighted Assets Ratio (CRAR) requirement, confirming that the high capacity of Omani banks possess the substantial buffer to absorb unexpected credit losses without facing insolvency.

## Macro Stress Testing

Given the significant dependence of the Omani economy on hydrocarbons, the Central Bank of Oman (CBO) uses oil prices as the anchor variable in its macro stress testing framework. The adverse scenario constructed for this purpose assumes a sustained decline in oil prices, starting from an average of USD 83/ barrel in 2023, decreasing to USD 50/barrel in 2024, and further plummeting to USD 40 per barrel in 2025 and 2026. This scenario aims to assess the potential impact of a severe oil price shock on the Omani banking sector. To simulate the repercussions of this oil price decline, the Oxford Economics Model is employed to generate relevant macroeconomic variables for Oman. These variables are then fed into a satellite model (Box 3.1) to derive default rates or probabilities of default. These default rates are critical inputs for the stress testing engine, which projects the financial variables of banks under stress conditions.

## Baseline Scenario

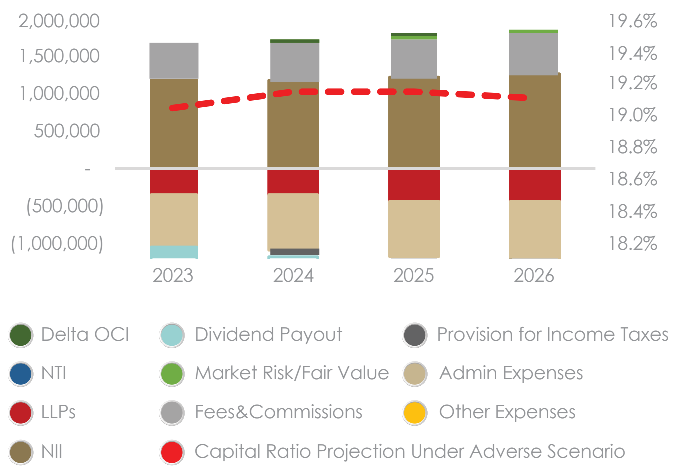
The baseline scenario provides a comprehensive outlook on the expected trajectory of macro-financial variables, reflecting both global and domestic economic developments. Detailed assumptions and projections for this scenario (Table 3.1)

**TABLE 3.1:
ASSUMPTIONS UNDERLYING BASELINE SCENARIO**

| | YEAR | | |
|---|---|---|---|
| | 2024 | 2025 | 2026 |
| Oil Prices | $82.2 | $77.4 | $77.1 |
| Nominal GDP Growth | 2.8% | 7.6% | 4.4% |
| Real GDP Growth | 2.3% | 6.8% | 3.3% |
| Lending Interest Rates | 5.33% | 5.22% | 5.10% |
| Stock Returns | 2.8% | 7.6% | 4.4% |
| Estimated PD rates | 1.38% | 1.26% | 1.24% |

*Source: Oxford Economics Model and CBO Staff Estimates

**GRAPH 3.1**
**CONTRIBUTION TO RETAINED EARNINGS OF BANKING SYSTEM UNDER THE BASELINE MACRO SCENARIO**




**GRAPH 3.2**
**CAPITAL WATERFALL OF BANKING SYSTEM UNDER THE BASELINE SCENARIO**

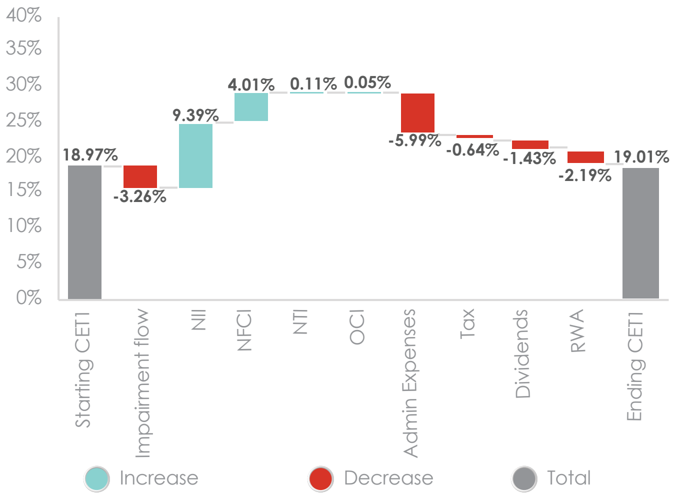



**TABLE 3.2:**
**ASSUMPTIONS UNDERLYING ADVERSE MACRO SCENARIO**

| | YEAR | | |
|---|---|---|---|
| | **2024** | **2025** | **2026** |
| **Oil price (per barrel)** | $50 | $40 | $40 |
| **Nominal GDP Growth** | -11% | 4% | 6% |
| **Real GDP Growth** | 2% | 6% | 3% |
| **Lending Interest Rates** | 7.18% | 6.91% | 6.65% |
| **Stock Returns** | -11% | 4% | 6% |
| **Estimated PD rates** | 3.12% | 2.95% | 2.93% |

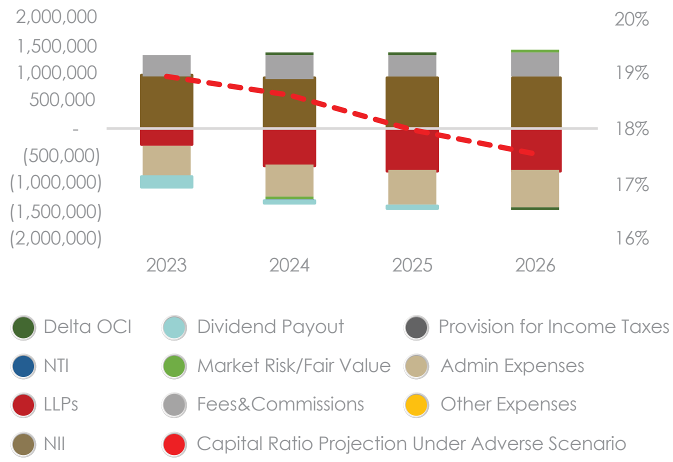
*Source: Oxford Economics Model and CBO Staff Estimates

Under this scenario, Omani banks are anticipated to demonstrate strong overall performance over the next three years. Despite an expected rise in the aggregate non-performing loans (NPLs) ratio from 4.5 percent to 7.2 percent, which will lead to an increase in credit provisioning expenses, banks are projected to manage these challenges effectively and remain profitable. The retention of profits as earnings is expected to bolster the Capital to Risk-weighted Assets Ratio (CRAR) during this period. Specifically, the overall banking CRAR is forecasted to improve from 18.97 percent at the end of December 2023 to 19.01 percent by the end of 2026 (Graph 3.1 & 3.2).

## Adverse Macro Scenario

An adverse macro scenario is used to analyze the repercussions of severe economic conditions. This scenario focuses on the effects of a significant and prolonged decline in oil prices over a three-year period, offering insights into how such an event could impact the banking sector's performance and resilience. The adverse macro scenario posits a steep reduction in oil prices throughout 2024, with prices remaining low through 2025 and 2026 (Table 3.2). This sharp decline is anticipated to lead to reduced profitability for businesses and households, impairing their ability to service debts. Consequently, this deterioration in credit quality is expected to elevate the credit risk faced by banks.

**GRAPH 3.3**
**CONTRIBUTION TO RETAINED EARNINGS OF BANKING UNDER ADVERSE MACRO SCENARIO**




**GRAPH 3.4**
**CAPITAL WATERFALL OF BANKING SYSTEM UNDER THE ADVERSE MACRO SCENARIO**

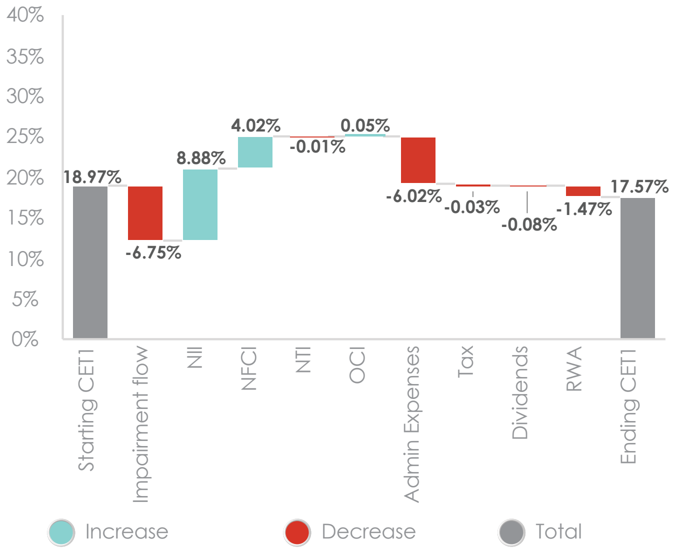



**TABLE 3.3:**
**ASSUMPTIONS UNDERLYING ADVERSE HYPOTHETICAL SCENARIO**

| | YEAR | | |
|---|---|---|---|
| **Varibles** | **2024** | **2025** | **2026** |
| **Lending Interest Rates** | 8.0% | 10.0% | 12.0% |
| **Share Price Index** | -15.0% | -15.0% | -15.0% |
| **NPLs Ratio** | 7.9% | 11.1% | 13.9% |

As a result, the aggregate non-performing loans (NPL) ratio for the banking system is projected to escalate from 4.5 percent at the end of December 2023 to 11.5 percent by the end of 2026. This substantial increase in NPLs would necessitate higher credit provisioning expenses, putting additional pressure on banks' financial performance. Despite these challenges, the banks are expected to manage these losses and continue to operate profitably throughout the stress period. Moreover, the overall Capital to Risk-weighted Assets Ratio (CRAR) of the banking system is forecasted to experience a modest decline, decreasing to 17.57 percent by 2026. Nonetheless, all individual banks are projected to remain solvent, maintaining capital levels above the CBO's requirement of 13.5 percent (Graph 3.3 & 3.4).

## Adverse Hypothetical Scenario

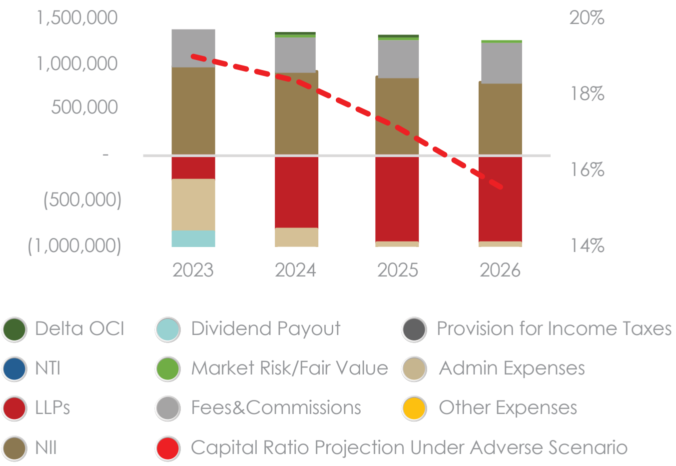
The implications of a severe hypothetical scenario are characterized by a significant deterioration in the quality of banking assets and an increase in funding costs. The scenario assumes multiple sovereign credit rating downgrades as the country continues to face enduring fiscal imbalances. These downgrades are projected to lead to increased capital outflows, as investor confidence wanes regarding economic prospects. The resultant effect is an upward pressure on interest rates and a downward impact on foreign reserves, which places additional strain on monetary policy.

The crisis modeled in this scenario is anticipated to persist for approximately three years, with pronounced effects on both GDP and government finances due to a substantial decline in oil prices. Details of the assumed shocks underlying this hypothetical scenario are provided in (Table 3.3).

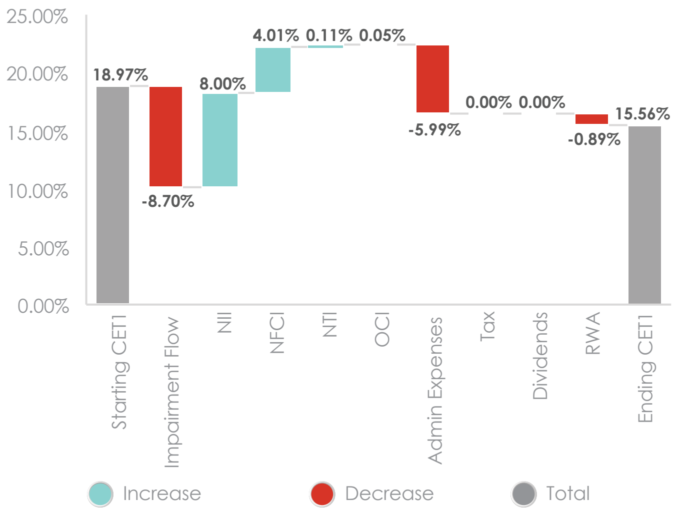
In this adverse context, banks are expected to experience considerable credit deterioration and elevated funding costs. It is assumed that banks will first utilize their retained earnings as a defense mechanism against these challenges. Any residual impact beyond this initial buffer is anticipated to be absorbed by the banks' capital reserves. Adjustments to Risk-Weighted Assets (RWA) will be made to account for increased provisioning requirements. Thanks to a positive interest sensitivity gap, the banks' net interest income is projected to partially mitigate the negative effects of substantial provisioning, thereby reducing the overall net losses within the sector (Graph 3.5).

Under the stress of these adverse conditions, the aggregate non-performing loans (NPL) ratio for domestic banks is forecasted to rise from 4.5 percent at the end of December 2023 to 13.9 percent by the end of 2026.

**GRAPH 3.5**
**CONTRIBUTION TO RETAINED EARNINGS OF BANKING SYSTEM UNDER THE ADVERSE HYPOTHETICAL SCENARIO**




**GRAPH 3.6**
**CAPITAL WATERFALL OF BANKING SYSTEM UNDER THE ADVERSE HYPOTHETICAL SCENARIO**




The aggregate Capital to Risk-weighted Assets Ratio (CRAR) of domestic banks is expected to decrease from 18.97 percent to 15.56 percent during this period (Graph 3.6). Despite this decline, it is projected that all individual banks will maintain a CRAR above the regulatory requirement of 13.5 percent, demonstrating their continued resilience amid economic stress.

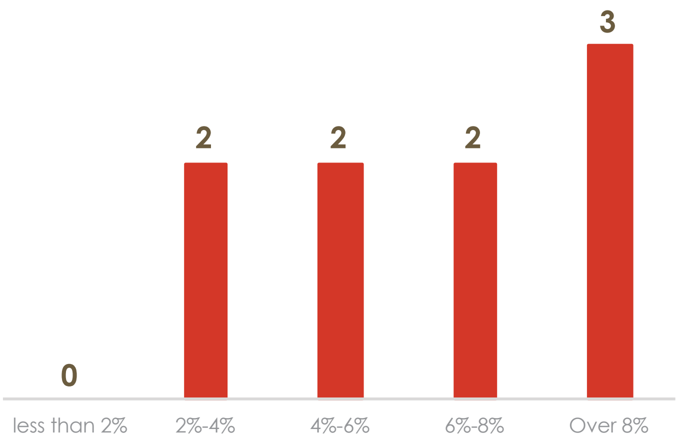
## Reverse Stress Testing

Reverse stress testing is employed to evaluate the resilience of banks under extreme credit risk conditions that would lead to non-compliance with CBO's regulatory Capital to Risk-weighted Assets Ratio (CRAR) requirement.

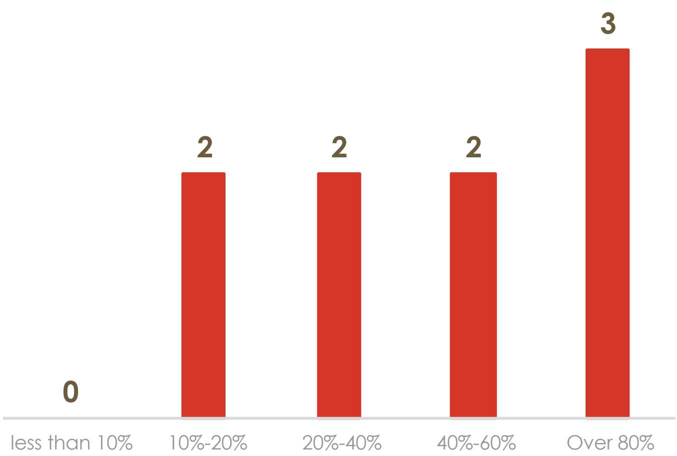
This testing methodology involves simulating scenarios where provisioning covers 70 percent of newly identified non-performing loans (NPLs), with the assumption that banks would not generate any profits to offset these provisions. Under these conditions, the additional provisioning for loan losses is entirely absorbed by the banks' capital reserves. The adverse scenario involves determining the extent of deterioration in bank's credit portoflio that would deplete the "excess" capital buffer. This buffer is defined as the difference between the actual capital held by banks and the minimum capital requirement established by the Central Bank of Oman (CBO). The final output of the test is the distance from peak point which shows the percentage difference between the NPL level at wich new provisions would deplete bank's buffers above the minimum capital requirements and the current NPL ratio.

As of December 31, 2023, reverse stress testing has provided insights into the capacity of the Omani banking system to handle severe credit deterioration. The analysis reveals that the banking system can absorb a deterioration up to 8.5 percent of the curent banking loan portfolio. At the individual level, the assessment demonstrates that seven out of nine domestic banks can endure a deterioration of more than 4 percentage points of performing loans before breaching the CBO's capital requirements, which are much higher than historical annual defult rate of the omani banking system at 1.1 percent. Additionally, the reverse stress test demonstrated that foreign banks have a very high capacity to absorb credit losses, primarily due to their high capital buffer (Graph 3.8).

**GRAPH 3.7**
**DISTANCE FROM BREAK POINT (Percent) FOR DOMESTIC BANKS AS OF 31 DECEMBER 2023**




**GRAPH 3.8**
**DISTANCE FROM BREAK POINT (Percent) FOR FOREIGN BANKS AS OF DECEMBER 2023**




## Liquidity Stress Testing

CBO utilizes two distinct liquidity stress testing approaches. The first approach centers on evaluating the adequacy of the Liquidity Coverage Ratio (LCR) in adverse liquidity conditions. This approach benchmarks banks' stressed LCRs against the regulatory minimum requirements to determine if their counterbalancing capacity is sufficient to withstand continuous liquidity outflows over a one-month period. The second approach focuses on a broader analysis of liquidity risk by examining stressed cash outflows over a six-month horizon. This approach uses hypothetical scenarios (stressed cash flow factors)to simulate extended periods of liquidity strain, assessing banks' ability to remain liquid at the conclusion of the stress test period.

## LCR-based Liquidity Stress Test

The LCR-based liquidity stress test framework aims to evaluate banks' liquidity resilience under various conditions. This framework includes a baseline scenario and two adverse scenarios designed to simulate different levels of liquidity stress. The baseline scenario applies the minimum haircuts and outflow rates stipulated by regulatory standards. In contrast, the adverse scenarios introduce more challenging conditions. Adverse Scenario 1 models higher outflow rates while maintaining the existing haircuts for High Quality Liquid Assets (HQLA). Adverse Scenario 2 exacerbates the stress by incorporating both increased outflows and larger haircuts. Each scenario assesses banks' performance against the regulatory LCR requirement of 100 percent, with detailed descriptions provided in (Box 3.2). Overall, liquidity conditions indicate that the Omani banking sector maintains a strong liquidity position. As of December 2023, the aggregate LCR is recorded at 224 percent, substantially above the regulatory minimum. Even under Adverse Scenario 1, the aggregate LCR is projected to decrease to 176 percent, still significantly exceeding the regulatory threshold (Graph 3.9).

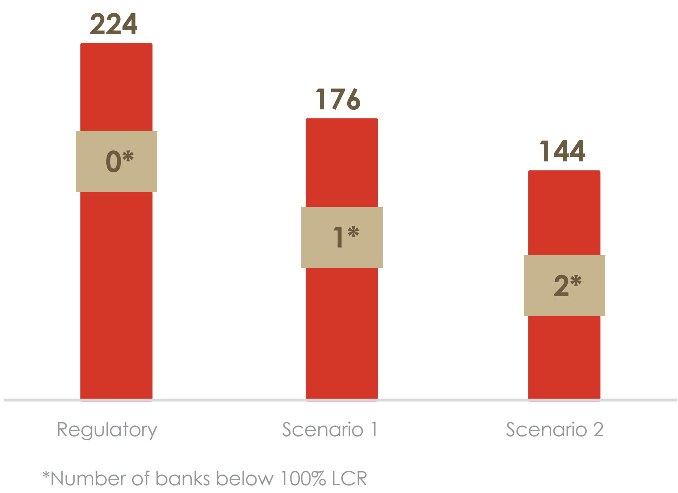
At the individual bank level, Scenario 1 reveals that one bank would experience a slight dip below the required 100 percent Liquidity Coverage Ratio (LCR). However, when subjected to the more severe liquidity pressures of Scenario 2, the bank's LCR is anticipated to decrease to 144 percent and two banks would drop below the required LCR of 100 percent. These reaffirm that banks are effectively maintaining a robust liquidity position, capable of meeting regulatory requirements even under heightened stress conditions.

## Cash Flow Analysis - 6 Months Scenario

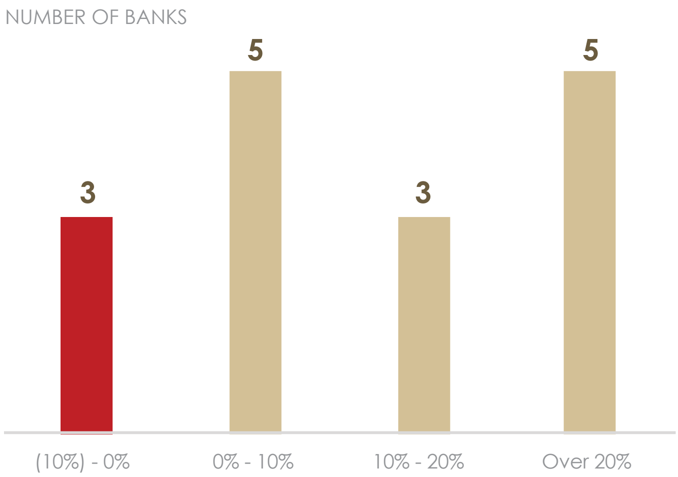
In addressing the risk of simultaneous liquidity stress across multiple banks, a specialized approach has been developed. This methodology involves simulating a range of liquidity shocks, including capital outflows, increased liquidity demands from corporate clients, and deposit withdrawals.

The analysis focuses on the ability of banks to endure these stresses over a six-month period by evaluating net cash flows and the available counter-balancing capacity
The outcome of this approach is the Net Liquidity Position (NLP), which is calculated as the difference between the available liquidity and the projected net cash flows during the stressed period. Assumptions regarding the rates of cash inflow and outflow under stress conditions are detailed in (Box 3.3). The simulations utilize aggregate data from individual banks to assess their liquidity positions after the simulated shocks. Under the hypothetical severe liquidity shock, the simulation projects that the Omani banking system would experience a cash outflow totaling 18.2 percent of its total liabilities over the six-month period. Despite this substantial liquidity outflow, the results indicate that the Omani banking sector retains sufficient counterbalancing capacity to manage the simulated liquidity stresses. At the conclusion of the stress period, the system is expected to maintain a liquidity buffer equivalent to 8.0 percent of total liabilities. Furthermore, all banks, with the exception of three, are anticipated to retain a favorable net liquidity position relative to their total liabilities by the end of the assessment period (Graph 3.10).

**GRAPH 3.9**
**SYSTEM LCR UNDER VARIOUS SCENARIOS**




**GRAPH 3.10**
**RATIO OF SURPLUS/SHORTFALL TO TOTAL LIABILITIES FOR BANKS UNDER 6 MONTHS WIDE SYSTEM STRESSED CASH OUTFLOW AS OF DECEMBER 2023**



## Box 3.1: Credit Risk Model

In the macroprudential stress testing, Satellite models play a crucial role by linking macroeconomic factors with key banking sector metrics. Specifically, within the credit risk framework, a streamlined empirical model is developed to relate macroeconomic variables to the probability of default (PD). This model generates projected PDs for both baseline and adverse scenarios, which are essential for estimating non-performing loans (NPLs) and loan loss provisions over a three-year stress testing horizon. These estimates are then used to assess capital adequacy ratios under varying scenarios. The credit risk model's development relies on a comprehensive dataset covering 72 quarters, from Q1 2006 to Q4 2023. By integrating these projections into the stress testing process, the model provides a detailed analysis of the banking system's resilience to macroeconomic shocks.

### Dependent Variable

The dependent variable for credit risk is a measure of PD or default rate (DR). It is calculated as the he ratio of new non-performing loans (NPLs) accrued over the past four quarters (from t-3 to t) to the initial stock of NPLs recorded (at time t-4) . The use of flow variables, such as the default rate or new NPLs, is favored over stock variables like the total NPLs or the NPL ratio. This preference is due to the fact that stock variables, representing accumulated NPLs over time, do not provide an accurate reflection of current credit risk conditions. Moreover, changes in the stock of NPLs might not necessarily align with changes in credit risk; for example, a decrease in NPLs could result from write-offs rather than an actual improvement in credit quality.Given data constraints, the model is applied to aggregate data from the entire credit portfolio, rather than conducting separate analyses for various economic sectors.

### Explanatory Variables

A range of macroeconomic variables potentially impacting debt servicing capacity or the default rate (DR) was evaluated as candidates for explanatory variables in the estimation process. These variables encompass fluctuations in oil prices, real GDP growth, lending rates, inflation, and stock market returns. Due to the availability of real GDP data exclusively on an annual basis, this data was interpolated to produce quarterly figures. The annual real GDP growth was then computed as the year-over-year (YoY) growth rate, enabling a more granular analysis of its impact on debt servicing and default probabilities.

## Estimation of Model

To estimate the model, the default rate (DR) was utilized as the dependent variable, with a set of macroeconomic indicators serving as explanatory variables. The DR was modeled as a function of macroeconomic trends and developments as outlined below:

$$DR_t = ß_X * X_{t-L} + \varepsilon_t, \quad \text{for } t=1,\ldots,T$$

Where, $DR_t$ is the probability of default for the banking sector at time t, $X_t$ is a vector of macroeconomic variables the sub-index L denotes time lags, and. $\varepsilon_t$t is an iid error term.

Several model specifications were evaluated, with the final model selected based on economic rationale (i.e., correct sign of coefficients), statistical significance, economic relevance, and overall model fit. The chosen model incorporates variables such as oil price growth, lagged lending rates, real GDP growth, and inflation. The default rate exhibits a negative relationship with changes in oil prices, real GDP growth, and inflation, while showing a positive relationship with lending rates. These findings align with existing literature on the subject. The detailed estimation results are presented in (Table 3.1.1).

**Table 3.1.1:**

| Regression Coefficients | Default Rate |
|---|---|
| Oil Price Growth (first difference) | -0.00278** |
| | (0.00127) |
| Lending Rates $_{t-1}$ | 0.229*** |
| | (0.0488) |
| Real GDP Growth | -0.0115**** |
| | (0.00668) |
| CPI Inflation $_{t-4}$ | -0.0289* |
| | (0.0146) |
| Constant | 0.000326 |
| | (0.00271) |
| Observations | 72 |
| R-squared | 0.300 |

Standard errors in parentheses
*** p<0.01, ** p<0.05, * p<0.1

## Box 3.2: Assumptions Underlying the LCR Stress Tests

| | | Scenarios | |
|---|---|---|---|
| **A. Deposits Outflow** | **Regulatory LCR** | **1** | **2** |
| **Retail Deposits (Customer Deposits):** | | | |
| Demand Deposits + Term Deposits with residual maturity up to 30 days | | | |
| ...Stable deposits (deposit insurance scheme meets addl criteria) | 3.0% | 4.5% | 6.0% |
| - Stable Deposits | 5.0% | 7.5% | 10.0% |
| - Less Stable retail Deposits | 10.0% | 15.0% | 20.0% |
| Term Deposits with residual maturity of more than 30 days | 0.0% | 0.0% | 0.0% |
| **Unsecured Wholesale Funding:** | | | |
| Demand and term deposits (less than 30 days) -stable deposits | 5.0% | 7.5% | 10.0% |
| Less Stable deposits | 10.0% | 15.0% | 20.0% |
| Non-financial corporates, sovereigns, central banks and PSE | 40.0% | 50.0% | 50.0% |
| …If entire portion covered by deposit insurance | 20.0% | 25.0 % | 25.0% |
| Operational deposits generated by clearing, custody and cash management activities | 25.0% | 37.5 % | 50.0% |
| **B. HQLA Haircuts** | | | |
| **Level 1 assets:** | | | |
| Coins and bank notes | 100.0% | 100.0% | 100.0% |
| Qualifying central bank reserves | 100.0% | 100.0% | 100.0% |
| Qualifying marketable securities from sovereigns, central banks, PSEs and multilateral development banks | 100.0% | 100.0% | 90.0% |
| Domestic sovereign or Central Bank debt for non-0 percent risk weighted sovereigns | 100.0% | 100.0% | 90.0% |
| **Level 2 assets:** | | | |
| Sovereign, CB, PSE, multilateral development banks assets (qualifying for 20 percent risk weighing) | 85.0% | 85.0% | 75.0% |
| Qualifying Corporate debt securities AA- or higher | 85.0% | 85.0% | 75.0% |
| Qualifying Covered bonds AA- or higher | 85.0% | 85.0% | 75.0% |
| **Level 3 assets:** | | | |
| Qualifying corporate debt securities, rated between A+ and BBB- | 50.0% | 50.0% | 50.0% |
| Qualifying common equity shares | 50.0% | 50.0% | 50.0% |

## Box 3.3: Assumptions Underlying the Cash Inflow/ Outflow over the Stress Scenarios of 6 Months

| Segment | Factor value |
|---|---|
| | 6 months |
| **A. Cash Outflow Rates** | |
| Current Deposits | 25% |
| Saving Deposits | 20% |
| Time Deposits | 15% |
| Other Deposits | 25% |
| Balances due to Other Banks | 100% |
| Other Borrowings | 100% |
| Bills Payable | 100% |
| Interest Payable | 100% |
| Repos | 100% |
| Committed lines of credit | 100% |
| Unutilized portion of overdraft and loans and advances | 100% |
| **B. Cash Inflow Rates** | |
| Balances due from HO/Affiliates/Branches | 100% |
| Balances due from Other Banks | 90% |
| Bills of Exchange and Promissory Notes | 80% |
| Overdrafts | 15% |
| Loans and Advances | 15% |
| Accrued Interest | 100% |
| Committed Lines of Credit | 100% |
| **C. Counterbalancing Capacity** | |
| Cash on Hand | 100% |
| Deposits with CBO | 100% |
| Investments | 80% |

Continuous Enhancement & Prosperity