Chapter Five

Money, Banking and Financial Institutions

MONEY, BANKING AND FINANCIAL INSTITUTIONS

The global financial system has in the past couple of years experienced several challenges. Apart from globalisation and financial integration issues, economic recessions and consequent adverse effects on growth in various countries impacted the financial system. The slowdown in the technology, media and telecom sectors, corporate accounting irregularities, widespread equity price declines and world financial markets passing through several upheavals tested the resilence of the international financial strength. Substantial easing of monetary policy, brought about by successive reductions in interest rates resulted in one of the most benign interest rate environment in recent decades world over. Exchange rates of major currencies showed swings both in terms of direction and volatility. Remarkably, the global financial system has remained resilient and stability has been maintained. Inflationary pressures across the globe remained relatively subdued. Progress has been made in strengthening financial infrastructures in the major international financial centers. Financial transparency and strengthened corporate governance are being pursued globally. The challenge going forward will be to ensure its effective implementation and enforcement. Domestically, the Central Bank of Oman continued to strengthen its supervisory and regulatory norms in line with international best practices. The strict accounting standards pursued coupled with stringent provisioning requirements required from the domestic banks in the previous year paid off, with the banks reporting high levels of profits and asset quality. Greater use of indirect monetary policy instruments, stiff capital adequacy norms, technological advancements, mergers and consolidation and a host of regulatory and prudential norms created the environment for confidence and stability in the banking system. A Financial Sector Assessment Program (FSAP) for Oman was conducted recently by a joint IMF/World Bank team. The assessment indicates that the banking and supervisory system compares well with international standards and measures.

The institutional framework of the financial sector in Oman comprises mainly the commercial banks and specialized banks. As at the end of the year 2002, the number of commercial banks stood at 15, of which six are locally incorporated and nine are branches of foreign banks together having a branch network of 330. With the merger of Majan International Bank with Bank Dhofar Al Omani Al Fransi in March 2003 the number of locally incorporated banks now number five. There were also 3 specialised banks in operation. The Oman Housing Bank and Oman Development Bank are owned by the Government, while the Alliance Housing Bank is privately owned. The specialized banks operated a network of 26 branches. As at the end of 2002, 11 commercial banks had been given approval to engage in specific investment banking activities on a tiered licensing system. There were also six non-bank financial institutions licensed by CBO engaged in hire purchase, leasing, debt factoring and similar credit based operations. Money exchange establishments stood at 45 of which 13 bureaus operated under the license of money exchange and draft issuance business. Besides the above, the non-bank financial intermediation sector also includes the insurance companies, public and private pension funds, capital markets, brokerage companies and the Muscat Securities Market.

Banking Policy and Developments

Oman's financial sector has been considerably strengthened and transformed in recent years with a modern financial system which can ensure sustainable development. Banks and other non-bank financial intermediaries participated largely in the country's efforts to achieve higher growth trajectory. Comfortable international reserves and sound macroeconomic policies have supported the financial system which operates in a liberalized economic environment. The banking sector experienced successive rounds of consolidation beginning in the 1990's with the commercial banks now comprising 14 and specialized banks 3. The banking system is however, dominated by three local banks accounting for 69 percent of total assets, 65 percent of total deposits and 70 percent of total credit as of end 2002. Commercial banks total assets stood at RO 4362.7 million amounting to 56 percent of GDP in 2002. Lending to the private sector accounted for 70 percent of total assets and 93 percent of total credit. Ten percent of total assets was held in securities which included local and foreign treasury bills and development bonds. Commercial bank liabilities are dominated by deposits which represented 64 percent while private sector deposits accounted for 52 percent. Core capital and reserves constituted 10 percent of total liabilities while supplementary capital elements amounted to another 2.3 percent.

The Central Bank of Oman has been moving towards the use of indirect monetary policy instruments in its liquidity management. Banks can repo Treasury bills, Development bonds and CDs issued by the CBO in the interbank as well as with the Central Bank. CD auctions are the main open market type operations the CBO currently conducts to absorb RO liquidity. To ease the excess liquidity conditions, the Central Bank reintroduced weekly CD auctions but beginning March 2003, only 28 day maturities are issued. Banks have access to a foreign exchange swap facility against US dollars at the CBO within individual bank limits. Interest rates in Oman are market determined with the exception of the interest rate ceiling on personal loans, currently at 11 percent.

The 5 percent reserve requirement mainly serves prudential objectives. Upto 3 percentage points can be covered by Treasury bills, development bonds and Central Bank CDs and the balance can be covered by cash in vaults or as clearing balances with the CBO. The Central Bank mainly uses the lending ratio instrument to influence banks intermediation activity. Currently it is set at 87.5 percent loan to deposit ratio. In addition, the CBO uses certain prudential and credit regulations to influence the intermediation of the banking system. To encourage the allocation of credit to the corporate sector, personal loans are limited to 40 percent of a bank's total credit. A bank's investment in shares and securities of corporations cannot exceed 20 percent of its net worth, subject to a maximum of 5 percent of each issuer's share capital. Banks are prohibited from investing more than 30 percent of its net worth in development bonds. This policy is designed to avoid crowding out the private sector and to ensure that Pension Funds and other institutions also have access to these securities. The Central Bank has also imposed a cap on the extension of credit facilities by banks to non-residents for operations abroad : the aggregate of direct and indirect obligations should not exceed 5 percent of the net worth of the lending bank for any non-resident individual borrower and for all non resident borrowers together the bank has to operate within a limit of 30 percent of its net worth.

The Central Bank of Oman continues to strengthen its supervisory and regulatory norms aligning them with the international best practices in order to safeguard the integrity, efficiency, soundness and stability of the financial system. Banks are being encouraged to fine-tune their risk management systems, corporate governance, internal control systems and disclosure and transparency practices. The supervisory initiatives have also been guided by the Central Banks' strong resolve in achieving full compliance with the Basel Core Principles (see box). Banks have been mandated to have in place comprehensive risk management processes including appropriate board and senior management oversight to identify, measure, monitor and control all sources of risk. Recognizing the need for evolving a framework that is consistent with the level of sophistication and operating environment, the Central Bank had issued comprehensive Guidelines on Risk Management Systems in Banks, based on international best practices, for implementation by all licensed banks. The Guidelines broadly cover management of credit, market and operational risks. The Guidelines are purported to serve as a benchmark to banks, which are yet to establish integrated risk management systems. Banks can evolve their own systems compatible with the type and size of operations as well as risk perception. The current off-site supervisory approach i.e. the Banks Off-Site Surveillance (BOSS) System is fundamentally based on micro-prudential approach that focuses only on bank-specific vulnerabilities. The Central Bank has decided to strengthen the approach by adding a macro- prudential dimension to the existing BOSS System. Accordingly, a new set of indicators has been constructed to assess the systemic vulnerability of the financial sector in the Sultanate. The Financial Soundness Indicators are designed to signal potential threats to the system and the relative strengths of individual financial institutions.

The Central Bank has been according utmost importance on enhancing corporate governance practices amongst banks and financial institutions in the Sultanate. Accordingly, detailed guidelines on corporate governance have been issued with the objectives of laying down the principles of demarcation between the role, responsibility and accountability of the Board of Directors and the line management. It is now incumbent on the banks and financial institutions to institute appropriate institutional and control mechanism to protect the interests of depositors, shareholders and other stakeholders.

Informational asymmetry is one of the biggest challenges to the financial institutions in taking informed credit decisions. In order to improve the quality of information, submission of audited financials have been made compulsory for credit users of RO. 250,000 or more and RO. 500,000 and above, if availed from more than one financial institution. Furthermore, the classification status of borrowers is now available, on-line to the banks and financial institutions, which will be contributing positively in improving the credit risk assessment mechanism and asset quality. Steps are underway to adopt the more risk sensitive Capital Accord which the Basel Committee is planning to introduce.

Oman adopts a strictly preventive approach towards money laundering and has an appropriate and strong legal and institutional framework, particularly with respect to preventive financial measures. Money Laundering Law was issued through Royal Decree 34/2002. The Law made the existing relevant provisions of earlier laws, regulations and instructions on the subject on a firm and formal footing besides introducing new clauses. Internal control arrangements, developing programmes for implementational of policies, protective clauses for disclosure, reporting of suspicious transactions etc. have been mandated. Penalties for offences have been clearly defined and made more stringent. Finally the eight additional recommendations of the Financial Action Task Force (FATF) as regards combating terrorism financing were adopted and conveyed to licensed institutions for compliance.

Compliance with Core Principles for Effective Banking Supervision in the Sultanate

1. The Core Principles for Effective Banking Supervision, articulated by the Basel Committee on Banking Supervision serve as an international benchmark on banking supervision and set out basic features of an effective bank-supervisory regime. Supervisors across various jurisdictions benchmark their supervisory systems against the Core Principles. The effectiveness of banking supervision, therefore, in any jurisdiction, can be assessed against the Core Principles. The Core Principles were initially enunciated as 25 Principles in 1997.

2. The Basel Committee has specified ‘essential’ and ‘additional’ criteria for each of the Principles, which are intended to judge compliance more objectively. Compliance with each Principle will require that the ‘essential criteria’ be met without any significant deficiencies. The ‘additional’ criteria are also best practices for supervision and will be a valuable tool in ensuring that the supervisory regime will keep up with the best practices. A five-point scale using the categories ‘compliant’, ‘largely compliant’, ‘materially not compliant’, ‘not compliant’ and ‘not applicable’ is being used to assess the degree of compliance, which methodology is also used by IMF/World Bank under Financial Stability Assessment Programme (FSAP) missions to assess the degree of compliance with Core Principles, in member countries.

3. Taking into account the subtleties in the operating environment of the banking system in the Sultanate, the Central Bank carried out a self-assessment of compliance with the Core Principles. The assessment, on the five-point scale, has revealed a high degree of compliance. The areas of non-compliance were - formal arrangements for exchange of information with domestic and cross-border supervisory agencies, explicit

capital charge for market risk against position in the trading book, lack of robust risk management systems in banks and authority on the appointment and removal of external auditors of banks.

4. The system of exchange of information with domestic and overseas supervisory agencies, on an informal basis, was well established in the Sultanate. Notwithstanding, Memoranda of Understanding (MOUs), drawn up on the lines of international best practices, are being executed with all host country supervisors of Omani banks. The Central Bank has also issued comprehensive Guidelines on Risk Management Systems in Banks, containing international best practices on the management of all material sources of risks, more particularly credit, market, operational, country and transfer risks, which shall form as benchmark to banks in enhancing their existing risk management policies, practices and procedures. A new Regulation is being framed to enhance the relationship between the Central Bank and the external auditors of licensed banks. The Central Bank is also planning to mandate explicit capital charge for market risk shortly.

5. With these refinements in supervisory practices, the Sultanate will be one among the rare category of Supervisors, which are almost in full compliance with the Core Principles. The joint Mission of the IMF/ World Bank has recently assessed that the regulatory regime in the Sultanate largely complies with international standards.

Monetary Development and Domestic Liquidity

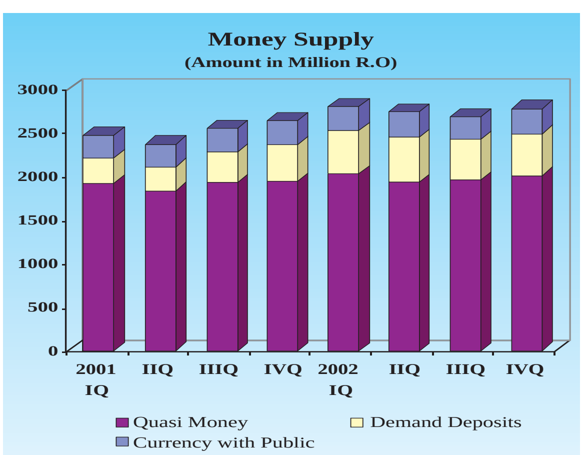
The primary objective of monetary policy is to maintain the peg vis-à-vis the US dollar with a view to maintaining price stability. The peg should be seen in the context of the Sultanate's oil export contracts fixed in US dollars and the medium term objective of a monetary union with the other GCC countries, which also have pegged their currencies to the dollar. The Central Bank has a range of standing facilities if banks need liquidity such as the repo facility, swap facility, rediscounting policies and the like. Treasury bills , development bonds and Central bank certificate of deposits on the other hand facilitate the absorption of liquidity. The inter-bank money market generally succeeds in recycling the liquidity among banks. Overall policies are aimed at smoothening out short term fluctuations in bank liquidity to avoid excessive adjustment costs to the banking system.

During the year 2002, the narrow measure of money supply (M1) which comprises the aggregate of currency with the public and local currency demand deposits rose by 10.7 percent to reach RO 769.2 million. The components of M1 reflected an increase of 14.5 percent in Rial Omani demand deposits while currency with the public witnessed a rise of 5 percent over the year. Quasi money (Rial Omani savings, time deposits, margins and foreign currency deposits) registered a moderate growth of 3.3 percent over the year to reach RO 1993.8 million compared to RO 1930.8 million a year ago. The impetus for quasi money growth came from Rial Omani saving deposits which increased from RO 467 million to RO 567.6 million while foreign currency deposits rose to RO 324.7 million compared to RO 202.9 million a year ago. The growth in quasi money on account of the above two components was largely offset by a sharp fall in Rial Omani time deposits during the period from 1237.4

Table 5.1
Monetary Survey

End of Period	Amount in Million RO 1998	1999	2000	2001	2002	Change in million RO 2002/01	% Change 2002/01
1. Domestic Liquidity (A+B)	**2131.3**	**2267.5**	**2404.0**	**2625.5**	**2763.0**	**137.5**	**5.2**
A. Money	502.8	509.5	533.9	694.7	769.2	74.5	10.7
a) Currency with public	244.3	273.5	276.8	275.9	289.7	13.8	5.0
b) Demand deposits in RO	258.5	236.0	257.1	418.8	479.5	60.7	14.5
B. Quasi Money	1628.5	1758.0	1870.1	1930.8	1993.8	63.0	3.3
(of which foreign cy. deposits)	(261.0)	(204.2)	(221.9)	(202.9)	(324.7)	(121.8)	60.0
2. Foreign Assets (net)	**654.1**	**829.3**	**773.8**	**731.7**	**1156.2**	**424.5**	**58.0**
Central Bank	771.2	1090.0	941.0	939.9	1219.8	279.9	29.8
Commercial Banks	-117.1	-260.7	-167.2	-208.2	-63.6	144.6	
3. Domestic Assets	**1477.2**	**1438.2**	**1630.2**	**1893.8**	**1606.8**	**-287.0**	**-15.2**
a) Claims on Government (net)	8.2	-220.3	-4.5	201.5	90.4	-111.1	-55.1
i) Government borrowings	357.6	338.4	327.5	506.4	382.9	-123.5	-24.4
Less : ii) Government deposits(-)	(-349.4)	(-558.7)	(-332.0)	(-304.9)	(-292.5)	12.4	
b) Domestic claims on Pvt. Sector	2563.1	2783.3	2809.2	3001.5	3012.7	11.2	0.4
c) Claims on Public enterprises	-	4.1	16.3	28.1	46.0	17.9	63.7
d) Other items (net)	-1094.1	-1128.9	-1190.8	-1337.3	-1542.3	-205.0	
i) Monetary authorities	-629.5	-577.8	-642.8	-724.1	-939.6	-215.5	
ii) Commercial banks	-464.6	-551.1	-548.0	-613.2	-602.7	10.5	

Source : Central Bank of Oman



million to RO 1076.9 million. The broad measure of money M2 (M1+quasi money) thus increased by 5.2 percent over the year to reach RO 2763 million as at the end of December 2002.

The factors affecting changes in broad money are given in the Monetary Survey Table 5.1. It can be seen that the increase in broad money by RO 137.5 million during the one year period ended December 2002

Table 5.2
Money Supply

End of Period	M1 Million RO	M1 % Change over prev. period	M1 % Change over 12 Months	M2 Million RO	M2 % Change over prev. period	M2 % Change over 12 Months
1998	502.8	-6.7	-6.7	2131.3	4.8	4.8
1999	509.5	1.3	1.3	2267.5	6.4	6.4
2000	533.9	15.7	4.8	2404.0	3.7	6.0
2001						
IQ	556.7	4.3	9.3	2460.8	2.4	12.1
IIQ	646.8	16.2	28.2	2459.3	-0.1	9.1
IIIQ	615.5	-4.8	33.4	2534.8	3.1	14.4
IVQ	694.7	12.9	30.1	2625.5	3.6	9.2
2002						
Jan	711.5	2.4	38.5	2686.5	2.3	12.2
Feb	750.1	5.4	37.8	2759.7	2.7	13.4
Mar	772.6	3.0	38.8	2786.6	1.0	13.2
Apr	744.5	-3.6	27.2	2708.6	-2.8	8.0
May	771.7	3.7	24.9	2744.7	1.3	9.3
June	805.7	4.4	24.6	2724.8	-0.7	10.8
July	761.7	-5.5	24.1	2708.3	-0.6	11.1
Aug	726.7	-4.6	14.8	2671.1	-1.4	9.5
Sept.	724.9	-0.2	17.8	2674.0	0.1	5.5
Oct.	749.2	3.4	17.5	2710.1	1.4	6.5
Nov.	729.0	-2.7	16.5	2711.0	0.1	6.3
Dec.	769.2	5.5	10.7	2763.0	1.9	5.2

Source: Central Bank of Oman

Table 5.3
Components of Private Domestic Liquidity
Millions of R.O.

A. In Million Rial Omani

End of the Period	1998	1999	2000	2001	2002
Money Supply (M1)	502.8	509.5	533.9	694.7	769.2
Currency with public	244.3	273.5	276.8	275.9	289.7
Demand deposits in local currency	258.5	236.0	257.1	418.8	479.5
Quasi Money	1628.5	1758.0	1870.1	1930.8	1993.8
Savings deposits in local currency	358.6	340.4	389.8	467.0	567.6
Time deposits in local currency	989.3	1186.5	1236.0	1237.4	1076.9
Deposits in foreign currency	261.0	204.2	221.9	202.9	324.7
Margins	19.6	26.9	22.4	23.5	24.6
Overall Domestic Liquidity (M2)	**2131.3**	**2267.5**	**2404.0**	**2625.5**	**2763.0**

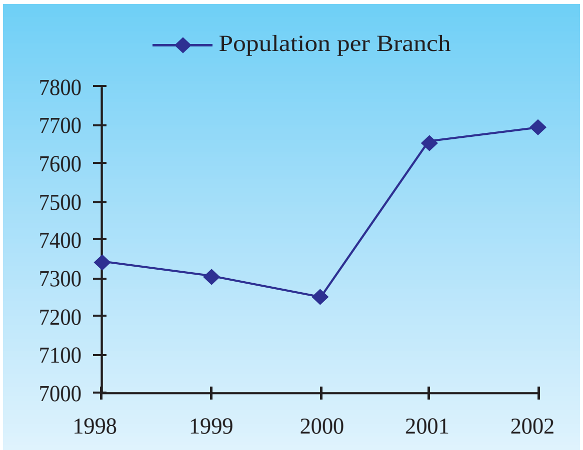
B. Percentage Total

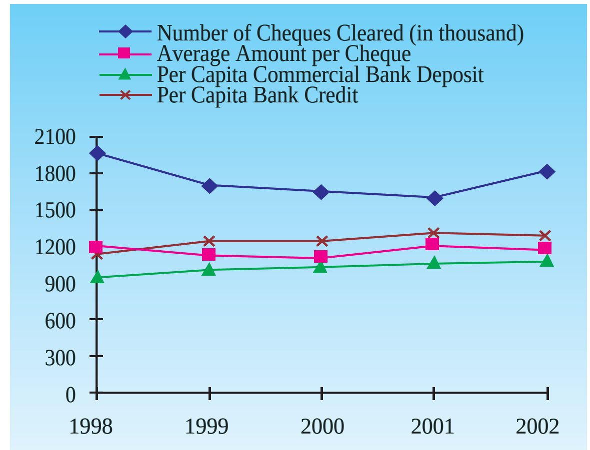
End of the Period	1998	1999	2000	2001	2002
Money Supply (M1)	23.6	22.5	22.2	26.5	27.8
Currency with public	11.5	12.1	11.5	10.5	10.5
Demand deposits in local currency	12.1	10.4	10.7	16.0	17.3
Quasi Money	76.4	77.5	77.8	73.5	72.2
Savings deposits in local currency	16.8	15.0	16.2	17.8	20.5
Time deposits in local currency	46.4	52.3	51.4	47.1	39.0
Deposits in foreign currency	12.2	9.0	9.2	7.7	11.8
Margins	1.0	1.2	1.0	0.9	0.9
Overall Domestic Liquidity (M2)	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**

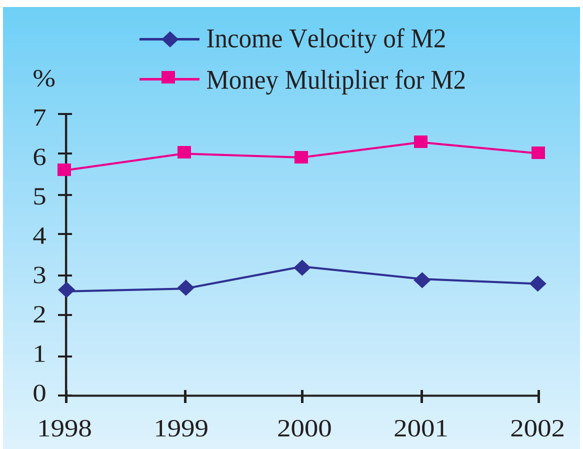
Source: Central Bank of Oman

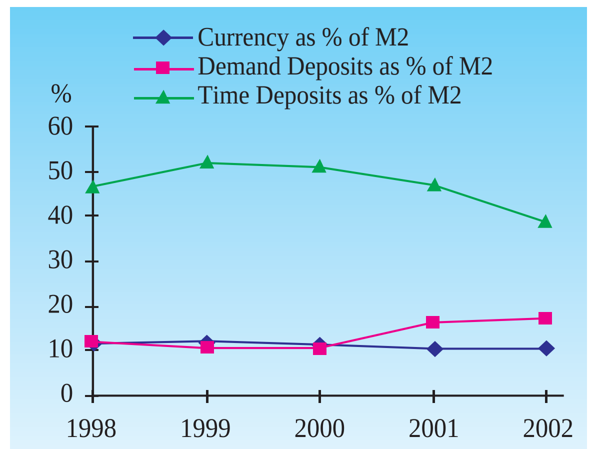
was accounted by an increase of RO 424.5 million in net foreign assets of the banking system, partly offset by the decline in domestic assets by RO 287 million. The Central Bank's net foreign assets registered an impressive increase of RO 279.9 million while commercial banks' net foreign assets also showed an increase of RO 144.6 million. Domestic claims on the private sector went up marginally by RO 11.2 million while claims on public enterprises rose by RO 17.9 million over the year. Net claims on the Government was reduced by RO 111 million as a result of improved fiscal position during the year.

The comparative position with regard to the rates of expansion of money for individual years for the five year period 1998 to 2002 is given in Table 5.2 and the components of the monetary aggregates in Table 5.3. It can be seen that over this period of five years, the growth rate of broad money remained fairly stable and moved within a reasonable band averaging 6.3 percent. The narrow measure of money M1 however, displayed major bouts of volatility during the period as a result of movements in Rial Omani demand deposits associated with the interest rate environment. Large shifts towards demand deposits particularly in 2001 and early 2002 was attributed to the fact that almost similar rates of interest were offered to term deposits as well as to large corporate demand deposits under Pension Funds. The changes in the composition of money stock reveals that while the share of currency with the public remained unchanged in 2001 and 2002 demand deposits increased its share from 16 percent to 17.3 percent. Within quasi money, savings deposits in local currency increased its share from 16.2 percent in 2000 to 17.8 percent in 2001 and further to 20.5 percent in 2002. The prize schemes on saving deposits would have a bearing on this development. Deposits in foreign currency registered a significant improvement in its share to overall money supply from 7.7 percent in 2001 to 11.8 percent in 2002. Time deposits in local currency, on the other hand witnessed a sharp fall in its share from 47.1 percent to 39 percent. The interest rate factor played a significant role in these developments.









Monetary and Banking Indicators

Financial markets remained fairly stable over most of the year despite global uncertainties with respect to both the geopolitical situation and the sluggish pace of the recovery. Interest rates, both domestic and international remained subdued while in the foreign exchange markets the US dollar depreciated markedly against the Euro as well as other currencies. Global inflation remained low and the CPI for Oman reported negative rate of inflation. In the banking sector, commercial banks reported high profitability levels following a difficult period in the previous year. Private sector credit remained sluggish while deposits registered growth leading to easy liquidity conditions. Overall domestic liquidity remained in tune with non-oil GDP growth. Comfortable international reserves and sound macro-economic policies have supported the financial system's robustness and enabled the development of financial products and markets. The nature of financial deepening that evolved can be summarized in a few indicators presented in Table 5.4. The number of commercial bank branches increased from 324 in 2001 to 330 in 2002 and the population served per branch also rose from 7654 to 7691. There was a substantial increase in the number of cheques cleared from 1.59 million in 2001 to 1.82 million in 2002 which is reflective of the increasing role of banks in the payments and settlement of transactions. Financial deepening, which can be measured by quasi money and broad money in percent of GDP, increased from 24.5 percent in 2000 to 25.6 percent in 2002 for the former, and from 31.5 percent in 2000 to 35.4 percent in 2002 for

Table 5.4
Select Monetary and Banking Indicators

	1998	1999	2000	2001	2002
Population estimate (in million) *	2.29	2.33	2.40	2.48	2.54
Number of branches of Commercial Banks	312	319	331	324	330
Population per branch	7339	7304	7251	7654	7691
Number of cheques cleared (in thousand)	1965	1695	1647	1589	1818
Average amount per cheque	1195	1129	1101	1208	1173
Commercial Bank deposits (in million)	2193.9	2349.6	2507.4	2683.1	2777.2
Per capita commercial bank deposit	958	1008	1045	1082	1093
Total commercial bank credit (in million)	2629.8	2898.9	2980.7	3241.0	3270.3
Per capita bank credit	1148	1244	1242	1307	1288
Share of currency in GDP (percent)	4.5	4.6	3.6	3.6	3.7
Share of quasi-money to GDP (percent)	29.9	29.2	24.5	25.2	25.6
Share of broad money to GDP (percent)	39.4	37.5	31.5	34.2	35.4
Income velocity of M2	2.6	2.7	3.2	2.9	2.8
Reserve Money	379.6	375.4	408.3	416.4	459.8
Money multiplier for M2	5.6	6.0	5.9	6.3	6.0

* *mid year estimate*

Table 5.5
Central Bank of Oman Assets and Liabilities (Million R.O.)

	1998	1999	2000	2001	2002	Growth (%) 2001/2000	Growth (%) 2002/2001
Foreign Assets	771.6	1090.4	941.4	940.3	1220.2	-0.1	29.8
a) Gold	26.3	26.3	26.3	31.0	0.1	17.9	-99.7
b) IMF Reserve assets	23.1	27.0	26.5	33.8	41.6	27.5	23.1
c) Balances with banks abroad	426.4	618.8	396.3	112.4	192.5	-71.6	71.3
d) Securities	295.8	418.4	492.3	763.1	986.0	55.0	29.2
Due from Government	159.1	3.8	4.5	79.4	25.7	-	-67.6
Due from Banks and other Institutions	12.5	30.1	2.9	-	-	-	-
Fixed Assets	12.2	8.3	6.9	6.0	5.7	-13.0	-5.0
Other Assets	68.9	100.4	97.8	88.6	89.6	-9.4	1.1
Total Assets / Liabilities	**1024.3**	**1233.0**	**1053.5**	**1114.3**	**1341.2**	**5.8**	**20.4**
Currency Issued	279.5	328.5	327.6	314.1	338.5	-4.1	7.8
Net Worth	508.7	509.6	531.9	573.0	666.0	7.7	16.2
a) Capital	200.0	250.0	250.0	250.0	300.0	-	20.0
b) General Reserves	94.6	59.1	89.7	120.5	86.9	34.3	-27.9
c) Others	214.1	200.5	192.2	202.5	279.1	5.4	37.8
Due to Government	57.0	242.6	26.0	19.4	16.1	-25.4	32.5
Due to banks and other institutions	100.1	46.9	80.7	102.3	121.3	26.8	18.6
Foreign Liabilities	0.4	0.4	0.4	0.4	0.4	-	-
Other Liabilities	78.6	105.0	86.9	105.1	198.9	20.9	89.2
a) CDs	-	-	-	27.8	119.0	-	328.1
b) Others	78.6	105.0	86.9	77.3	79.9	-11.0	3.4

Source : Central Bank of Oman

the latter. The income velocity of money (the ratio of GDP at current prices to M2) declined from 3.2 in 2000 to 2.8 in 2002 while the money multiplier with respect of M2 (M2 over reserve money) rose from 5.9 in 2000 to 6.3 in 2001 but fell back to 6 in 2002.

Central Bank Operations

A comparative position of the balance sheet of the Central Bank is given for a five year period in Table 5.5. As can be seen from the data presented, the pattern of growth in total assets is largely dependent on the growth of foreign assets which constitutes the major item in total assets. Total assets of the Central Bank stood at RO 1341.2 million at the end of 2002 compared to RO 1114.3 million a year ago, giving an increase of 20.4 percent. Foreign assets increased sharply by 29.8 percent in 2002 from RO 940.3 million in 2001 to RO 1220.2 million after having registered a marginal drop of 0.1 percent in the previous year. The level of foreign assets is linked to the order of foreign currency deposits of the Government held with CBO, Rial Omani requirements of the Government against which foreign currency is tendered and sale or purchase of foreign currency to or from commercial banks for import, export and remittance purposes. Over the years, the composition of foreign assets strongly indicate a distinct preference towards bonds and securities in the portfolio rather than in balances with banks. Investments in bonds and securities thus increased from RO 295.8 million in 1998 to RO 763.1 million in the year 2001 and further to RO 986 million in 2002. On the other hand, balances maintained with banks abroad fell significantly from RO 618.8 million in 1999 to RO 192.5 million by the end of 2002. A significant development that took place during the year is the sale of gold, the value of which is reported in the balance sheet at RO 0.1 million in 2002 from RO 31 million in 2001.

Table 5.6
Central Bank's Own Foreign Assets
Millions of R.O.

	Dec. 2001	Dec. 2002	Absolute Change 2002/2001
1. Gross Foreign Assets	940.3	1220.2	279.9
a) Gold	31.0	0.1	-30.9
b) IMF Reserve Assets	33.8	41.6	7.8
c) Short term placements	112.4	192.5	80.1
d) Securities	763.1	986.0	222.9
Less:			
Foreign currency deposits from Government	19.4	16.1	-3.3
Foreign currency deposits from local banks	-	-	-
2. Central Bank's own foreign assets	920.9	1204.1	283.2

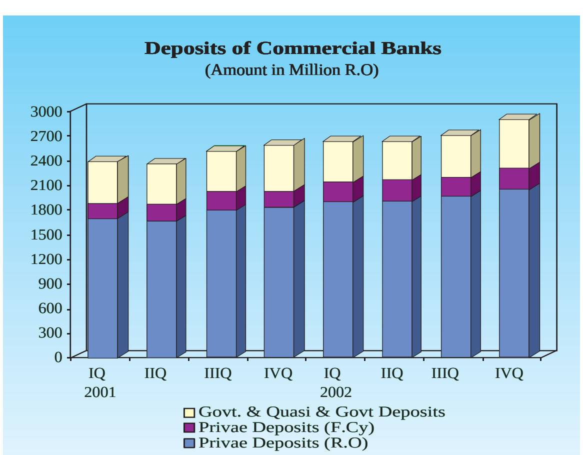
Source : Central Bank of Oman

Currency issued by the Central Bank registered an increase of 7.8 percent, from RO 314.1 million in 2001 to RO 338.5 million in 2002. Networth of the Central Bank also rose significantly by 16.2 percent to reach RO 666 million as at the end of 2002. While capital was augmented from RO 250 million to RO 300 million, general reserves declined from RO 120.5 million to RO 86.9 million. General reserves constituted 25.7 percent of currency issued as at the end of 2002. Other reserves also witnessed major increases during 2002. These include RO 7 million increase in reserves against Bond Fluctuation and RO 4 million rise in reserves against Currency fluctuation to RO 36.5 million and RO 76 million respectively. Currency and financial asset valuation reserves were also augmented during the year. Central Banks liabilities to local banks in the form of clearing balances and capital deposits also rose from RO 102.3 million in 2001 to RO 121.3 million in 2002. Certificate of deposits issued by the Central Bank stood at RO 119 million as at the end of 2002 compared to RO 27.8 million at the end of the previous year.

Commercial Banks Operations

The challenge facing commercial banks in Oman is the efficient mobilization of savings and optimal financial intermediation to ensure that the mobilized resources are deployed to maximize overall real output of the economy. By and large, the most important financial intermediaries in Oman are the commercial banks. Diversified instruments for savings mobilization, an efficient regulatory and supervisory framework, reinforced institutional environment and a well functioning capital market help to channel available resources into productive activities. Banks in Oman maintain strong capital footings, are well provisioned, adopt stringent credit quality procedures, follow international accounting standards and are transparent in disclosures. A series of consolidation and mergers which commenced in the 1990's continues to date leading to bigger and stronger commercial banks. Above all, a well established Bank Deposit Insurance Scheme is also in place providing support, confidence and protection to the banking public.

Data on commercial banking aggregates is provided in table 5.7. During the year 2002, total assets of commercial banks rose by 3.8 percent to RO 4362.7 million. Total credit rose moderately by 0.9 percent to RO 3270.3 million as at the end of 2002. However, credit to the private sector registered a marginal decline of 0.6 percent over the year. The decline can be mainly attributed to banks becoming cautious and undertaking only quality lending following their earmarking of large provisions for non-performing loans in the previous year. Industry wise deployment of credit generally registered declines in all major sectors barring personal loans, utilities sector and agriculture.



Investments by commercial banks in local treasury bills stood at RO 69 million while holdings of Government Development Bonds amounted to RO 118.4 million as at the end of 2002. Investment in shares and securities in the domestic market reduced to RO 24.1 million as at the end of 2002 from RO 32.7 million a year ago. Investment in foreign securities and treasury bills increased by 14.7 percent to RO 85.9 million. Investment by banks in certificate of deposits issued by the Central Bank of Oman stood at RO 119 million at the end of the year as banks increasingly used this avenue for parking their excess short term funds.

Total deposits held with commercial banks rose by 3.5 percent to reach RO 2772.2 million over the 12 month period ended December 2002. Of these deposits, Rial Omani deposits accounted for 86.6 percent and foreign currency designated deposits the remaining 13.4 percent. Private sector deposits grew by 4.1 percent and the increase was mainly reflected under savings deposits followed by demand deposits. Time deposits registered a decline of 7.7 percent to RO 1159.8 million. Balances due to banks

Table 5.7
Combined Balance Sheet of Commercial Banks
Amount in Million R.O.

	1998	1999	2000	2001	2002	% Change 2002/2001
Cash and deposits with CBO	134.8	101.6	132.2	138.3	166.7	20.5
Due from banks abroad	283.0	205.9	275.8	202.4	322.3	159.2
Total Credit	2629.8	2898.9	2980.7	3241.0	3270.3	0.9
a) Credit to Private Sector	2590.0	2830.1	2885.1	3072.3	3054.6	-0.6
b) Credit to public enterprises	-	4.1	16.3	28.1	46.0	63.7
c) Credit to Government	39.8	64.7	79.3	140.6	169.7	20.7
Securities	314.4	396.3	356.4	422.4	416.4	-1.4
a) Treasury Bills (at cost)	87.6	127.8	40.0	160.0	69.0	-56.9
b) Government Bonds	70.6	117.3	120.9	126.2	118.4	-6.2
c) Other domestic securities	31.6	36.0	33.3	32.7	24.1	-26.3
d) Foreign securities	124.6	89.6	78.8	74.9	85.9	14.7
e) Others *	-	25.6	83.4	28.6	119.0	316.1
Fixed assets	34.4	38.1	39.3	46.8	36.9	-21.2
Other assets	183.3	201.9	179.2	154.0	150.1	-2.5
Total assets / liabilities	**3579.7**	**3842.7**	**3963.6**	**4204.9**	**4362.7**	**3.8**
Government deposits	292.4	316.1	306.0	285.5	276.4	-3.2
Deposits of public enterprises	98.8	121.7	191.5	215.7	229.2	6.3
Deposits of private sector	1802.7	1911.7	2009.9	2181.9	2271.6	4.1
a) Demand	283.8	257.4	283.8	440.0	523.2	18.9
b) Savings	375.1	355.5	407.3	485.1	588.6	21.3
c) Time	1143.8	1298.8	1318.8	1256.8	1159.8	-7.7
(of which in foreign currency)	(277.4)	(240.3)	(220.5)	(224.3)	(321.0)	(43.1)
Due to banks abroad	551.1	572.8	534.7	517.8	486.8	-6.0
Core Capital and Reserves	425.6	454.2	433.3	425.8	432.8	1.6
Provisions and reserved interest	117.0	130.4	157.9	232.5	297.4	27.9
Other liabilities	292.1	335.8	330.3	345.7	368.5	6.6

Source : Central Bank of Oman

** includes investment in CDs issued by CBO*

abroad registered a steady decline since the year 2000 as banks had to rely less on borrowed funds for their operations. From a peak level of RO 572.8 million in 1999, balances due to banks abroad declined to RO 517.8 million in 2001 and further to RO 486.8 million in 2002. The core capital and reserves of commercial banks stood at RO 432.8 million as at the end of 2002. It constituted 15.6 percent of total deposits and 10 percent of total assets as at the end of December 2002.

Sectoral Flow of Bank Credit

The distribution of credit to different sectors of the economy is given in Table 5.8. It is important to note here that the grouping or classification of credit by banks based on industry or occupation of borrowers cannot be that precise, due to the fact that there are borrowers who are engaged in multiple activities spread across several industrial or occupational groups. Allocation of credit facilities among multiple uses could lead to some analysis distortion. The interpretation is further compounded as certain degree of diversification of end uses is to be expected in the case of facilities such as overdrafts. Besides, with partnerships or proprietorship business, the borderline between business and personal transactions tend to get blurred leading to a certain degree of misclassification. For example, in 1997, much of the increase in bank credit to the private sector was directly or indirectly channeled to the securities market. These

Table 5.8
Distribution of Commercial Bank Credit by Economic Sectors
Millions of R.O.

	2000	2001	2002
Import Trade	381.4	324.4	314.6
Export Trade	9.6	5.6	5.2
Wholesale & Retail Trade	168.1	176.0	136.2
Mining and Quarrying	73.8	80.7	80.1
Construction	204.7	231.2	225.1
Manufacturing	242.2	326.3	287.1
Electricity, gas and water	14.7	52.8	64.6
Transport and Communication	42.4	70.3	54.2
Financial Institutions	240.9	197.0	154.7
Services	169.5	232.2	233.4
Personal Loans	977.8	1054.3	1169.2
Agriculture and allied activities	29.6	18.8	25.2
Government	79.3	140.6	176.7
Non-Resident lending	109.3	103.6	66.0
All Others	237.4	227.2	278.0
Total Credit	**2980.7**	**3241.0**	**3270.3**

Source: Central Bank of Oman

limitations will have to be borne in mind while analyzing and interpreting the data on sectoral flow of credit.

From the data relating to the distribution of bank credit by economic sectors as at the end of 2002, it can be seen that the major areas of concentration are personal loans (35.8%), import trade (9.6%), manufacturing (8.8%), services sector (7.1%) and construction (6.9%). The pattern of credit flows become more clear from incremental bank credit during the year. The major increase during 2002 was seen in the category of personal loans with an additional credit flow of RO 114.9 million. Notwithstanding the demand side factor, the increase may also be to some extent linked to the relaxation on the quantitative ceiling to 40 percent of total credit effective January 2002 from the earlier 35 percent together with the interest rate factor. The increased incremental credit during the year was also forthcoming in the electricity and water utilities sector by RO 11.8 million and under agriculture and allied activities by RO 6.4 million. However credit flow towards other major areas declined such as wholesale and retail trade by RO 39.8 million, manufacturing by RO 39.2 million and financial institutions by RO 42.3 million. Non-resident lending, comprising mainly credit extended to corporates outside Oman also witnessed a fall by RO 37.6 million over the year.

Interest Rate Structure

Wide swings or dis-equilibrium in interest rates affect macro economic performance adversely. While high interest rates discourage investment as fresh investment becomes less profitable, low interest rates below equilibrium level do not provide incentive for savers. Therefore, equilibrium level of interest rate balances savings and investment in the economy. The interest rate in a country like Oman which has a fixed exchange rate arrangement is determined by the interest rate in the country to whose currency the domestic currency is pegged. The behaviour of domestic interest rates generally follows in the long run the pattern of interest rates in the country of peg. To the

Table 5.9 (a)
Weighted average Interest Rate on Rial Omani Time deposits
Percent per annum

Rate of Interest (% per annum)	December 2000		December 2001		December 2002	
	Amt in RO Mln.	% Share	Amt in RO Mln.	% Share	Amt in RO Mln.	% Share
Upto 2%	0.5	0.0	43.1	3.1	489.7	40.4
Over 2% to 3%	2.5	0.2	270.0	19.6	372.6	30.7
Over 3% to 4%	3.1	0.2	418.9	30.3	62.7	5.2
Over 4% to 5%	4.4	0.3	221.7	16.1	92.3	7.6
Over 5% to 6%	39.3	2.7	129.3	9.4	55.9	4.6
Over 6% to 7%	275.8	18.8	97.0	7.0	24.6	2.0
Over 7% to 8%	590.9	40.3	49.2	3.6	12.1	1.0
Over 8% to 9%	522.5	35.6	122.9	8.9	91.6	7.5
Over 9% to 10%	28.1	1.9	28.8	2.1	12.1	1.0
Over 10%	0.2	0.0	0.0	0.0	0.0	0.0
Total	**1467.3**	**100.0**	**1381.0**	**100.0**	**1213.6**	**100.0**
Weighted average interest rate on time Deposits	7.625%		4.498%		2.890%	

Table 5.9 (b)
Weighted average Interest Rate on Rial Omani
Total Deposit
Percent per annum

Rate of Interest (% per annum)	December 2000 Amt in RO Mln.	December 2000 % Share	December 2001 Amt in RO Mln.	December 2001 % Share	December 2002 % Share	December 2002 Amt in RO Mln.
Upto 2%	585.1	26.4	894.6	37.1	1641.7	68.3
Over 2% to 3%	29.4	1.3	341.5	14.2	399.9	16.6
Over 3% to 4%	48.8	2.2	515.9	21.4	70.9	2.9
Over 4% to 5%	38.7	1.7	231.9	9.6	93.2	3.9
Over 5% to 6%	70.8	3.2	130.6	5.4	58.3	2.4
Over 6% to 7%	295.3	13.3	97.0	4.0	25.1	1.0
Over 7% to 8%	590.9	26.7	49.2	2.0	12.5	0.5
Over 8% to 9%	525.2	23.7	122.9	5.1	91.6	3.8
Over 9% to 10%	28.1	1.3	28.8	1.2	12.1	0.5
Over 10%	0.2	0.0	0.0	0.0	0.0	0.0
Total	**2212.6**	**100.00**	**2412.5**	**100.00**	**2405.3**	**100.00**
Weighted average interest rate on RO Total Deposit	5.455%		2.856%		1.673%	

Table 5.9 (c)
Weighted average Interest Rate on Rial Omani
Total Lending
Percent per annum

Rate of Interest (% per annum)	December 2000 Amt in RO Mln.	December 2000 % Share	December 2001 Amt in RO Mln.	December 2001 % Share	December 2002 % Share	December 2002 Amt in RO Mln.
Upto 5%	124.9	5.1	404.6	16.3	524.8	20.7
Over 5% to 7%	103.0	4.2	164.7	6.6	196.7	7.8
Over 7% to 8%	191.6	7.9	95.3	3.8	108.2	4.3
Over 8% to 9%	225.4	9.3	171.5	6.9	147.8	5.8
Over 9% to 10%	427.5	17.6	326.1	13.1	349.4	13.8
Over 10% to 11%	321.2	13.2	275.8	11.1	341.2	13.5
Over 11% to 12%	180.6	7.4	198.3	8.0	466.1	18.4
Over 12% to 13%	814.1	33.5	802.1	32.2	350.6	13.9
Over 13%	45.4	1.8	51.2	2.0	46.2	1.8
Total	**2433.7**	**100.0**	**2489.6**		**2531.0**	**100.0**
Weighted average interest rate on RO lending	10.060%		9.234%		8.549%	

extent that interest rates are out of alignment with the US dollar rates, they generally tend to converge as capital flows in and out of the country. However, differences do persist in the interest rates mainly in the short term, for considerations such as the rate of return to capital in the domestic economy, level and state of bank liquidity, transactions costs, risk premium etc.

In Oman, interest rate ceilings were in force until 1993, but now these only exist on personal loan rates. Commencing October 1993, as a first move towards deregulation of interest rates, the Central Bank of Oman freed the Rial Omani deposit rate ceiling and followed it up in June 1994 by deregulating lending rates with the exception of consumer loans. In January 1999, the interest rate ceiling on consumer loans was also lifted, but a quantitative ceiling on personal loans was imposed which continues to be in force

Table 5.9 (d)
Weighted average Interest Rates
Percent per annum

End of Period	Deposits: Private Sector RO Time Deposits (1)	Deposits: Total R.O. Deposits (2)	Deposits: Total Deposits (RO+FCY) (3)	Lending: Private Sector RO Lending (4)	Lending: Total RO Lending (5)	Lending: Total Lending (RO+FCY) (6)	Spread (4)-(1)	Spread (5)-(2)	Spread (6)-(3)
Mar-00	7.685	5.498	5.421	10.302	10.277	9.696	2.617	4.779	4.275
Jun-00	7.580	5.345	5.336	10.112	10.072	9.677	2.532	4.727	4.340
Sep-00	7.602	5.478	5.460	10.102	10.063	9.699	2.500	4.585	4.239
Dec-00	7.672	5.455	5.434	10.108	10.060	9.678	2.436	4.605	4.244
Mar-01	7.145	4.907	4.880	9.941	9.900	9.385	2.796	4.993	4.505
Jun-01	6.617	4.203	4.116	9.514	9.472	8.773	2.897	5.269	4.657
Sep-01	5.699	3.720	3.616	9.466	9.425	8.434	3.767	5.705	4.818
Dec-01	4.469	2.856	2.753	9.392	9.234	7.866	4.923	6.378	5.113
Mar-02	3.573	2.247	2.170	9.129	8.948	7.531	5.556	6.701	5.361
Jun-02	3.346	1.860	1.830	8.954	8.806	7.420	5.608	6.946	5.590
Sep-02	3.096	1.813	1.784	8.790	8.702	7.351	5.694	6.889	5.567
Dec-02	3.003	1.673	1.646	8.806	8.549	7.229	5.803	6.876	5.583

Table 5.9 (e)
Domestic Overnight Inter-Bank Lending Rates
(Five Major Banks)

Period	2001		2002	
	Daily avg. Amount in RO Mln	Monthly weighted avg. interest rate*	Daily avg. Amount in RO Mln	Monthly weighted avg. interest rate*
Jan	6.0	2.061	4.2	0.746
Feb	9.0	1.836	6.2	0.714
March	10.7	2.292	4.9	0.588
IQ Avg	**8.6**	**2.063**	**5.1**	**0.683**
April	8.3	1.857	9.9	0.809
May	11.6	1.615	7.4	0.573
June	10.6	1.524	7.4	0.724
IIQ Avg	**10.2**	**1.665**	**8.2**	**0.702**
July	11.0	2.112	9.3	0.644
Aug	13.7	1.596	13.4	1.034
Sep	18.1	2.047	9.2	0.744
IIIQ Avg	**14.3**	**1.918**	**10.6**	**0.807**
Oct	17.6	1.691	15.5	0.697
Nov	12.8	1.690	11.1	0.512
Dec	7.0	0.959	10.3	0.552
IVQ Avg	**12.5**	**1.447**	**12.3**	**0.587**

* *Weighted by invidual transaction amounts*

with relaxations. In October 1999, however, the ceiling of 13 percent per annum on personal loans was reimposed on account of very high and unreasonable rates being charged as this segment of the market appeared to be interest rate inelastic. Effective January 2002, the ceiling on interest rate on personal loans was reduced to 12 percent per annum and the quantitative ceiling enhanced to 40 percent of the total credit extended by a bank. The interest rate ceiling on personal loans sanctioned or extended from April 2003 was further reduced to 11 percent per annum.

Before proceeding to examine the interest rate spreads and cost of funds, it may be useful to examine the distribution of Rial Omani time deposits by interest rate class intervals. In line with the major softening of international interest rates, Rial Omani time deposit rates too fell drastically as can be seen in Table 5.9 (a). A case in point is the 'upto 2%' interest bracket, where the relative share from a low of 3.1 percent in 2001 rose significantly to a share of 40.4 percent in 2002. In the over '2% to 3%' class interval, the share of Rial Omani time deposits also rose from 19.6 percent in 2001 to 30.7 percent in 2002. Put differently, in the year 2001, while 22.7 percent of Rial Omani time deposits earned interest ranging from zero to three percent, in the year 2002 it accounted for 71.1 percent. As a consequence of this pronounced downward shift into lower interest rate ranges, the weighted average interest rate on Rial Omani time deposits fell steeply from 7.625 percent in 2000 to 4.498 percent in 2001 and further to 2.890 percent in 2002.

The weighted average interest rates on total Rial Omani deposits and total Rial Omani lending is given in Tables 5.9(b) and 5.9(c). It can be seen that almost 85 percent of Rial Omani deposits were held in the interest bracket of 'upto 3%' in 2002 when compared to 51 percent in the previous year. The above trend is similarly seen with regard to the interest rates charged on Rial Omani lending, albeit at a lesser pace. In the lowest interest rate range of 'upto 5%', the relative share increased from 5.1 percent in 2000 to 16.3 percent in 2001 and further to 20.7 percent in 2002. Due to the personal loan ceiling rate of 13 percent in 2001, the largest share amounting to RO 802 million (32.2%) of Rial Omani lending appears to have been concentrated in the interest range of 'over 12% to 13%'. With the reduction in the interest rate ceiling in 2002 to 12 percent, the largest share amounting to RO 466 million (18.4%) was concentrated in the interest range of 'over 11% to 12%'. As in the case of deposit rates, the weighted average interest rate on Rial Omani lending too registered a declining trend from 10.060

percent in 2000 to 9.234 percent in 2001 and further to 8.549 percent in 2002.

Table 5.9(d) analyses the interest rate spreads defined as the difference between the weighted average rates of lending and deposits. It must be noted, however, that there are various prize and lottery schemes that commercial banks use to attract deposits, which to some extent distorts the interest rate structure by reducing effective deposit rates and rendering spreads larger than what is in reality. The average interest rate spread between lending and deposit rates in local currency not only remained fairly high but moved up in 2002. From an interest spread of 6.378 percent in December 2001, the spread widened to 6.876 percent in December 2002. The weighted average interest rate on all deposits (RO and F.cy combined) which stood at 2.753 percent in December 2001 declined to 1.646 percent in December 2002. The weighted lending rate (RO and F.cy combined) also registered a decline from 7.866 percent to 7.229 percent over the year. The interest rate spread between total lending and total deposits thus moved up from 5.113 percent to 5.583 percent over the year.

Domestic Inter-bank Rial Omani Interest Rates

The interbank interest rate in the domestic market reflects the residual demand and supply of funds by banks when adjusting their liquidity positions. Its particular advantage is that it helps instant monitoring and assessment of liquidity during the course of the day. The Central Bank has taken steps to activate the market by introducing repos facilities between banks for government securities such as treasury bills and development bonds, so that the market is based on secured transactions. The domestic interbank money market seems to function relatively well and helps in recycling the liquidity among banks, although it is not uncommon that banks frequently find themselves on the same side of the market.

The major part of domestic interbank transactions in Rial Omani takes place in the form of overnight lending. Interbank transactions for extended tenors are few and far between. The overnight domestic interbank rate (for five major banks) is given in Table 5.9 (e). It can be seen therefrom that in line with all other interest rates discussed above, the interbank rate too, softened considerably during the year 2002, particularly so with the comfortable liquidity state in the domestic market. The weighted average overnight inter bank rates which ruled at 2.063 percent in the first quarter of 2001 steadily declined over the subsequent quarters to average 1.447 percent in the last quarter of 2001. During the year 2002 the interbank rates witnessed steep declines culminating in an average of 0.587 percent during the last quarter of the year.

Commercial Banks Profitability

Profits of commercial banks rebounded in the year 2002 after having suffered a major set back in the previous year. In the year 2001, the sharp fall in profitability was the outcome of large non-performing loans and financial failures of a few business entities requiring heavy provisioning. Additionally, the mandatory application of international accounting standards (IAS 39) required banks to set aside provisions for bad loans and to some extent for impairment of investments. The stringent provisioning

Table 10
Profitability of Commercial Banks
(in Million R.O.)

	2000	2001	2002	% Change 2001/2000	% Change 2002/01
1. Interest Income	344.8	326.5	290.9	-5.3	-10.9
2. (Interest Expenses)	(189.1)	(164.7)	(102.5)	(-12.9)	(-37.8)
3. Net Interest	155.7	161.8	188.4	3.9	16.4
4. Foreign Exchange	8.5	7.2	7.9	-15.3	9.7
5. Fees and Commissions	13.3	14.9	17.2	12.0	15.4
6. Other Income	22.6	25.6	32.2	13.3	25.8
7. Gross Income (3+4+5+6)	200.1	209.5	245.7	4.7	17.3
8. Operating Expenses	93.6	96.7	111.2	3.3	15.0
a) Administrative Costs	83.0	86.4	100.5	4.1	16.3
b) Depreciation	10.4	9.8	10.4	-5.8	6.1
c) Others	0.2	0.5	0.3	150.0	-40.0
9. Gross Profits (7-8)	106.5	112.8	134.5	5.9	19.2
10. Provision for doubtful debts *	41.9	103.5	64.4	147.0	-37.8
11. Profits after provisions (9-10)	64.6	9.3	70.1	-85.6	
12. Provision for Taxes	12.7	4.4	8.2	-65.4	86.4
13. Net Profit after Provisions & Taxes (11-12)	51.9	4.9	61.9	-90.6	

** includes provision for decline in investment value.*
Source : Central Bank of Oman

policy of the apex bank implemented for the year 2001 thus set the stage for the promising results registered in the year 2002. Increase in net interest earned during the year mainly as a result of sharp decline in interest expenses and lower levels of provisioning for the year helped profits to increase significantly. Overall, banks average return on equity stood at 14.3 percent in 2002 while the average return on assets stood at 1.4 percent.

Gross profits (before provisions and taxes) of commercial banks increased to RO 134.5 million in 2002 from RO 112.8 million in 2001, giving a rise of 19.2 percent. Net profits after provisions and taxes, on the other hand, shot up substantially to RO 61.9 million in 2002 from a mere RO 4.9 million recorded in the previous year. Net profits of local banks increased to RO 56.9 million in 2002 from RO 8 million in 2001 while that of foreign banks moved up to RO 5 million compared to a net loss of RO 3.1 million in the previous year.

With the prevailing benign interest rate environment, total interest income during the year declined by 10.9 percent from RO 326.5 million in 2001 to RO 290.9 million in 2002. The major component under interest income, i.e. loans and advances registered a decline of 9.4 percent to RO 251 million. Sluggish growth in overall credit and in particular a decline in private sector credit coupled with a fall in the weighted average rate of interest on lending contributed to the decline. Interest earned on placements with banks declined by 21.3 percent from RO 14.1 million in 2001 to RO 11.1 million in 2002 consequent to reduced interbank interest rates.

Foreign exchange earnings comprising income earned on the purchase and sale of foreign currencies and valuation changes, improved by 9.7 percent to RO 7.9 million in 2002. Fee based income such as commissions on letters of credit and guarantees and on draft business registered significant increase at 15.4 percent to reach RO 17.2 million during the year. Interest expenses which comprise mainly payments on customer deposits and borrowings from banks witnessed a sharp decline of 37.8 percent during the year from RO 164.7 million in 2001 to RO 102.5 million in 2002. Lower interest payouts mainly due to the depressed international interest rates, large chunk of saving deposits attracting nil interest rate (due to prize schemes) and excess liquidity in the system contributed to the major fall in interest expenses. This being the case, net interest earned increased by 16.4 percent (RO 26.6 million) in 2002 when compared to an increase of 3.9 percent (RO 6.1 million) in the year 2001 with its attendant favourable impact on profitability.

Operating expenses of commercial banks rose by 15 percent during 2002 when compared to a rise of 3.3 percent in the previous year. The major item under this head constituted administration costs. Within this group, salaries and other staff costs rose by 16.2 percent from RO 51.3 million in 2001 to RO 59.6 million in 2002.

The staff expense ratio i.e. staff costs as a percentage of gross income thus rose from 20.9 percent in 2001 to 24.3 percent in 2002. Rents paid and other occupancy costs including payment for utilities increased by 3.7 percent to RO 11.8 million. Depreciation on banks property and equipment rose by 5.9 percent from RO 9.8 million in 2001 to RO 10.4 million in 2002.

With regard to the sources and uses of funds, of the gross profits of RO 134.5 million in 2002, 47.9 percent (RO 64.4 million) had been earmarked and set aside as provisions for bad and doubtful debts as well as for investment related provisions. In the previous year provisions accounted for 91.8 percent of gross profits amounting to RO 103.5 million. Payment of taxes almost doubled during 2002 to reach RO 8.2 million. Transfers to reserves for the year 2002 increased to RO 9.5 million from RO 7.2 million in the previous year. Cash dividends paid out by local banks more than doubled to RO 32.4 million in 2002 from RO 15.8 million in 2001 while stock dividends rose by 46 percent from RO 1.68 million to RO 2.45 million. Profit remittances by foreign banks rose to RO 1 million in 2002 from RO 2.2 million of inward remittance during the previous year to account for losses incurred. In addition to the profit remittances made by foreign banks in 2002, an amount of RO 4 million had been retained in the country without being remitted abroad.

Specialised Banking Institutions

At the end of 2002, there were three specialized banks. Two are public sector banks, the Oman Housing Bank and the Oman Development Bank, that provide soft financing (subsidized by the government) to mainly low and middle income Omanis to build or purchase residential property and to private sector investors to finance projects. The other specialized bank, Alliance Housing Bank is privately owned and provides mortgage loans.

Oman Housing Bank (OHB)

Oman Housing Bank provides finance by way of long term soft housing loans to all the segments of Omani society in various regions to enable them to construct suitable houses. Total assets of the bank stood at RO 162.8 million as at the end of 2002. Mortgage loan accounts at RO 160.8 million as at the end of 2002 was higher by 1.3 percent when compared to RO 158.8 million outstanding as at end 2001. The share capital of the Bank remained at RO 30 million at the end of the year.

Oman Development Bank (ODB)

Oman Development Bank provides loans to development projects, including activities directly related to agriculture and fisheries in the Sultanate of Oman by granting loans, administering grants and subsidies, participating in share capital and providing technical assistance to companies. In accordance with its objectives, interest on loans and advances is charged to the customers at a rate which is subsidized by the Government. In addition the Bank also acts as agent on behalf of the Government for :

a. the disbursement and collection of Government soft loans,

b. the operations of the Export Credit Guarantee Agency,

c. the disbursement of amounts from the Fisheries Research Fund and

d. the disbursement and collection of SANAD Fund Loans

As at the end of the year 2002, the total loans and advances to customers net of provisions stood at RO 28.1 million. The share capital of ODB remained at RO 20 million as at the end of 2002.

Alliance Housing Bank (AHB)

The primary objective of Alliance Housing Bank is to help the local housing market by providing Omanis with long term loans to purchase, build or improve housing. The Bank has concentrated on simple mortgage based lending to individuals and the average loan is less than RO thirty thousand. Though most of its loans are to owner occupiers, a significant number of Omanis own property for rent and the Bank also provides loans to that segment. The Bank operated through a network of seven branches. The Bank expanded its operations in 2002 with its mortgage loan portfolio improving by 48.9 percent from RO 30.9 million in 2001 to RO 46 million in 2002. The share capital of Alliance Housing Bank stood at RO 21 million as at the end of the year.

Investment Banking Institutions

At the end of 2002, eleven commercial banks – six local banks and five branches of foreign banks, had been licensed to engage in specific investment banking activities on a tiered licensing system. There are broadly seven tiers, namely, corporate finance, project finance, investment brokerage and investment advisory service, portfolio management, underwriting both lead and sub, investment management and custodian and fiduciary services.

Of these eleven banks, eight had been issued with comprehensive licenses covering all tiers of activity, two had obtained restricted licenses to engage in the activity of “Investment brokerage and investment advisory services” only, while the remaining commercial bank had been issued with a restricted license covering project finance and investment brokerage and advisory services.

Non Bank Financial Intermediation (NBFI)

The emerging non bank financial intermediation sector for Oman mainly consists of consumer finance and leasing companies, money exchange companies, the insurance sector, pension funds, capital markets, which all complement banking activities. While the sector is still relatively small, it has the potential for playing a significant developmental role. The insurance sector comprises around 15 companies and constitutes life insurers, reinsurance, while the non-life insurance business is dominated by the compulsory motor insurance class. Pension funds in

Oman are confined largely to the public sector. The Public Authority for Social Insurance (PASI) provides for private sector employees.

Money Exchange Companies

Money Exchange Business is carried out by two types of institutions in the Sultanate, namely, those who are engaged in money exchange and sale of drafts and the others who are exclusively engaged in money exchange.

As at the end of December 2002, thirteen establishments were licensed to conduct money exchange and issuance of drafts business. During the year under review, one new exchange company was opened (Global Money Exchange Company), two new branches and four exchange counters of these companies were also opened. In addition to the above there were about 32 firms doing the business of money changing only. Exchange companies undertaking the activity of draft issuance are annually examined and inspected by the Central Bank of Oman to ensure that they keep proper books and records, comply with the regulations and that they are solvent.

The total assets of the thirteen establishments engaged in money exchange and issuance of drafts business amounted to RO 13.5 million as at end of 2002. Nearly 84 percent was held in the form of cash, balances with banks and short-term investments. The total equity of these companies as at the end of 2002 amounted to RO 8.3 million as against RO 7.8 million in year 2001.

Consumer Finance and Leasing Companies

There are currently six finance and leasing companies operating under the license of the Central Bank of Oman. They are primarily engaged in retail /consumer financing on hire-purchase basis, leasing, factoring and bridge financing to local industry. Over the last few years of operations, the market share of consumer finance and leasing companies have witnessed a substantial growth in financing activities, particularly leasing and hire purchase of consumer durable goods although as a percentage of commercial bank assets they remain very limited. The growth levels can be construed to a shift as well as the increasing demand of consumers over and above the traditional consumer banking avenues open to them.

Finance and leasing companies will have to resort to alternate sources of funding in order to sustain the level of growth of lending. The increasing consumer demand for credit/loans may have to be met by raising funds through foreign borrowings and through negotiable debt instruments subject to approval by the regulatory authorities.

During 2002, United Finance Company became the first company to issue convertible corporate bonds in the stock market through public issue. At end of March 2003, CBO relaxed its limits on permitted foreign currency borrowing, allowing NBFIs to borrow in foreign currency up to 100 percent of their net worth subject to certain conditions.

In 2002, aggregate retail (consumer) led borrowing made up the bulk of total lending, accounting for 72 percent of financing and leasing activities. Conversely, aggregate corporate borrowing accounted for the residual share, making up 28 percent of total financing and leasing activities for the same year. The consolidated paid up share capital of all six finance and leasing companies amounted to RO 33.1 million in 2002, up by RO 2.075 million over the previous year. At end of 2002, aggregate capital and reserves stood at RO 46.2 million.

The total outstanding credit (net of provisions) extended in the form of hire purchasing, lease financing & factoring, observed significant growth over the last few years. Net investment in financing and leasing activities witnessed an annual growth rate of 37.7 percent in 2000, and 29 percent in 2001. As at the end 2002, net investment in finance and leasing activities stood at RO 174.3 million reflecting a marginal decline from RO 176.7 million in the previous year. Total combined assets of finance and leasing companies also witnessed a marginal decline in 2002, in line with the moderate economic growth. Total assets stood at RO 182.5 million in 2002.

The institutional and regulatory framework put in place by CBO, and the prudent provisioning policies has positioned finance and leasing companies on a sound footing to respond positively to pressures. The combined level of specific provisioning outstanding remained low and manageable at 6.6 percent in 2002. The consolidated net profit after provisions and taxes for the year 2002 stood at RO 6.279 million which was higher than the net profit of RO 5.773 million reported for 2001. As of December 2001, the aggregate weighted average rate of interest charged per annum by financial institutions on overall credit was 12.66 percent, and in December 2002, the rate of interest charged per annum by financial institutions on overall credit was 12.73 percent.

The performance of these finance and leasing companies is summarized individually for 2002 hereunder.

Muscat Finance Co. (SAOG)

Muscat Finance Company (MFC) operates from seven locations, a head office in Muscat, and six branches located in Sohar, Barka, Ibri, Salalah, Sur and Nizwa. The company is involved in three distinct markets, namely retail financing, where the financing is to individual customers, mainly for automotive and electronic goods, secondly in equipment leasing, where the financing is to small and medium enterprises (SMEs) for expansion, modernization and replacement requirements, and finally for factoring and working capital, where finance is provided to SMEs for cross border or domestic trade or for the execution of projects, usually against an assignment of receivables.

The issued share capital of the company stood at RO 5.750 million as at end of 2001. In 2002 share capital was increased to RO 6.037 million with the accretion of RO 0.287 million worth of stock dividend declared in 2001. As at the end of 2002, total assets (liabilities) of the company amounted to RO 31.9 million. Net debtors arising from financing activities remained practically unchanged in 2002 at RO 29.9 million, and accounted for 93.7 percent of total assets. Borrowings from banks and financial institutions stood at RO 14.9 million. Net profits after provisions and taxes witnessed a growth of 13.9 percent translating to RO 1.614 million in 2002.

National Finance Co. (SAOG)

National Finance Co.'s principal activity consists of leasing business. The company conducts its operations from 5 distinct locations, a head office in Muscat and from four branches in Sur, Salalah, Sohar and Nizwa.

National Finance Co. increased its share capital to RO 6.038 million in 2002 by means of bonus shares issued during the year. Of total assets amounting to RO 48.2 million, net investment in finance leases stood at RO 46.5 million and made up 96.5 percent of total assets in 2002. Bank borrowings amounted to RO 30.2 million and accounted for 62.7 percent of total liabilities. The company's net profit stood at RO 1.389 million registering a growth rate of 15.6 percent in 2002.

Oman Orix Leasing Company (SAOG)

Oman Orix Leasing Company's operations consist mainly of hire purchase and lease financing activities. As of December 2002, Oman Orix Leasing Co. conducted its operations from a head office in Muscat and two branches, one in Sohar and the other in Salalah.

The company's paid up capital remained unchanged at RO 5 million during 2002. Total assets declined during 2002 mainly due to sharp reductions in net investment in finance leases, whereas reductions in liabilities can be attributed to the decrease in bank overdrafts and short term loans. Net investments in finance leases at the end of 2002 stood at RO 25.3 million and made up 96.3 percent of total assets valued at RO 26.3 million. The net profit after provisions and taxes remained more or less unchanged over the previous year at RO 0.512 million in 2002.

Al Omaniya Financial Services (SAOG)

Al Omaniya Financial Services provides hire purchase and lease finance for vehicles and other assets. The company operates from two locations, a head office in Muscat and a branch in Sohar.

The share capital of Al Omaniya remained unchanged at RO 5 million during 2002.

The company's assets of RO 33.5 million registered a growth rate of 7.8 percent over the previous year. Finance leases worth RO 31.9 million made up the bulk of total assets, and accounted for 95.2 percent of total assets. On the liabilities side, due to banks witnessed a growth rate of 7.2 percent over the previous period amounting to RO 23.7 million in 2002. The net profits grew by 21 percent over the year, and stood at RO 1.42 million as at end of 2002.

United Finance Co. (SAOG)

United Finance Company's main activities consist of hire purchase and lease financing, bridge loans, debt factoring and financing of receivables, leasing and vehicle financing. It currently operates from five locations, a head office that is located in Muscat, and four branches located in Firq, Ibra, Falaj Al Qabail, and Salalah.

The share capital of the company was increased to RO 6 million by means of RO 1 million worth of stock dividends issued during 2002. Net financing, leasing and factoring activities stood at RO 34.3 million in 2002, witnessing a growth of 9.9 percent for the year. Bank borrowings stood at RO 19.4 million and accounted for 54.7 percent of total liabilities. During 2002, United Finance Company issued RO 2.653 million worth of Convertible Corporate Debt Bonds in the market through Public Issue. The net profit of the company for the year stood at RO 1.174 million.

Taageer Finance Co. (SAOC)

Taageer Finance Company undertakes hire purchase, leasing and funding for the corporate and consumer business sector. The company's share capital stood at RO 5 million in 2002. Total assets at end of 2002 stood at RO 7.178 million, and consisted mainly of net investments in finance leases of RO 6.4 million. Borrowings from banks and financial institutions was insignificant at RO 0.3 million. The profit for the same period was RO 0.171 million.

NBFI Indicators: Finance & Leasing Cos., (RO Millions)	1998	1999	2000	2001	2002
Total Assets (Liabilities)	93.0	111.3	150.3	190.8	182.5
Net Investment in Financing and Leasing Activities	76.6	99.4	137.0	176.7	174.3
Cash and Bank Balances	13.50	9.73	10.85	11.26	4.33
Specific Provisions earmarked for Financing & Leasing Activities	6.04	7.45	10.20	11.06	14.36
Specific Provisions as % of Gross Financing & Leasing Activities	6.43	6.11	6.03	5.03	6.56
Borrowings from Banks & Financial Institutions	54.44	57.51	80.56	121.07	112.21
Paid Up Capital	18.44	20.83	23.25	31.00	33.08
Capital & Reserves	27.84	29.41	33.98	42.65	46.18
Net Profit for the Period	1.99	3.45	4.51	5.77	6.28
Weighted Average Rate of Interest Charged (% per annum)	-	-	-	12.66	12.73
Number of Branches (Including Head Office)	12	16	17	19	23

Muscat Securities Market

Muscat Securities Market (MSM) Law 53/88 was issued in June 1988. The Law provided for setting up the market as an independent governmental entity charged with both the regulation and the provision of operational facilities and for trading, settlement and registration of securities. The Market commenced operations on May 20, 1989. By a Royal Decree, a new capital market law was passed in November 1998 separating the regulatory and exchange functions. The Capital Market Authority (CMA) was established as the governmental regulator responsible for monitoring and supervising capital market activity on the MSM. The CMA has introduced corporate governance and disclosure practices and adopted an electronic trading monitoring system, to monitor and supervise investors' trading activity. Royal Decree No. (18/2002) amended some provisions of the Capital Market Law No. (80/98). The amendments reflect the Authority's objectives in promoting the standards of companies listed in the MSM.

The Muscat Securities Market has witnessed tangible improvement over the past year. The primary market registered significant activity during the year 2002 as 11 new securities were listed with a value of RO 182.8 million, two of which are public joint stock companies, four are closed joint stock companies, one investment fund and four bonds. Side by side, 15 joint stock companies increased their capital by RO 27.8 million thus bringing to RO 210.6 million the total value of the primary market issues which were listed for trading during the year compared to RO 155.3 million during the previous year i.e. an increase of 35.6 percent.

Trading volumes in the Secondary Market improved considerably during the year and stood at 191.8 million shares traded compared with 127.9 million shares in the

Stock Market Indicators

	1998	1999	2000	2001	2002
Number of issues in the Primary Market	47	20	19	24	26
Value of listed issues (in RO Millions)	440	189	77	155	210
Secondary Market Activity (in RO Millions)					
Value of trading	915	253	215	164	231
Number of Shares Traded	283.7	140.8	146.1	127.9	191.8
Average value of trading per day	3.662	1.033	0.888	0.669	0.921
Market capitalisation	2266	2262	1948	1722	1984
The general share price index at the end of the year (points)	228.47	250.26	201.20	152.08	191.86

Source: MSM Annual Report 2002
& MSM Statistics, December 2002

previous year. The value of trading in the secondary market reached RO 231.3 million in the year 2002 compared with RO 163.8 million in 2001 i.e., an increase of 41 percent. The average value of trading per day also improved to RO 0.921 million in 2002 as against RO 0.669 million in the previous year. The positive performance of the MSM during the year was reflected in the market capitalization of the securities listed as it amounted to RO 1983.6 million in 2002 compared with RO 1721.8 million in the previous year. Foreign participation in the capital of the listed joint stock companies calculated on the basis of the market capitalization recorded a slight increase in the year 2002 to reach 14.94 percent compared to 14.31 percent in the previous year. The market capitalization ratio, which can be measured as market capitalization divided by GDP is indicative of the size of the market. On this basis, the market capitalization ratio improved to 25.4 percent in 2002 compared to 22.5 percent in 2001. The General share price index increased by 40 points reaching 191.86 at the end of 2002 compared with 152.08 at the end of 2001 thus achieving an increase of 26.2 percent. The sector-wise indices revealed that banks and investment companies index improved by 36.7 percent in 2002 to 240.1 from 175.7 at the end of the previous year. The industrial sector index also showed a significant improvement from 116.4 at the end of 2001 to 154.3 at the end of 2002 while the services sector registered a marginal increase from 109.4 to 112.1.