

# BAHRAIN

## Recent developments

| Table 1   | 2017  |
|---|-------|
| Population, million                               | 1.5   |
| GDP, current US\$ billion                         | 35.3  |
| GDP per capita, current US\$                      | 23648 |
| School enrollment, primary (% gross) <sup>a</sup> | 101.1 |
| Life expectancy at birth, years <sup>a</sup>      | 76.9  |

Source: WDI, Macro Poverty Outlook, and official data.  
Notes:

(a) Most recent WDI value (2016)

*This year, fears over Bahrain's liquidity position came to the fore and necessitated regional partners to declare their intention of a bailout. Bahrain also announced the discovery of large hydrocarbon reserves. A potential increase in Bahraini oil production will complement several prominent non-oil projects to support continued GDP growth. However, unlike the sustained twin-deficits faced by the country, these bright prospects are backloaded in time and are prone to uncertainties.*

Bahrain's GDP grew by 3.9 percent in real terms in 2017 despite a sizeable contraction in the hydrocarbon sector (Figure 1). Oil sector contracted further in Q1 2018 by 14.7 percent year on year, due to oilfield maintenance. The non-oil sector grew by 1.9 percent over the same period, driven by large scale construction projects and related domestic demand growth. Notwithstanding steady growth in the real sector, increased risks associated with large current account and fiscal deficits triggered strong market reactions in the first half of 2018 (Figure 2). Net foreign reserves fell to a month's worth of import cover in June 2018. Bond spreads on Bahraini sovereign debt, as recorded on its 6 percent bond due in 2044, widened sharply from 450 basis points in January to over 550 basis points by June 2018. One-year forward premia for the Bahraini dinar rose nearly 40 percent to 192.50 in mid-June. In late June Bahrain's GCC partners (Saudi Arabia, Kuwait and UAE) announced their intention of a financial package to help placate market concerns in Bahrain. In mid-August, Ministers of Finance from the three partner countries met in Bahrain to review a proposed financial support program. Unlike the previous US\$7.5 billion pledged to Bahrain by these countries in 2011-12, the new program will be tied to the achievement of fiscal targets monitored by the Arab Monetary Fund. The details of these targets are not announced yet. Budget balance improved from a deficit of 18 percent in 2015-16 to an expected deficit

of 5 percent in 2018. The recovery can be attributed to rising oil prices, and to a lesser extent higher non-oil revenue. However, the legacy of slow adjustment to the 2014 shock is considerable; public debt increased from 44 percent of GDP in 2014 to 90 percent in 2017.

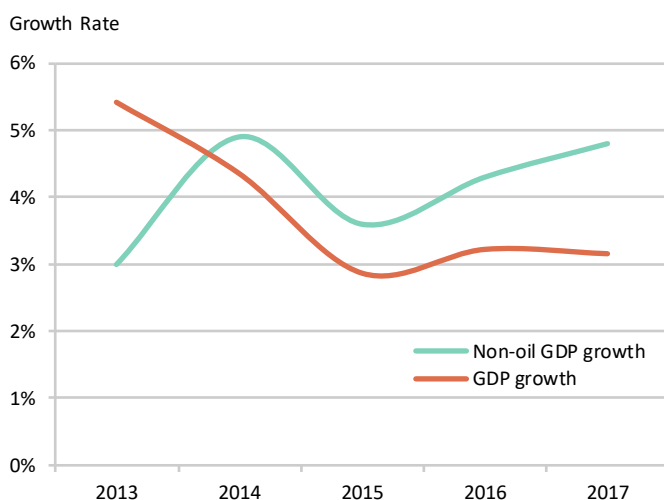
External balance is recovering gradually, from a current account deficit of 4.6 percent in 2016-2017 to an expected deficit of 2.8 percent this year. The current account improvement can almost exclusively be attributed to recovering goods exports, which are set to grow by 24 percent in value terms this year as oil prices recover. Simultaneously, imports of goods are forecast to expand at over 12 percent as domestic demand grows swiftly. While recovering export revenues are likely to mitigate further deficits going forward, the recent depletion of foreign exchange reserves increases Bahrain's external vulnerability in light of a US\$750 million sukuk bond maturing in November 2018.

Although no official information is available, pockets of poverty are likely to exist in Bahrain, especially among non-Bahraini nationals. Little comprehensive welfare analysis is available due to restricted access to household survey data and limited capacity. Price subsidies (for energy and food) form an important part of the social protection system.

## Outlook

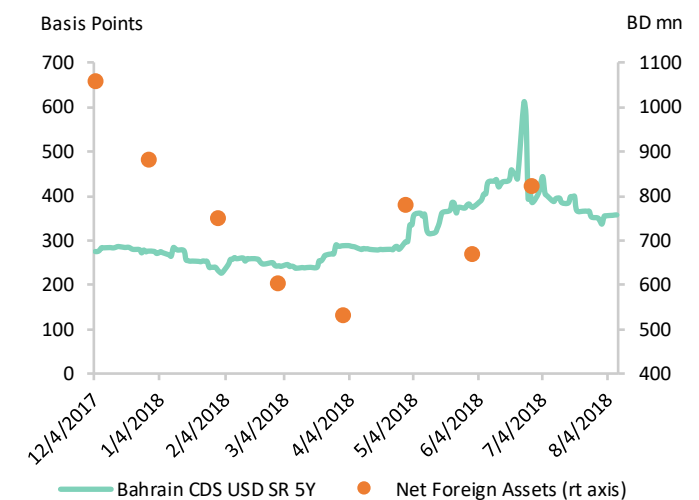
The Bahraini economy is projected to grow by 3.2 percent in 2018 and by 2.6

**FIGURE 1 Bahrain / Non-oil GDP leading overall growth**



Sources: EDB and IMF, accessed August 14, 2018.

**FIGURE 2 Bahrain / Bahraini 5 Year credit default swap vs net foreign assets**



Sources: Bloomberg and Bahrain Central Bank.

percent in 2019, driven by higher oil production, a raft of mega projects (e.g., a scheduled capacity enlargement at Aluminum Bahrain, Alba), may raise aluminum production capacity by over 50 percent), and continued regional support. Non-oil exports have shown signs of improvement in recent months, and a myriad of development projects suggest these will expand over the forecast period. Continued guaranteed financing of large infrastructure and other commercial projects will also support growth, although these are likely to start tapering off in 2019.

With elevated oil prices over the horizon, the fiscal deficit is expected to narrow to 5.0 percent of GDP by 2018 and further to 4.8 percent in 2019. Further corrections will require significantly strengthened and accelerated reform efforts. The government is considering introduction of a voluntary departure program for public sector staff,

deepening subsidy reforms, and privatizing select health and education services; timely progress on implementing these actions will help support medium-term fiscal consolidation.

The current account deficit should narrow to 2.8 percent of GDP in 2018 and further to 1.9 percent in 2019. Despite the improvement in the current account, however, reserves will remain within a couple months' worth of imports in the absence of swift disbursements from GCC partners. Consumer price inflation should increase temporarily as subsidies are removed, utility prices increase, and VAT is introduced (expected in 2019).

## Risks and challenges

Previous financial assistance from GCC partners to Bahrain had come in the

form of grants that were not tied to the achievement of specific objectives. However, because a more-frontloaded reform program is needed to address the structural economic problems and sustained twin deficits in the country, future assistance is likely to be supportive of key reform actions and close monitoring by the Arab Monetary Fund. Credit market reactions to this assistance will depend on the successful design and implementation of a credible program.

Beyond immediate fiscal reforms, the game-changer for Bahrain's economic outlook would be the development of the newly-discovered hydrocarbon reserves. While these reserves are sizeable, there is uncertainty about the market value and fiscal revenue expected from these resources, as it is unclear whether the bulk of these resources can be recovered.

**TABLE 2 Bahrain / Macro poverty outlook indicators**

(annual percent change unless indicated otherwise)

|   | 2015  | 2016  | 2017  | 2018 e | 2019 f | 2020 f |
|---|-------|-------|-------|--------|--------|--------|
| <b>Real GDP growth, at constant market prices</b> | 2.9   | 3.2   | 3.9   | 3.2    | 2.6    | 2.8    |
| Private Consumption                               | 1.9   | 0.5   | 12.3  | 1.6    | 2.0    | 2.2    |
| Government Consumption                            | 0.3   | -0.5  | -3.6  | 0.8    | -1.6   | 0.4    |
| Gross Fixed Capital Investment                    | -8.5  | 11.0  | 0.8   | 3.3    | 5.7    | 5.1    |
| Exports, Goods and Services                       | -1.0  | -1.8  | 3.6   | 4.5    | 3.5    | 2.2    |
| Imports, Goods and Services                       | -5.6  | -3.4  | 6.5   | 4.1    | 3.5    | 2.0    |
| <b>Inflation (Consumer Price Index)</b>           | 1.8   | 2.8   | 1.4   | 3.0    | 5.1    | 2.4    |
| <b>Current Account Balance (% of GDP)</b>         | -2.4  | -4.6  | -4.5  | -2.8   | -1.9   | -3.4   |
| <b>Fiscal Balance (% of GDP)</b>                  | -18.4 | -17.9 | -12.9 | -5.0   | -4.8   | -4.0   |

Source: World Bank, Poverty & Equity and Macroeconomics, Trade & Investment Global Practices.  
Notes: e = estimate, f = forecast.