BAHRAIN

Table 1	2019
Population, million	1.5
GDP, current US$ billion	37.9
GDP per capita, current US$	25257.1
School enrollment, primary (% gross)[a]	99.4
Life expectancy at birth, years[a]	77.2

Source: WDI, Macro Poverty Outlook, and official data.
Notes:
(a) Most recent WDI value (2018).

Bahrain's economy is expected to contract in 2020 due to lower international oil prices and the spread of COVID-19. Fiscal and external deficits are expected to rise sharply in 2020, reversing the narrowing path observed in 2019. The overall budget deficit is projected to only gradually narrow over 2021-22 given lower oil revenues, and the large off-budget spending. Downside risks arise from duration and depth of the twin crises of continued weakness in oil prices and COVID-19.

Key conditions and challenges

Even before COVID-19, lower oil prices since 2014 had widened fiscal and external imbalances and intensified macroeconomic vulnerabilities. Developing new oil and gas fields (e.g., in the Khalij al-Bahrain Basin) while diversifying the economy, and boosting non-oil revenues, and streamlining subsidies remain the keys to macroeconomic sustainability. But diversification hinges upon Bahrain's ability to reduce unemployment of nationals and develop the local skills base to transition the economy toward competitive activities besides finance. On the fiscal side, the authorities responded to debt vulnerabilities with the announcement of the Fiscal Balance Program (FBP) in late 2018, which provided a roadmap for a structural fiscal adjustment over the medium term.

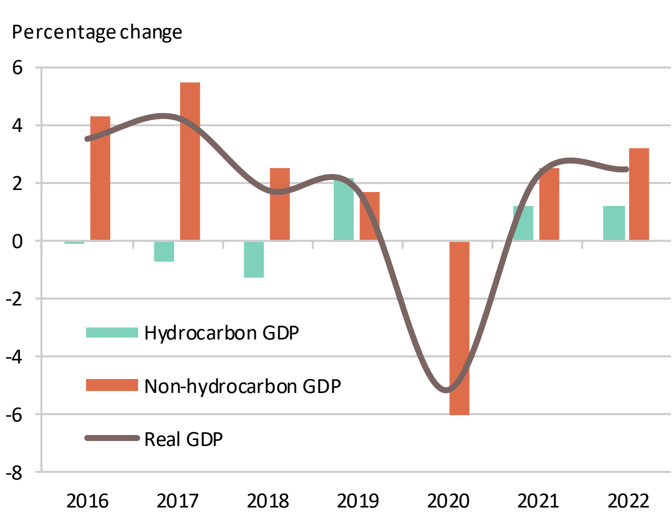
While the total fiscal deficit was declining under the FBP, it remained at over 10 percent of GDP in 2019 due to lower oil prices and large off-budgetary spending. Even before COVID-19, the prospect of achieving a balanced budget by 2022, committed under FBP, was most unlikely. More so, the mitigation measures of BD4.3 billion (or 4.2 percent of GDP)—introduced in March 2020 for 3 months period and extended in July—to support the country's citizens and private sector to weather the negative economic impact of the pandemic—are expected to put additional pressure on public finances. Until conditions ease and policy stance shifts from mitigation to resumed consolidation, the trajectory envisaged under the FBP will be delayed.

Recent economic developments

Hit by the sharp drop in oil prices and unfavorable global and domestic conditions including disruptions from COVID-19, preliminary official data indicate that Bahrain posted a 1.1 percent (y/y) contraction in its real GDP in Q1/2020. The decline was caused by disruptions in the non-oil economy which contracted by 1.7 percent (y/y), weighed down by the lockdown measures and travel restrictions, especially for services and tourism sectors where Bahrain has heavily invested. Weak consumer demand driven by social distancing and rising uncertainties due to the pandemic led to 2 percent (y/y) deflation in the first 7 months of 2020; rising prices expected in the next 2 quarters could offset that on annual basis.

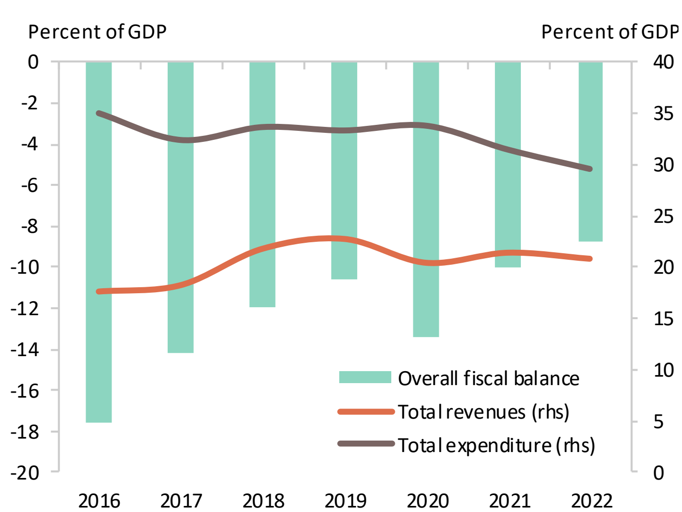
The plunge in oil prices and volatility in the global commodity markets and trade negatively impacted the demand for oil and aluminum (the key downstream sector), putting a significant strain on government revenues. Figures released by MoF reveal that government revenues in the first half of 2020 (H1/2020) fell by 29 percent (y/y). Oil revenues declined by 35 percent. As a result, Bahrain's overall budget deficit has almost doubled to BD 798 billion in

FIGURE 1 Bahrain / Real annual GDP growth



Sources: Bahrain authorities, World Bank; and IMF staff projections.

FIGURE 2 Bahrain / General government operations



Sources: Bahrain authorities, World Bank; and IMF staff projections.

H1/2020 (y/y), from BD 404 billion in H1/2019, up 98 percent.

The collapse in the tourism industry that accounted for 2.5 percent of GDP (2019) is also weighing heavily on tax revenues and economic activity. To bolster finances, the country secured a loan of about US$1 billion in March to repay a US$1.25 billion bond due end-March 2020, and in May, raised US$2 billion from international markets. The current account deficit widened as the value of exports declined by 9 percent (y/y) during Q2/2020 driven by lower oil exports revenues.

According to the most recent available data from the Labor Market Regulatory Authority (LMRA), while the number of foreign workers reached 594,944 in the second quarter of 2019, accounting for 79.5 percent of the country's total employment, Bahraini employment reached 153,103 during the same period. It is too soon to assess the scale of foreign worker departures prompted by COVID-19 impacts.

Outlook

Faced with further pandemic disruptions coupled with only modest recovery in oil prices over the remainder of the year, real GDP is expected to contract by 5 percent at end-2020. Over 2021-22, growth could bounce back to an average of 2 percent, supported by infrastructure projects and the pick-up in non-oil activity.

Lower oil prices and large off budgetary spending, along with constrained oil production capacity are projected to widen the overall fiscal deficit to over 13 percent of GDP in 2020. Persistent large fiscal deficits will lead to a rapid rise in public debt estimated to reach 130 percent of GDP in 2020. The expansion of Aluminum Bahrain (Alba) capacity will boost non-oil revenues as global demand recovers. Then, the overall budget deficit is projected to only gradually narrow in 2021-22, given lower oil revenues. In the aftermath of the pandemic, continuing fiscal reforms and better-targeted subsidies under the FBP will help to narrow the fiscal deficit. However, public debt is expected to increase further in 2021-22, given the sizable gross financing needs.

The current account deficit is estimated to widen sharply to nearly 8 percent of GDP in 2020 owing primarily to lower exports revenues from oil and aluminum combined with a collapse in tourism revenue. Foreign reserves are estimated to decline to US$2 billion in 2020 from US$3.7 billion at end-2019. Large current account deficits are likely to persist in 2021-22 albeit at slightly moderated levels.

Key risks stem from price volatility along the energy value chain (oil, petroleum products, energy-intensive industry), eventual tightening of global financial conditions, prolonged COVID-19, and insufficient fiscal adjustment, all of which would further increase the fiscal deficit and public debt. Delays in fiscal reforms under the FBP could lead to unfavorable macro-financial dynamics and squeeze capital spending. The current fiscal path makes a balanced fiscal position by 2022 all but impossible; changing the course will require a mix of using ample financing to absorb shocks with renewed commitment to streamline "big-ticket" subsidies and improve spending efficiency. While the new deal to normalize relations with Israel could benefit Bahrain in terms of trade, tourism, and technological cooperation, it is not yet clear what the full potential economic impact of this deal will be. Negative COVID-19 impacts on labor incomes are to be expected, especially in sectors such as tourism and services. Therefore, designing a reform program that safeguards the most vulnerable is critical. The likelihood of protracted foreign worker travel restrictions could be an impetus to boost domestic labor market matching of positions with incumbent nationals and foreign workers, building on existing labor market reforms in that direction.

TABLE 2 Bahrain / Macro poverty outlook indicators (annual percent change unless indicated otherwise)

	2017	2018	2019	2020 e	2021 f	2022 f
Real GDP growth, at constant market prices	4.3	1.8	1.8	-5.2	2.2	2.5
Private Consumption	1.3	-1.9	1.6	-3.5	2.3	3.0
Government Consumption	11.0	0.6	0.9	6.3	2.1	1.4
Gross Fixed Capital Investment	10.6	9.5	5.0	-7.9	1.8	5.0
Exports, Goods and Services	3.7	3.3	4.3	-10.0	5.0	4.1
Imports, Goods and Services	7.6	5.7	4.4	-8.2	5.9	4.2
Real GDP growth, at constant factor prices	4.3	1.8	1.8	-5.2	2.2	2.5
Agriculture	-0.9	3.8	1.8	1.5	1.5	1.5
Industry	0.6	2.3	1.2	-5.2	2.5	2.5
Services	7.2	1.4	2.3	-5.3	2.0	2.5
Inflation (Consumer Price Index)	1.4	2.1	1.0	0.0	2.5	2.3
Current Account Balance (% of GDP)	-4.5	-5.9	-3.0	-7.9	-6.4	-5.3
Net Foreign Direct Investment (% of GDP)	0.8	1.9	1.9	2.2	2.1	2.0
Fiscal Balance (% of GDP)	-14.2	-11.9	-10.6	-13.4	-10.0	-8.7
Primary Balance (% of GDP)	-10.6	-7.6	-6.1	-8.5	-5.1	-4.0

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