Euler Hermes Economic Research

Country Report

Bahrain

Depleted FX reserves cause economic crisis

General Information

GDP	USD31.8585bn (World ranking 94, World Bank 2016)
Population	1.43mn (World ranking 151, World Bank 2016)
Form of state	Constitutional Monarchy
Head of government	H.R.H. Prince KHALIFA bin Salman bin Hamad Al Khalifa
Next elections	2018, legislative (Council of Representatives)

Strengths

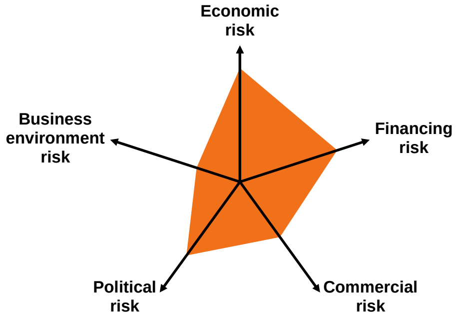
- Relatively (in a regional context) diversified economy, with oil, manufacturing (including aluminum and petro-chemicals) and financial sectors
- Pro-business stance and commercial and trading environment rated highly by independent international assessments
- Financial and other support from larger regional states, particularly Saudi Arabia

Weaknesses

- Tensions between the ruling Sunni community and the Shia majority
- Regional instability, including potential for contagion stemming from events in Iran, Iraq and/or Syria
- Despite economic diversification, there is still a high dependence on oil revenues, directly (own output) and indirectly (regional influence)
- Sharply deteriorated public finances since 2015
- Low FX reserves (import cover < 2 months)
- Very high external debt
- Poor data transparency

Country Rating

C3



Source: Euler Hermes

Trade Structure

By destination/origin (% of total)

Exports		Rank		Imports
Saudi Arabia	18%	1	24%	Saudi Arabia
United Arab Emirates	15%	2	10%	United Arab Emirates
United States	10%	3	8%	United States
Japan	6%	4	8%	China
Qatar	4%	5	6%	Japan

By product (% of total)

Exports		Rank		Imports
Non-ferrous metals	23%	1	15%	Road vehicles
Petroleum & products thereof	23%	2	8%	Petroleum & products thereof
Iron and steel	6%	3	4%	Industrial machinery and parts
Manufactures of metal	5%	4	4%	Metal ores and metal scrap
Metal ores and metal scrap	4%	5	4%	Electrical mach. & appliances

Source: Unctad (2016)

Economic Overview

From low oil prices to financial crisis...

The Bahraini economy is relatively diversified compared with fellow members of the GCC regional grouping. The hydrocarbon sector accounts for approximately 20% of GDP (vs. more than 40% in Saudi Arabia, e.g.). Nonetheless, the sector remains all-important, especially since oil and gas account for around 85% of government revenues. Bahrain has the highest fiscal breakeven oil price in the region, at about 93 USD/bbl.

As a result, Bahrain's fiscal and external vulnerabilities have steadily increased in the wake of continued low oil prices since 2014. The annual fiscal deficit surged to around -18% of GDP in 2015-2016 and, though declining, it is projected to remain very large in the range of -10% to -12% in 2017-2019. Consequently, public debt has jumped from 44% of GDP in 2014 to currently around 90%.

The annual current account balance shifted into a deficit of -2.4% of GDP in 2015, after 12 years of large surpluses. The shortfall widened to -4.7% in 2016 and is forecast to remain above -4% in 2017-2018.

Financing the fiscal and external deficits brought the Central Bank's foreign exchange (FX) reserves down to about USD1.6bn in July 2017 (import cover of just 0.8 months). Still, Bahrain was able to tap global bond markets as recently as September, when it raised USD3bn. Expectations among investors are that rich Gulf neighbors will support Bahrain in order to avoid a full-blown financial crisis that could spill over to the region. Bahrain's SWF is comparatively small, comprising about USD10bn at end-2016.

In any case, Bahrain reportedly asked Saudi Arabia and the UAE for financial support in November 2017 in order to replenish its FX reserves and avert a currency devaluation. We expect that the neighbors will provide aid, if needed, but also ask the smallest GCC member state for more efforts to control its public finances, which will have an impact on the growth outlook. Overall, the latest developments indicate increased country risk of Bahrain.

...and slower growth

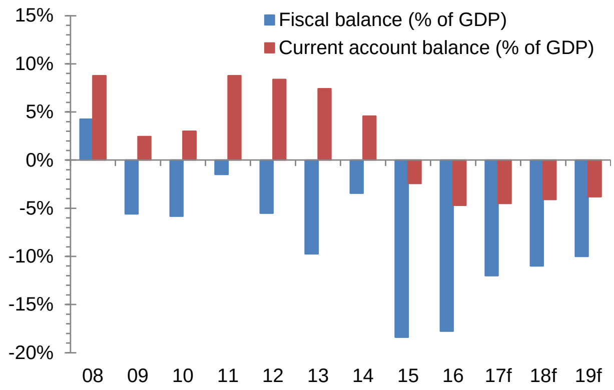
Real GDP growth picked up from +3% in 2016 to +3.4% y/y in H1 2017. Yet we expect a slowdown in the wake of the emerged financial crisis and forecast full-year growth of +2.7% in 2017 and +1.7% in 2018. We expect annual average inflation to pick up from 1.4% in 2017 to 3.4% in 2018 as a result of subsidy reform and tax hikes. Coupled with public spending cuts and public sector wage restraint this should weigh on consumer spending.

Key economic forecasts

	2016	2017e	2018f	2019f
GDP growth (% change)	3.0	2.7	1.7	2.0
Inflation (%, yearly average)	2.8	1.4	3.4	2.8
Fiscal balance (% of GDP)	-17.7	-12.0	-11.0	-10.0
Public debt (% of GDP)	82.3	90.0	97.0	109.0
Current account (% of GDP)	-4.7	-4.5	-4.1	-3.8
External debt (% of GDP)	139.8	147.0	150.0	155.0

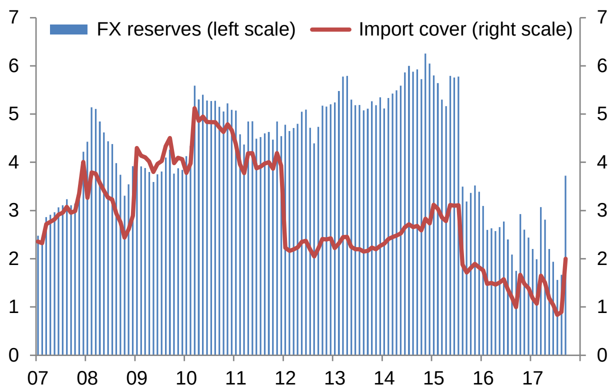
Sources: National statistics, IHS, Euler Hermes

Fiscal and current account balances (% of GDP)



Sources: IMF, Euler Hermes forecasts

Foreign exchange reserves (USD bn) and import cover (months)



Sources: IMF, IHS, Euler Hermes

Last review: 2017-12-04
Country Risk Analyst:
Manfred Stamer
manfred.stamer@eulerhermes.com