Euler Hermes Economic Research

Country Report

Bahrain

Solid performance, but growth constraints

General Information

GDP	USD22.945bn (World ranking 101, World Bank 2012)
Population	1.32 million (World ranking 154, World Bank 2012)
Form of state	Constitutional Monarchy
Head of government	H.R.H. Prince Khalifa bin Salman bin Hamad Al Khalifa
Next elections	2014, legislative (Council of Representatives)

Strengths

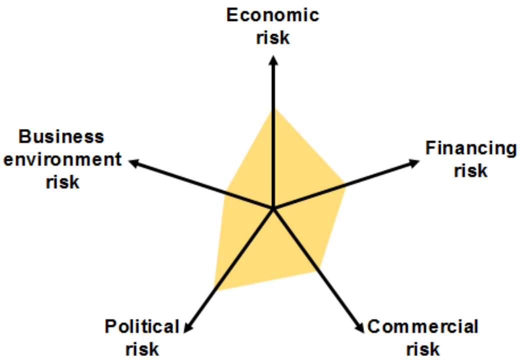
- Relatively (in a regional context) diversified economy, with oil, manufacturing (including aluminium and petro-chemicals) and financial sectors.
- Pro-business stance and commercial and trading environment rated highly by independent international assessments.
- Financial and other support from larger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

Weaknesses

- Tensions between the ruling Sunni community and the Shia majority.
- Regional volatility, including potential for adverse contagion stemming from events in neighbouring Iran and Iraq and Syria.
- Despite economic diversification, there is still a dependence on oil revenues, directly (own output) and indirectly (regional influence).
- Poor data transparency.

Country Rating

B2



Source: Euler Hermes

Trade structure

By destination/origin (% of total)

Exports		Rank		Imports
Saudi Arabia	12%	1	30%	Saudi Arabia
United Arab Emirates	7%	2	9%	United States
India	7%	3	9%	China
Korea, Republic of	6%	4	6%	Japan
Qatar	6%	5	5%	France

By product (% of total)

Exports		Rank		Imports
Petroleum and related materials	38%	1	23%	Petroleum and related materials
Non-ferrous metals	18%	2	10%	Road vehicles
Metalliferous ores and metal scrap	10%	3	5%	Other transport equipment
Manufactures of metal, n.e.s.	4%	4	4%	Other industrial machinery
Gas, natural and manufactured	3%	5	4%	Metalliferous ores and metal scrap

Source: UNCTAD (2012)

Economic Overview

GDP growth will remain below potential and also below the long-term average

GDP growth (+3.6%) improved in 2012, following the downturn in 2011 (+2.1%) resulting from domestic political unrest and weak external markets, including in the eurozone. In 2012, the recovery was a result of a rebound in non-oil output (manufacturing, hotels and restaurants, insurance and, to a lesser extent, construction and banking) because crude oil production contracted as a result of disruption in the Abu Saa'fa field. However, the oil sector remains the cornerstone of the economy and the source of overall growth. Unlike the rest of the GCC, Bahrain has limited crude oil reserves but it has a large refinery (Sitra) and imports oil from its neighbours, which it processes and exports as value-added products.

EH expects GDP growth of around +3.7% in 2014 and +3.5% in 2015. Higher rates of growth depend on rebuilding consumer and investor confidence and these depend on maintaining security and improving domestic stability. Moreover, growth rates depend on performance by the oil, mining and financial sectors and this will also reflect uncertain global developments. Accordingly, the GDP forecasts have upside and downside risks.

Inflationary pressures are mounting but remain manageable

Inflationary pressures were relatively subdued until 2012, with an annual average end-year inflation rate of around 1.7% in 2000-11. Since then, increased social spending by the state has boosted domestic demand and growth in prices. The latter has also been fed by relatively large increases in housing and utility prices, reflecting changes in state subsidies. Global commodity prices have eased somewhat and inflationary pressures through food prices will be muted in the remainder of 2014 and in 2015. Overall, annual inflation will remain above the long-term average but is unlikely to be much in excess of 3% at end-2015 and is forecast to be below that level in 2014.

EH does not envisage that the exchange rate regime will be changed in the review period to end-2015 and we expect the fixed peg of BHD0.376 = USD1 throughout that period. Bahrain is unlikely to take unilateral action on its exchange rate, preferring to await the onset (timing indeterminate) of the Gulf monetary union and single currency. EH does not expect the introduction of an effective common GCC currency before end-2015.

Large current account surpluses…

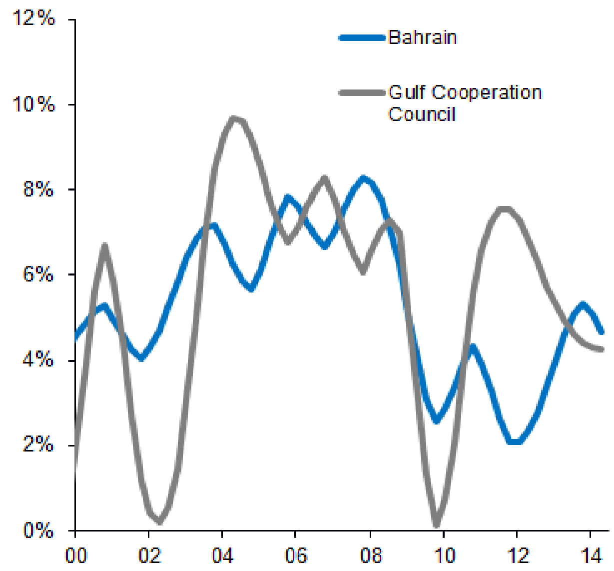
Despite the political and social turmoil in 2011, the current account of the balance of payments registered a surplus of 11.2% of GDP (compared with 3% in 2010). High global oil prices boosted exports of refined products but there was also a positive growth registered by non-oil exports (mainly aluminium, rebar and petrochemicals). By contrast, the protests and demonstrations weakened growth in import demand. The same trends continued into 2012 and 2013, although the surpluses eased to around 7% of GDP. Tourism revenues (mainly from people driving over the King Fahd Causeway from Saudi Arabia) have improved somewhat from 2011-12 but long-range visitors still appear reticent about travelling to the country. EH expects current account surpluses will remain around 7% of GDP in 2014 and also in 2015.

Key economic forecasts

	2012	2013	2014f	2015f
GDP growth (% change)	3.6	5.3	3.7	3.5
Inflation (%, end-year)	2.6	4.0	1.5	3.4
Fiscal balance (% of GDP)	-2.0	-3.3	-4.2	-4.2
Public debt (% of GDP)	36.3	41.4	44.9	48.3
Current account (% of GDP)	7.2	7.8	7.4	7.1
External debt (% of GDP)	53.5	54.9	55.9	56.5

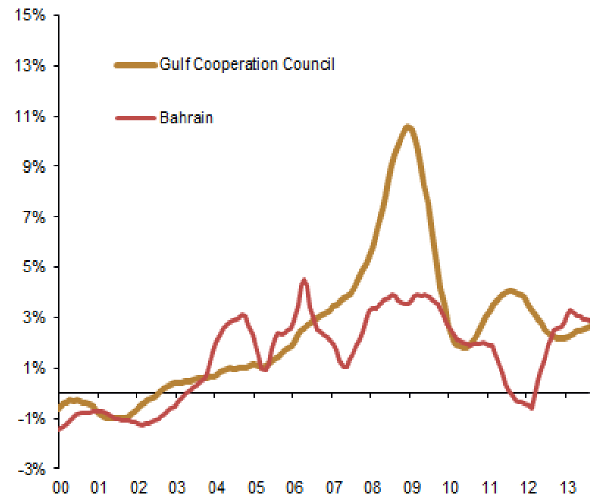
Sources: IHS Global Insight, national sources, Euler Hermes

GDP growth (% y/y, 4 quarters cumulated)



Sources: IHS Global Insight, Euler Hermes

Inflation (%)



Sources: IHS Global Insight, Euler Hermes

...and external debt ratios are comfortable

External debt ratios are still comfortable with debt/GDP and debt/foreign exchange earnings forecast at around 56% and 66%, respectively, in 2014. Annual servicing commitments on external debt are relatively low and forecast to remain <8% of total export earnings in 2014 and 2015.

Foreign exchange reserves of around USD5 billion provide import cover of over three months, which is the international benchmark comfort level. In addition, Bahrain has an oil stabilisation fund for use in times of economic hardship and Saudi Arabia remains ready to supply further support, in need. All this tends to signify that problems should not arise in relation to trade payments and other financial obligations in the review period.

Public finances

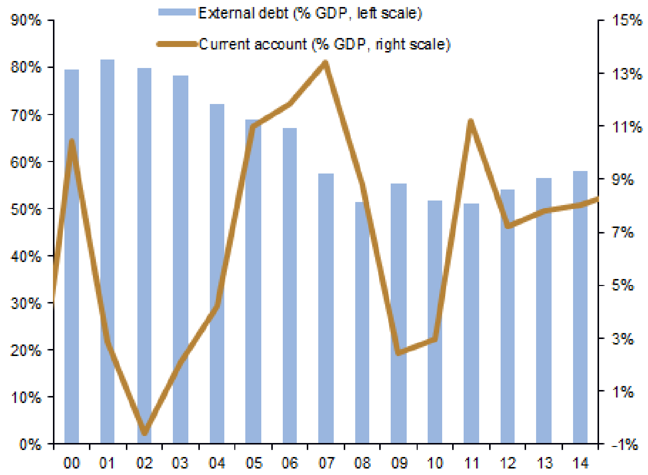
Budget deficits have been recorded each year since 2009. Official budget projections tend to adopt conservative oil prices in the forecasts and are a guideline only to fiscal balances. Accordingly, while state spending will remain high in attempts to assuage social dissent, the 2013 deficit outcome will remain manageable at around -3.3% of GDP (up on the previous two years but below the levels in 2009 and 2010, -4.3% and -4.8% of GDP, respectively). Continued high state expenditure and an easing in international oil prices, will increase the deficit in 2014 (EH expects -4.2% of GDP), although Bahrain's finances will continue to be underpinned by financial aid from fellow-members of the GCC, particularly Saudi Arabia. The GCC pledged around USD10 billion in direct budgetary aid over a ten-year period.

Public debt has increased rapidly since 2008 and currently amounts to around 44% of GDP. Most of the increase derives from external debt issuance. The IMF recently warned of the dangers inherent in boosting public debt.

Planning for the future

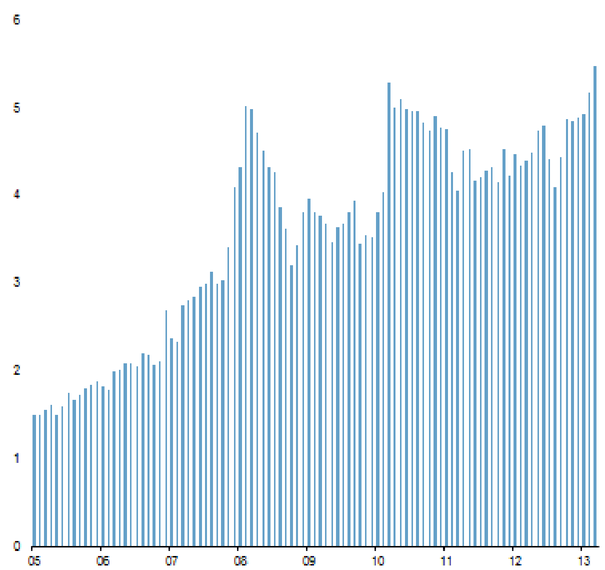
As elsewhere in the GCC, particularly Oman and Saudi Arabia, Bahrain is increasingly adopting a policy of providing nationals with jobs rather than employing foreign workers (Bahrainisation), where possible. Implementation of the policy became more imperative with the Arab Spring and associated unrest that partly reflected poor job prospects. Currently, more than 70% of the workforce consists of expatriates and domestic unemployment and poverty are particularly high among the majority Shia population. However, the capital intensive nature of industry does not provide a significant number of additional jobs.

External debt and current account balance (% of GDP)



Sources: IHS Global Insight, Euler Hermes

Foreign exchange reserves (USD bn)



Sources: IHS Global Insight, Euler Hermes

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Last review: 2014-09-20
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