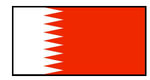
Euler Hermes Economic Research

Country Risk Analysis

Bahrain

Regional support aids short-term stability



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	KHALIFA bin Salman 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.

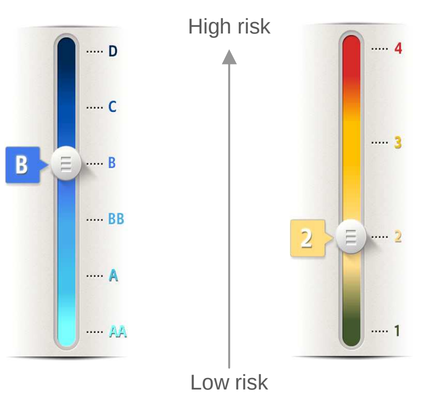
Weaknesses

- Tensions between the ruling Sunni elite and the Shia majority came to the fore with the Arab Spring and these have not been addressed effectively. Localised protests and demonstrations continue to be held.
- Regional volatility, including potential for adverse contagion stemming from events in neighbouring Iran and Iraq.
- Despite economic diversification, there is still a dependence on oil revenues, directly (own output) and indirectly (regional influence).
- Poor data transparency.

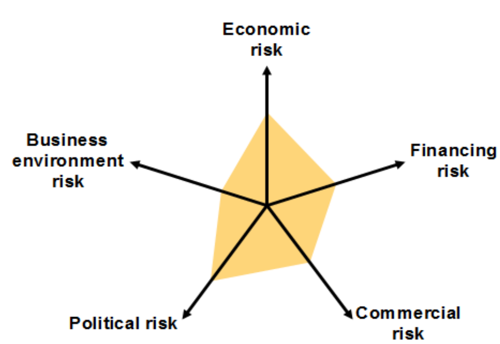
Country Rating

B2

Country Grade **Country Risk Level**

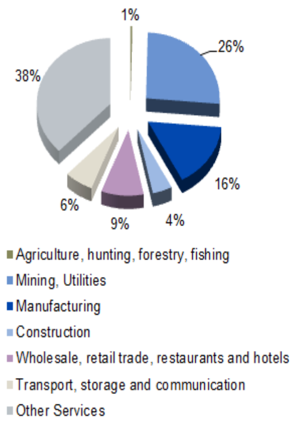


Risk Dimensions



Economic Structure

GDP breakdown (% of total, 2011)



Sources: Chelem, UnctadStat, IHS Global Insight, Euler Hermes

Trade structure (% of total, 2011)

By destination/origin

Exports		Rank		Imports
Saudi Arabia	12%	1	34%	Saudi Arabia
United Arab Emirates	7%	2	9%	United States
India	6%	3	7%	China
Japan	6%	4	5%	Brazil
Qatar	6%	5	5%	Germany

By product

Exports		Rank		Imports
Petroleum, petroleum products and related	31%	1	8%	Road vehicles
Non-ferrous metals	22%	2	7%	Metalliferous ores and metal scrap
Metalliferous ores and metal scrap	16%	3	6%	Non metallic mineral manufactures, n.e.s.
Manufactures of metal, n.e.s.	3%	4	6%	Electrical machinery, apparatus and appliances,
Gas, natural and manufactured	3%	5	6%	Other industrial machinery and parts

Economic Forecast

	2009	2010	2011	2012	2013f	2014f
GDP growth (% change)	2.5	4.3	2.1	3.4	4.2	4.0
Inflation (%, end-year)	1.6	1.0	0.2	2.6	3.3	2.9
Fiscal balance (% of GDP)	-6.6	-7.0	-1.7	-2.6	-2.7	-3.5
Public debt (% of GDP)	25.4	35.5	36.5	33.6	41.7	45.2
Current account (% of GDP)	2.4	3.0	11.2	7.3	5.9	3.0
External debt (% of GDP)	56.2	53.4	50.7	54.5	56.2	55.0

Sources: IHS Global Insight, National sources, Euler Hermes

Economic Growth

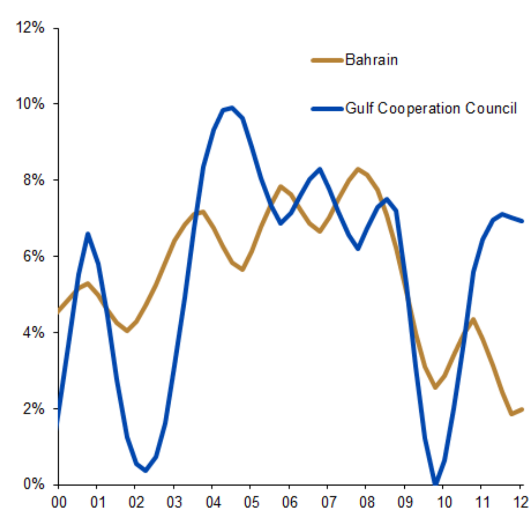
Growth recovered after the stability-impaired rate in 2011

GDP growth (+3.4%) 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 value-added products.

Growth outlook in 2013-14

EH expects GDP growth of around +4.2% in 2013 and +4% in 2014. 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.

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



Sources: IHS Global Insight, Euler Hermes

Economic Policies

As elsewhere in the GCC, particularly Oman and Saudi Arabia, Bahrain is increasingly adopting a policy of providing nationals with jobs rather than foreign workers (Bahrainisation). 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 is particularly high among the majority Shia population. However, the capital intensive nature of industry does not provide a significant number of additional jobs.

Inflationary pressures are likely to remain subdued

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 2013 and in 2014. Overall, annual inflation will remain above the long-term average but is unlikely to be much in excess of 3% at end-2013 and is forecast to be below that level in 2014.

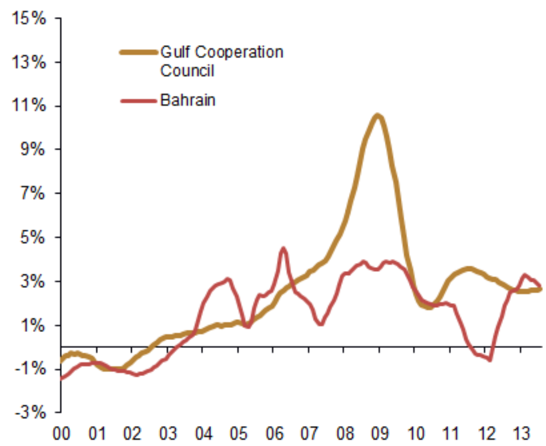
EH does not envisage that the exchange rate regime will be changed in the review period to end-2014 and we expect the fixed peg of BHD0.376 = USD1 throughout that period. Bahrain is unlikely to take unilateral action on its exchange rate, preferring to await the onset (timing indeterminate) of the Gulf monetary union and single currency. EH does not expect the introduction of an effective common GCC currency before end-2014.

Fiscal deficits

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 -2.7% 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 likely easing in international oil prices, will increase the deficit in 2014 (EH expects -3.5% 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 has pledged around USD10 billion in direct budgetary aid over the next ten years.

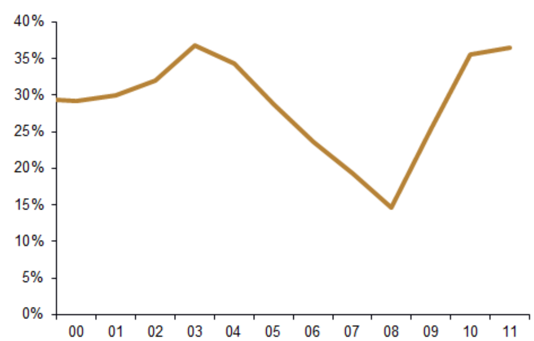
Public debt has increased rapidly since 2008 and currently amounts to around 42% of GDP. Most of the increase derives from external debt issuance. In July 2012, Bahrain auctioned ten-year paper raising USD1.5 billion. The IMF recently warned of the dangers inherent in boosting public debt.

Inflation rate (%)



Sources: IHS Global Insight, Euler Hermes

General government gross debt (% of GDP)



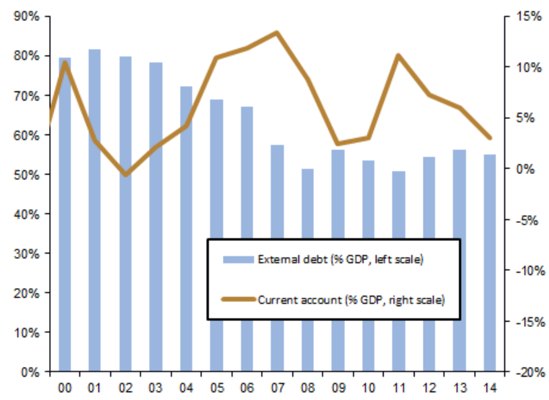
Sources: IHS Global Insight, Euler Hermes

External Sector

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, although the surplus eased to 7.3% 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 appear reticent about travelling to the country. EH expects export receipts will weaken as global energy prices ease in 2013-14 and double-digit current account surpluses will not return in this period. Nevertheless, annual surpluses will be around 6% of GDP in 2013 and over 3% in 2014.

External debt (% of GDP)

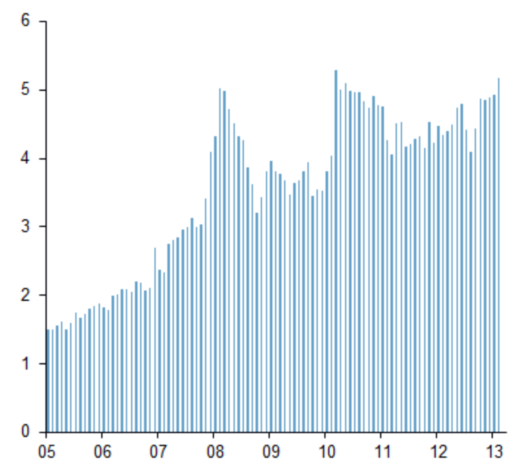


Sources: IHS Global Insight, Euler Hermes

External debt ratios remain comfortable

External debt ratios are still comfortable with debt/GDP and debt/foreign exchange earnings forecast at around 55% and 52%, respectively, in 2014. Annual servicing commitments on external debt are relatively low and forecast to remain <6.5% of export earnings in 2013 and 2014.

FX reserves (USDbn)



Sources: IHS Global Insight, Euler Hermes

Adequate import cover, with additional financial support, in need

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.

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Contact Euler Hermes Economic Research Team
research@eulerhermes.com

Last review: 2013-11-20
Country Risk Analyst:
Andrew Atkinson
andrew.atkinson@eulerhermes.com