

Economic Research

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Country Outlook: Bahrain



MALAYSIAN RATING CORPORATION BERHAD
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In a nutshell

- The near- and medium-term prospects of Bahrain's economy have recently been clouded by political unrest that swept the region following the downfall of the governments of Tunisia and Egypt in January and February 2011 respectively. Bahrain's majority Shi'a populace is protesting against the rule of the Al-Khalifa family of rulers, themselves of minority Sunni origin, with the Shi'a accusing the government of discriminating against them in areas such as employment, housing, education and public services. The protests, in which several people died and hundreds were injured, call for constitutional reform and a more representative parliament.
- From an economic standpoint, however, Bahrain was generally in better shape in 2010, with growth expected to accelerate to around 4.0%, according to the Economic Development Board (EDB), after moderating sharply by 3.1% following the Great Recession in 2009. We believe that the growth target is within reach, as higher oil prices, having averaged at around USD79 per barrel in 2010 (2009: USD62 per barrel), have pushed prices of refined petroleum up, giving a significant boost to Bahrain's economy.
- The inflationary environment has been favourable and Bahrain has not experienced double-digit growth in its consumer price index (CPI) since 1990. The CPI growth in December 2010 showed that inflation remained benign, clocking in at 1% compared with the high of 5.1% recorded in December 2008. With the economy projected to grow below its potential, demand-led inflation will likely remain a remote possibility. This outlook is also supported by the prevailing labour-market conditions, where total employment was unchanged in 2Q2010.
- The global economic crisis in 2007/08 had a profound effect on government finances, as revenue from oil, the main source of government income, fell drastically in late 2008 and remained relatively low for most of 2009 before trending up again in 2010. Consequently, the government's fiscal position went in the red, with deficits surging to 446 million Bahraini dinars (BD), about 5.8% of gross domestic product (GDP) in 2009, while government debt rose in tandem with the increase in the deficit level. However, in the latest Budget 2011-2012, the government aimed to reduce its budget deficit to between 4.0% and 5.0% of GDP in 2011 and 2012 respectively from an estimated 8.7% of GDP in 2010. We believe that the estimates look reasonably attainable, given that oil demand is picking up in light of better prospects of the global economy in the near term.
- The balance of payments (BOP) position has been generally healthy, given the persistent surpluses recorded in the current account which averaged more than 7% of GDP since 2000 due to the overall favourable trade performance led by oil exports. The capital and financial account, on the other hand, remained in deficit in the past years, reflecting a two-way flow of capital. The only concern, however, is that the country's foreign exchange reserves are relatively low despite being higher than the minimum required international standard.
- Based on a macroeconomic matrix comparison (using the average of five-year median), Bahrain is in a relatively favourable position in the following areas: (1) 'government revenue and fiscal balance,' due to rising oil prices; (2) 'growth and inflation,' where its position is almost comparable to Thailand and Malaysia; (3) 'current account and fiscal balance,' due to relatively strong trade performance as a result of favourable oil prices; (4) 'population growth and GDP per capita,' due to high income per capita; and (5) 'public debt and fiscal balance,' due to relatively low public debt and small fiscal surpluses. However, Bahrain's position is relatively unfavourable in terms of the reserves-to-imports ratio.

Introduction

Bahrain, an archipelago of 36 islands located off Saudi Arabia's eastern coast, has an area of 727 square kilometers and 161 kilometres of coastline. Its history began as early as 5,000 years ago as the site of the ancient Bronze Age civilisation of Dilmun, and it was a prominent trade centre that linked Mesopotamia and the Indus Valley due its strategic location in the Persian Gulf. 2,000 B.C. marked the beginning of the civilisation's decline as Indian trade was cut off, and from 750 B.C. onwards, Assyrian kings began making claims over the islands. The new Babylonian empire later included Dilmun shortly after 600 B.C., after which the Arabian tribes of Bani Wa'el and Persian governors reigned over the land. In the 7th century, many inhabitants converted to Islam, and the country Bahrain (hitherto known by the Greek name Tylos) came into being.

As the region's pearling and trade centre, Bahrain was then variously ruled by the Ummayyad Caliphs of Syria, the Abbasid Caliphs of Baghdad, Persian, Omani and Portuguese forces until the Al-Khalifa family, a branch of the Bani Utbah tribe that has reigned over Bahrain since the 18th century, succeeded in capturing Bahrain from a Persian garrison that was in control of the islands in 1783. British influence came into the picture when the family signed the first of many treaties to establish Bahrain as a British Protectorate, ensuring that the family would not dispose of territory and enter into relationships with any foreign government without British consent. In exchange, the Protectorate received British protection against military threats from Ottoman Turkey. This development enabled the region's main British naval base to relocate in Bahrain in 1935 after the commencement of large-scale oil production.

About 30 years later, Bahrain joined eight other states (Qatar and the seven Trucial Sheikhdoms now known as the United Arab Emirates) under British protection to form a union of Arab emirates after the British government ended treaty relationships with the Persian Gulf sheikhdoms. However, as the sheikhdoms had not agreed on unification terms by 1971, Bahrain chose to declare itself independent on August 15, 1971; thereafter, it drew up its constitution and elected its first parliament in 1973. The National Assembly was disbanded by the Amir in August 1975 after it tried to legislate the end of Al-Khalifa rule and the removal of US Navy forces from the country.

About two decades later, Bahrain's political landscape was marred by violence arising from dissatisfaction amongst the Shi'a majority. The Amir then implemented an overhaul of the cabinet in 1995, the first in 20 years, and increased the Consultative Council's membership from 30 to 40 in 1996 to more efficiently advise on legislation proposed by the cabinet and suggest new laws. King Hamad bin Isa al-Khalifa then came into power in 1999 and pushed economic and political reforms to improve relations with the Shi'a community, whose political societies participated in 2010 parliamentary and municipal elections. Al Wifaq, the largest Shi'a political society, won the largest number of seats in the elected chamber of the legislature. However, Shi'a discontent has resurfaced in recent years with street demonstrations that have erupted into violence.

The recent political upheaval, which started in February 2011, intensified after security forces shot and killed a young protester, resulting in serious clashes with the police force. The police force has received widespread criticism for its use of tear gas, hollow-point bullets and batons to violently disperse protesters, with several people killed and hundreds injured, according to the Shiite opposition. Bahraini King Hamad bin Isa Al-Khalifa apologised for the deaths in a televised address, and promised to launch a probe into the killings and into the security service's response to the protests. He also pledged to make good on previous promises of reforms, including loosening media control and offering special social-welfare payments to the needy. However, these have failed to quell Shi'a anger and mistrust of the rulers.

Bahrain's population is estimated at 1,214,705 people come July 2011 (assuming a population growth rate of 2.81%), with 77% in the 15-64 years age bracket. Muslims (Shi'a and Sunni tribes) comprise 81.2% of the citizenry, while Christians and others comprise 9% and 9.8% respectively, according to a 2001 census.

Chart 1: The map of Bahrain



Source: US Department of State

The government and legal system

The current governing structure is a constitutional hereditary monarchy. Following the suspension of the initial constitution on August 26, 1975, the National Action Charter was approved by a national popular referendum on February 14-15, 2001, and a new constitution came into being a year later. The legal system is based on Islamic law and English common law, and has not accepted compulsory International Court of Justice jurisdiction.

The King (chief of state), Prime Minister (head of government) and Council of Ministers (cabinet; appointed by the King and headed by the Prime Minister) form the executive branch of the government, while the legislative branch comprises the bicameral parliament (al-Majlis al-Watani), a 40-member elected Council of Representatives and a 40-member Shura (Consultative) Council appointed by the King, with both chambers' members serving four-year terms. The judicial branch of the government comprises the High Civil Appeals Court which is independent and possesses the right of judicial review. There are 12 municipalities (also known as manatiq): Al Hidd, Al Manamah, Al Mintaqah al Gharbiyah, Al Mintaqah al Wusta, Al Mintaqah ash Shamaliyah, Al Muḥarraḡ, Ar Rifā' wa al Mintaqah al Janubiyah, Jidd Hafṣ, Madīnat Hamad, Madīnat 'Isa, Juzur Hawar, and Sitrah. The five governorates are Asamah, Janubiyah, Muḥarraḡ, Shamaliyah, and Wasat.

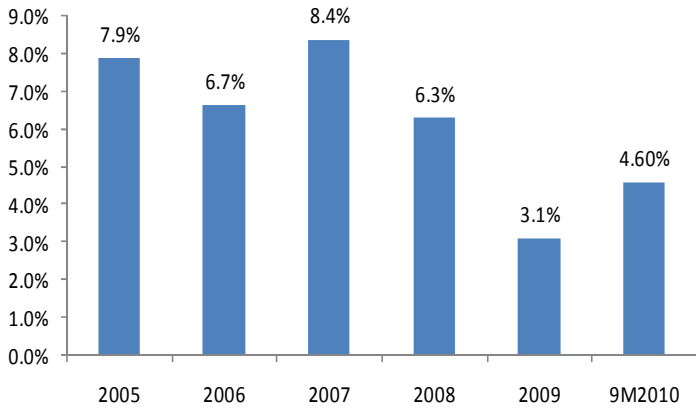
The chief of state is King Hamad bin Isa Al-Khalifa, and his heir apparent is Crown Prince Salman bin Hamad Al-Khalifa, son of the monarch. Sheikh Khalifa bin Salman Al-Khalifa is the Prime Minister, while Sheikh Ali bin Khalifa Al-Khalifa, Sheikh Muhammad bin Mobarak Al-Khalifa, and Sheikh Abdullah bin Khalid Al-Khalifa are the Deputy Prime Ministers. The elections for the Council of Representatives were last held in two rounds on 23 and 30 October 2010, with the next election to be held in 2014.

The economy

Bahrain has one of the Persian Gulf’s most diversified economies and is popular with numerous multinational firms due to its highly advanced communication and transport facilities. The first Gulf state to discover oil, Bahrain has attempted to diversify by signing a Free Trade Agreement with the US in August 2006, as its oil reserves are anticipated to be exhausted in a decade or so. Nevertheless, oil features prominently on the country’s agenda, seeing that petroleum production and refining account for more than 60% of Bahrain’s export receipts, 70% of government revenues, and 11% of GDP (exclusive of allied industries). The country also produces aluminum, its second largest export after oil, and has worked hard to solidify its reputation as a business centre and global hub for Islamic banking and finance.

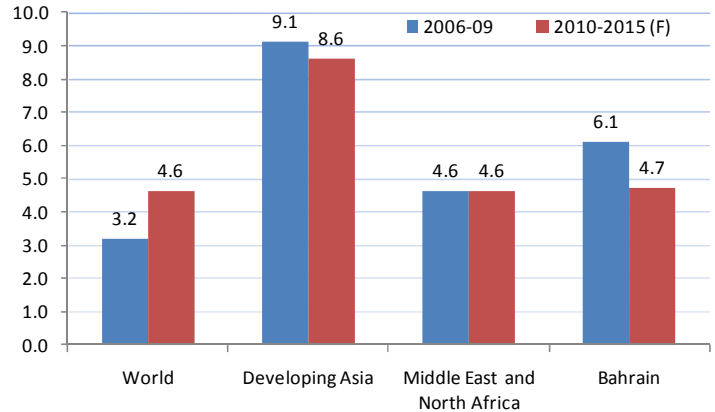
Today, the financial sector is the largest contributor to GDP, accounting for over 20% of GDP. Hundreds of international financial institutions operate in Bahrain, while various Islamic commercial, investment and leasing banks as well as Islamic insurance (takaful) companies call Bahrain home. The country is also working to develop other service industries such as information technology, healthcare and education.

Chart 2: GDP growth (%)



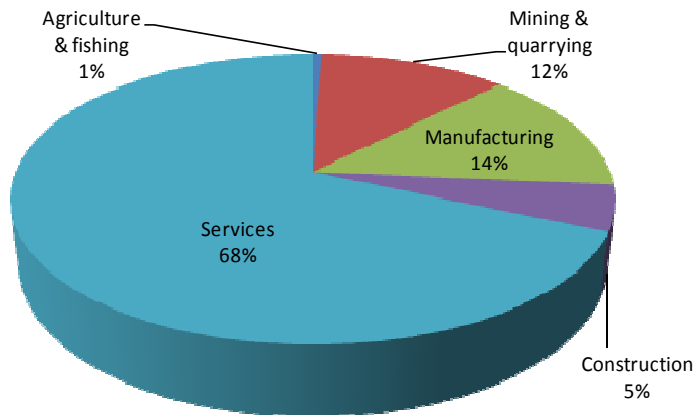
Source: Central Informatics Organisation (CIO), Bahrain

Chart 3: GDP growth trajectory (%)



Sources: IMF & MARC Economic Research
Note: F = Forecast

Chart 4: Bahrain’s economic structure



Source: CEIC

Economic performance

The economy was generally in better shape in 2010 as growth is expected to accelerate to 4.0% after moderating sharply at 3.1% in 2009 (2008: 6.3%). The latest quarterly GDP releases showed that the economy continued to rebound at a 4.3% clip in 3Q2010, albeit slower than in the preceding quarter (2Q2010: 4.6%). Growth has largely emanated from sectors like hotels & restaurants (+15.0%), manufacturing (+8%), financial services (+6.0%), communication (+6.0%), construction (+5%) and wholesale & retail trade (+5.0%).

Economic activities continued to expand at a healthy pace, with growth averaging 4.6% in the first three quarters of 2010, stronger than the 2.4% expansion registered in the corresponding period in 2009. The Economic Development Board (EDB), the public agency responsible for formulating and overseeing the economic development of Bahrain, is confident that growth will come in at 4% for the whole of 2010.

We believe that the growth target is within reach as higher oil prices, which averaged around USD79 per barrel in 2010 (2009: USD62 per barrel) has pushed prices of refined petroleum up, giving a significant boost to Bahrain's economy. According to the International Energy Agency (IEA), global oil demand rose by 2.8 million barrels per day (mb/d) year-on-year (y-o-y) in 2010 to stand at 87.8 mb/d in 2010, and will likely increase by a further 1.5 mb/d in 2011 to reach 89.3 mb/d this year, following better economic prospects in advanced economies.

Table 1: Quarterly GDP growth

Growth (Y-o-Y%)	1Q09	2Q09	3Q09	4Q09	1Q10	2Q10	3Q10
GDP	2.8%	2.4%	1.9%	5.3%	4.9%	4.6%	4.3%
Goods-producing Industries	-5.4%	-6.0%	-4.0%	-1.6%	3.9%	4.6%	na
Mining	0.5%	-0.7%	1.1%	-2.0%	0.5%	1.1%	na
Manufacturing	-4.0%	-3.7%	-1.4%	4.2%	6.8%	8.2%	na
Construction	-18.2%	-20.8%	-21.5%	-16.1%	2.2%	2.9%	na
Electricity & Water	-9.9%	-1.6%	14.4%	15.2%	16.6%	7.0%	na
Other Goods Industries	-2.1%	-8.2%	-8.1%	-6.8%	-1.6%	1.1%	na
Services-producing Industries	0.5%	-0.6%	-0.5%	2.0%	6.6%	8.2%	na
Wholesale & Trade	-8.3%	-8.4%	-9.3%	-15.3%	3.3%	8.0%	na
Hotels & Restaurants	8.5%	7.8%	9.1%	15.4%	14.4%	15.6%	na
Transport & Communications	11.9%	9.0%	10.8%	13.1%	6.9%	9.3%	na
Financial Services	-3.8%	-4.4%	-2.9%	-1.1%	6.0%	7.7%	na
Business Services	17.7%	12.2%	8.6%	10.6%	4.9%	5.3%	na
Other Services Industries	9.3%	7.0%	6.4%	7.1%	9.1%	9.5%	na
Real Estate	-17.4%	-16.4%	-19.0%	-4.5%	1.2%	1.3%	na

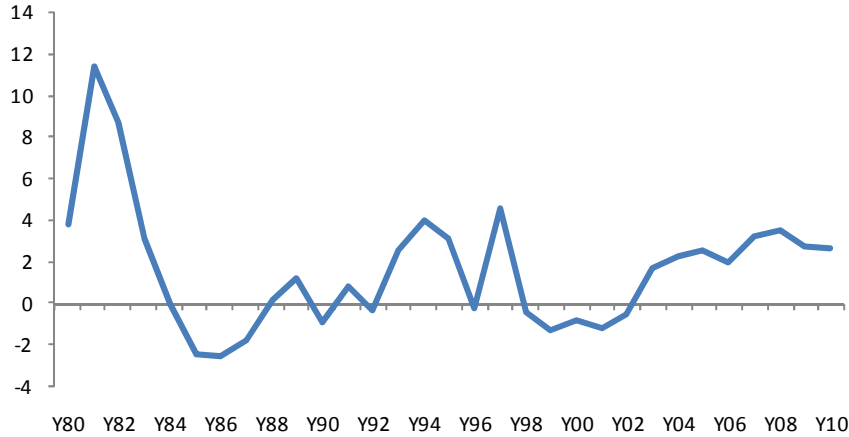
Source: Central Informatics Organisation (CIO)

Inflation dynamics

The inflationary environment has been favourable, and Bahrain has not experienced double-digit growth in its CPI since 1990. As a result, the country's real income has not been significantly eroded when compared with other Gulf Cooperation Council (GCC) countries. Such an environment has evidently led to a sustained growth in consumer spending. The latest print for the CPI in December 2010 showed that inflation remained benign, clocking in at 1% compared with the high of 5.1% recorded in December 2008. With the economy projected to grow below its potential, demand-led inflation will likely remain a remote possibility. This outlook is also supported by labour-market conditions, with total employment remaining unchanged in 2Q2010 while private-sector wages reported a sequential decline of 0.7% quarter-on-quarter (q-o-q) during the same period.

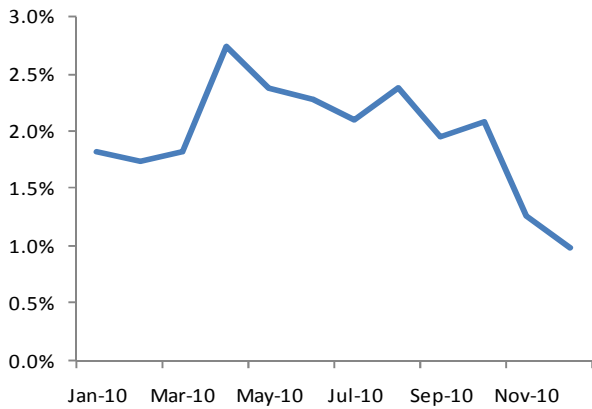
Asset prices continued to languish, judging by prices of real estate which are in the doldrums, especially in the office market segment. According to CB Richard Ellis, the sheer volume of new quality space due for completion in 2010 and 2011 will likely be in the region of 280,000 square metres - a hefty growth of 73% in local Class A office space in a market that is virtually static in demand terms.

Chart 5: CPI, 1980 - 2010 (%)



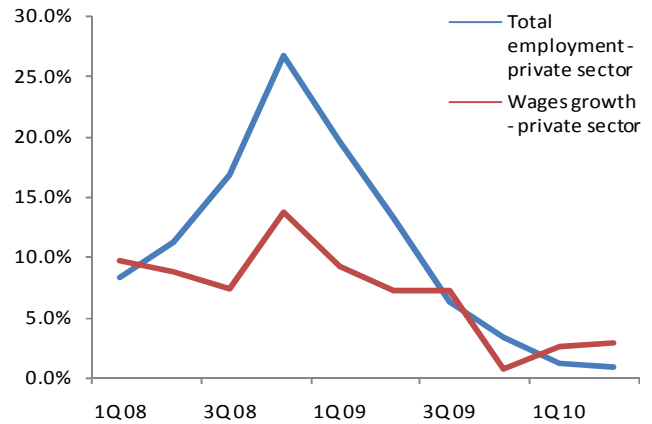
Source: IMF

Chart 6: CPI, recent months (%)



Sources: CEIC & Central Informatics Organisation (CIO)

Chart 7: Total employment – private sector and wage growth (%)



Source: Central Bank of Bahrain (CBB)

Table 2: CPI – breakdown (%)

	Jan-10	Feb-10	Mar-10	Apr-10	May-10	Jun-10	Jul-10	Aug-10	Sep-10	Oct-10	Nov-10	Dec-10
Consumer Price Index (CPI)	1.8%	1.7%	1.8%	2.7%	2.4%	2.3%	2.1%	2.4%	2.0%	2.1%	1.3%	1.0%
CPI: Food and Non Alcoholic Beverages	1.5%	3.0%	3.6%	8.6%	6.3%	6.9%	4.1%	5.8%	5.8%	6.5%	3.2%	3.1%
CPI: Alcoholic Beverages and Tobacco	9.0%	10.0%	10.5%	10.5%	10.4%	7.0%	3.7%	1.4%	0.7%	0.9%	1.6%	1.9%
CPI: Clothing and Footwear	0.8%	0.2%	1.3%	1.9%	1.9%	1.4%	1.1%	0.7%	2.3%	2.4%	2.9%	3.3%
CPI: Housing, Water, Electricity, Gas and Other Fuels	0.0%	0.0%	-1.4%	-1.5%	-1.6%	-1.5%	-1.5%	-1.5%	-1.5%	-1.5%	-1.5%	-1.5%
CPI: Furnishing, Household Equipment and Routine Household Maintenance	2.9%	3.1%	2.4%	1.8%	1.1%	-0.8%	0.6%	0.5%	-0.1%	2.6%	2.4%	1.4%
CPI: Health Care Services	2.0%	1.9%	3.9%	3.9%	3.9%	4.6%	4.6%	4.6%	2.6%	2.6%	2.6%	4.6%
CPI: Transport	2.6%	1.8%	4.1%	3.9%	3.9%	4.5%	5.3%	5.6%	3.9%	2.9%	1.8%	1.4%
CPI: Communication	-5.1%	-5.1%	-5.1%	-5.1%	-5.1%	0.0%	0.0%	0.0%	-0.8%	-0.8%	-0.7%	-0.7%
CPI: Recreation and Culture	0.4%	-0.2%	0.1%	0.2%	0.2%	0.1%	0.1%	0.1%	0.1%	0.2%	0.2%	-0.4%
CPI: Education	7.8%	7.8%	7.8%	7.8%	7.8%	7.8%	7.8%	7.8%	2.6%	2.6%	2.6%	2.6%
CPI: Restaurants	6.2%	6.2%	6.5%	6.5%	6.5%	6.5%	6.5%	6.5%	6.6%	6.6%	6.6%	0.4%
CPI: Miscellaneous Goods and Service	6.4%	1.3%	-2.1%	3.1%	2.5%	0.9%	2.2%	2.0%	2.2%	2.1%	1.2%	1.8%

Source: CEIC

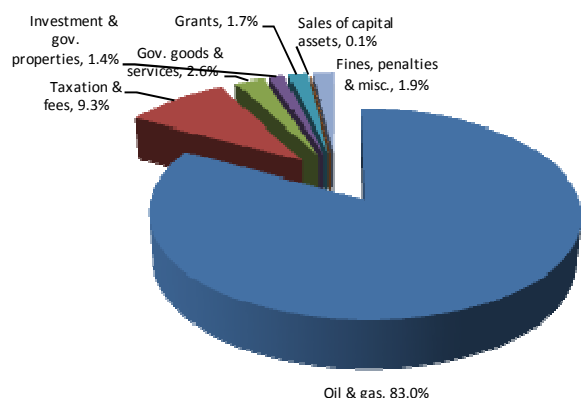
Public finance

The government derived its revenue mainly from oil and gas activities (80% of total revenue) in the last five years. Income from taxation was almost nonexistent as there was no imposition of personal and corporate income taxes as well as value added taxes (VAT). However, oil companies are taxed at approximately 46% of net profits. On the expenditure side, the government's recurrent expenditure constituted a hefty 76% of total expenditure in the past five years. Of this amount, spending on manpower or emoluments was the biggest component since the majority of the public sector's employment (87% of total public sector employment as of 2Q2010) was dominated by the Bahrainis. This was followed by transfers (12.2% of total expenditure) and grants, subsidies & repayment of loan interest (6.5% of total expenditure). On the other hand, spending on projects, similar to development expenditure, only formed about 24% of total expenditure.

The global economic crisis in 2007/08 had a profound effect on government finances as revenue from oil fell drastically in late 2008 and remained relatively low for most of 2009 before trending up in 2010. Total revenue fell 36.2% in 2009 (2008: +31.5%) as oil and gas revenue dropped significantly by 37.9% (2008:+40.1%). Consequently, the government's fiscal position went in the red with the deficit surging to BD446 million (equivalent to 5.8% of GDP) in 2009. In the same vein, government debt rose in tandem with the increase in the deficit level. The government's outstanding debt climbed from BD1.2 billion in 2008 (14.6% of GDP) to BD1.8 billion in 2009 (25.4% of GDP). Despite the sharp rise, a higher concentration of domestic debt – 64.8% of total debt – should alleviate concerns over the high debt-to-GDP ratio as the government's exposure to exchange-rate volatility and its subsequent implications on the nation's debt repayment capacity are rather minimal.

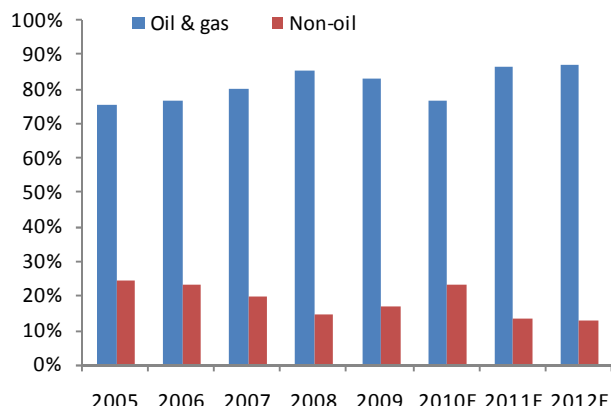
In the latest Budget 2011-2012, the government is expected to reduce its budget deficit to between 4.0% and 5.0% of GDP in 2011 and 2012 respectively from an estimated 8.7% of GDP in 2010. The lower deficits are expected to come from higher revenue which is likely to increase by 49.8% and 2.5% in 2011 and 2012 respectively, while total expenditure is anticipated to increase by 17.0% and 4.8% during the same period. Such projections are based on the assumption that oil prices will remain relatively high and stable, averaging at around USD80 per barrel, according to the government's base-case scenario. We believe that the estimates look reasonably attainable, given that oil demand is picking up in view of the better prospects of the global economy in the near term. In fact, should oil prices remain at the current level of approximately USD105 per barrel, a balanced budget position could well be in store in 2011 and 2012 as the Ministry of Finance (MOF) indicated that the target can be achieved if oil prices climb above USD97 and USD100 per barrel in 2011 and 2012 respectively.

Chart 8: Breakdown of government revenue (% of total in 2009)



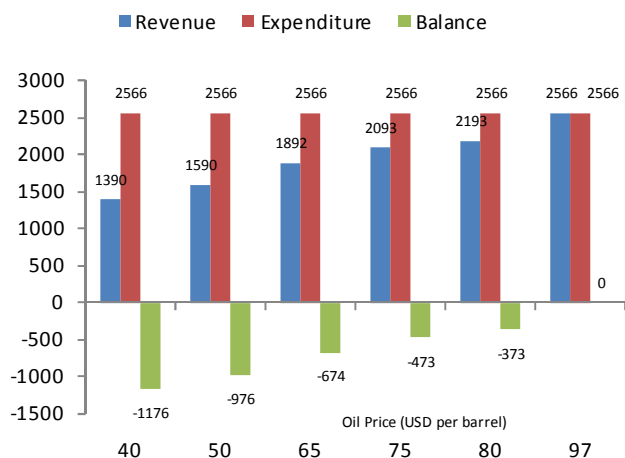
Source: Ministry of Finance

Chart 9: Government revenue - historical breakdown (% of total)



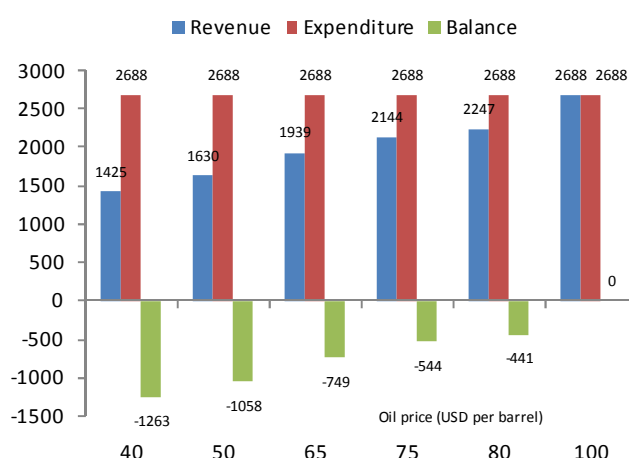
Source: Ministry of Finance

Chart 10: Scenario analysis - 2011 (BD Million)



Source: Ministry of Finance

Chart 11: Scenario analysis – 2012 (BD Million)



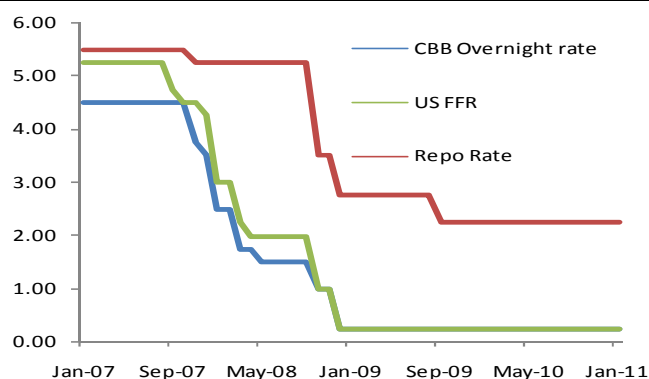
Source: Ministry of Finance

Monetary policy

The Central Bank of Bahrain (CBB) has maintained a fixed exchange rate between the Bahraini dinar (BD) and the US dollar (USD) at a rate of BD0.376 per USD since 1980 with no restrictions on capital mobility. In light of the country's openness to international trade (164% of GDP in 2009), the peg regime has served the country well as it contributes to low and stable inflation rates and continuous accumulation of international reserve assets. Because of the fixed exchange rate regime, CBB policy rates are closely aligned with US interest rates. This alignment was reflected in the recent reductions in the overnight deposit and repurchase rates by 425 basis points (bps) and 325 bps to 0.25% and 2.25% respectively following the commencement of policy accommodation in 2007 by the US Federal Reserve (Fed).

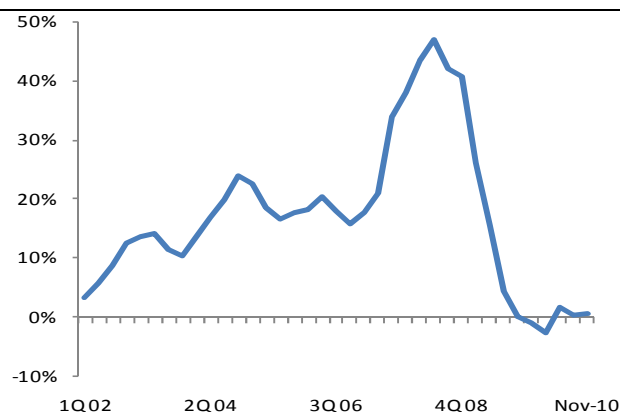
With the Fed maintaining its ultra-accommodative stance, liquidity in Bahrain's banking system is increasingly abundant, causing the ratio of 'loans to non-banks-to-total deposits' to decline among retail banks from 62.0% in 2008 to 53.8% as of November 2010. Despite that, lending activities have not been forthcoming, as evidenced by retail banks' loans growth which stood at only 0.5% y-o-y in November compared with the 47.0% peak in 2Q2008. Such meager lending growth was perhaps the result of the cautious sentiment among bankers which, if it persists, could potentially undermine the strength of the current economic growth.

Chart 12: Bahrain policy rates and US Fed Funds Rate (FFR)



Source: CEIC

Chart 13: Loan growth – retail banks (y-o-y%)



Source: Central Bank of Bahrain (CBB)

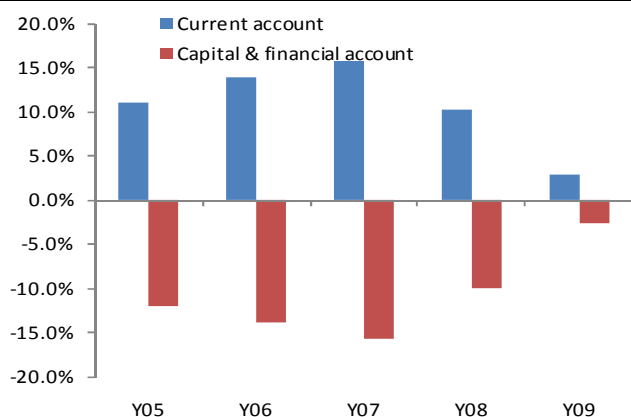
Balance of payments

The BOP position has been generally healthy, given the persistent surpluses recorded in the current account which averaged more than 7% of GDP since 2000. Oil exports, which make up more than two-thirds of the country’s exports, are the main factor for the overall favourable trade performance. The latest BOP in 2009 showed that the country continued to enjoy a current account surplus of BD210.6 million or 2.7% of GDP, albeit lower than the BD848.6 million or 10.2% of GDP recorded in the preceding year. This was largely attributed to lower oil prices in 2009 which caused a 35.4% drop in oil exports during the year.

The capital and financial account, on the other hand, remained in deficit in past years, reflecting free capital mobility in the economy. This was evidenced by foreign direct investment (FDI) which continued to flow into the country while portfolio and other investment components were gyrating between surplus and deficits over the years, signaling a two-way flow in the capital account.

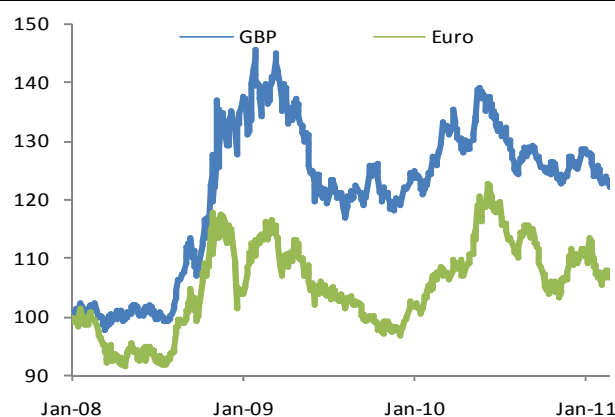
Bahrain remained a net creditor to the world at large, and this was demonstrated by its net international investment position (IIP) which registered a surplus of BD6.03 billion in 2009, higher than the BD5.81 billion recorded in the preceding year. However, the foreign exchange reserves position is relatively less favourable when compared with some Asian countries and other GCC members. This, to some extent, reflects the outflows of capital from the capital account which offset some of the inflows in the current account. The positive point, however, is the fact that the level of reserves has slowly crept up to BD1.8 billion in November 2010 due to stronger oil prices.

Chart 14: Bahrain’s balance of payments (% of GDP)



Source: Central Bank of Bahrain (CBB)

Chart 15: BD against GBP and Euro (2008 = 100) *

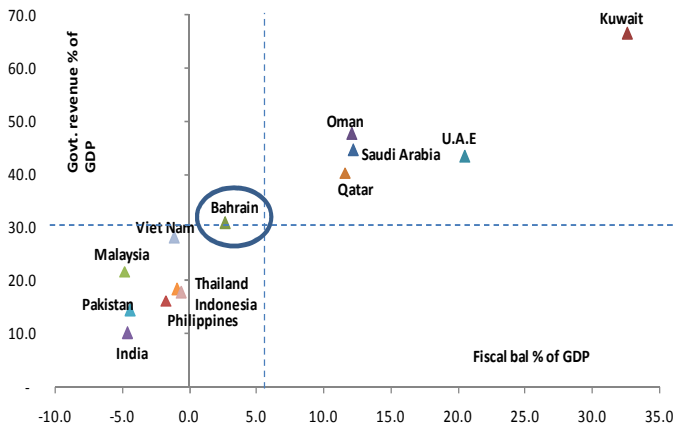


Source: Central Bank of Bahrain (CBB)

- Up means BHD is appreciating against GBP and Euro, and vice versa.

Matrix comparison – five-year median

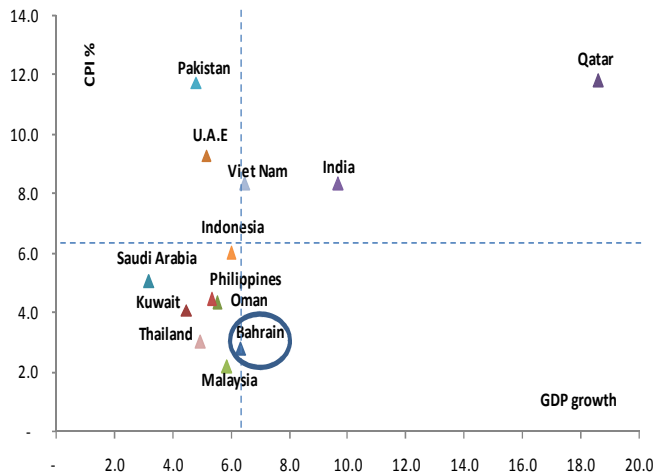
Chart 16: Government revenue vs. fiscal balance



Source: IMF & MARC Economic Research

- Bahrain’s position in the ‘government revenue and fiscal balance’ matrix is better than some Asian economies such as India, Pakistan, Malaysia, Thailand, Indonesia and the Philippines, albeit less favourable than its GCC peers.
- Although Bahrain’s fiscal position has recently deteriorated, rising oil prices will benefit the economy in the near future.
- Notwithstanding this, a gradual move towards improving the tax base will result in higher revenue and a more stable income stream for the government.

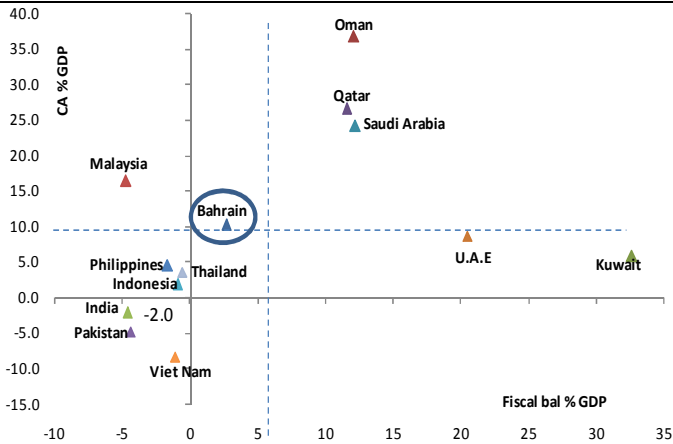
Chart 17: CPI & GDP growth



Source: IMF & MARC Economic Research

- As for the ‘growth and inflation’ matrix, Bahrain is in a relatively better position than its GCC peers and some Asian countries due to its favourable inflation environment. With the average of five-year median growth of above 6% and inflation rate below 3%, Bahrain’s position is almost comparable to Thailand and Malaysia.
- Although cost-driven inflationary pressures have slowly crept up, the absence of demand-driven pressures will likely put a lid on the CPI in the near term, despite the ongoing recovery in economic activity. This will keep Bahrain’s position in the most favourable quadrant in this matrix.

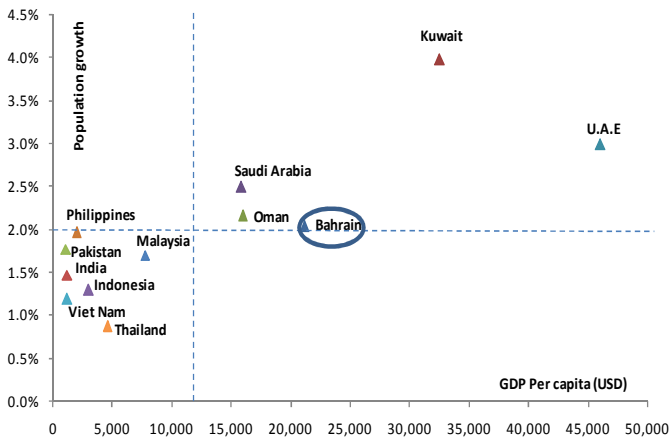
Chart 18: Current account % of GDP vs. fiscal balance % of GDP



Source: IMF & MARC Economic Research

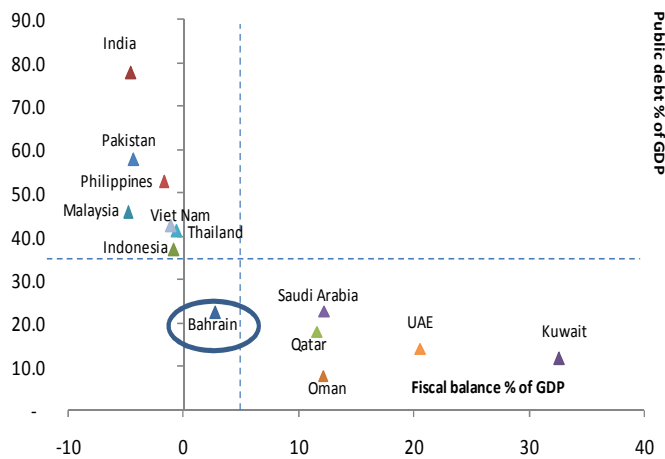
- For the ‘current account and fiscal balance’ matrix, Bahrain’s position is more favourable than some Asian economies due to its stronger current account position. However, Bahrain is relatively worse off than its GCC peers due to a less favourable fiscal position as a result of its narrower revenue base.
- We take comfort from the fact that the country will likely register larger current account surpluses in the years to come if oil prices remain relatively strong.
- Higher demand for crude oil, as forecasted by the IEA, will likely benefit the economy and be a ‘credit positive’ for Bahrain, which depends heavily on oil revenue as a major source of income.

Chart 19: Population growth vs. GDP per capita



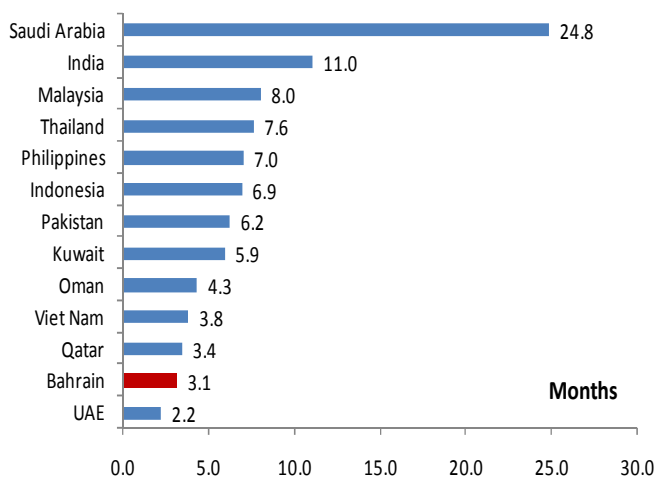
Source: IMF & MARC Economic Research

Chart 20: Public debt % of GDP vs. fiscal balance % of GDP



Source: IMF & MARC Economic Research

Chart 21: Reserves-to-imports ratio (x)



Source: IMF & MARC Economic Research

- Bahrain is in a relatively favourable position when it comes to the 'population growth and GDP per capita' matrix due to its high income per capita. With its smaller population, issues concerning poverty and wealth distribution are easier for the government to address.
- In line with the aspirations of other GCC countries, Bahrain has set a goal in its Economic Vision 2030 to improve citizens' living standards and employability to ensure every household earns twice as much disposable income by 2030. This, should it materialise, could maintain Bahrain's current position in the quadrant.

- In this matrix, Bahrain is located in the second most favourable quadrant with its low public debt and small fiscal surplus. It is heartening to note that its public debt is relatively low when compared with other Asian countries such as India and Pakistan.
- Low debt levels and positive fiscal balances are important ingredients for a balanced growth path without causing unnecessary strain on its resources. As a result, these resources can be used for other purposes such as to upgrade the living standards of its citizens through infrastructure projects that can be beneficial in the long term. Apart from that, the government's minimal role in the economy will minimise the risk of a 'crowding-out' in private investment.

- Bahrain ranks lower than most GCC and Asian countries when it comes to the reserves-to-imports level, although it remains above the international standard of 3.0 times. The country's accumulation of reserves hitherto has somewhat been offset by outflows in the capital account.
- The positive point, however, is that the level of reserves has rebounded and continued to increase amidst rising oil prices. As of November 2010, the amount of reserves stood at BD1.8 billion, higher by BD521.3 million when compared with 1.33 billion at the end of December 2009.

Table 3: Assessments of selected macroeconomic matrices – a summary

Quadrant	Verdict
Government revenue and fiscal balance	<i>Favourable</i> – higher ratio of government revenue to GDP compared with some Asian economies.
CPI and GDP growth	<i>Favourable</i> – lower inflation than its GCC peers with respectable GDP growth in the past five years.
Current account and fiscal balance	<i>Favourable</i> – smaller fiscal surpluses than its GCC peers but stronger current account position than some Asian countries.
Population growth and GDP growth	<i>Favourable</i> – high income per capita with a steady population growth.
Public debt and fiscal balance	<i>Favourable</i> – lower public debt despite smaller fiscal surpluses than its GCC peers.
Reserves-to-imports	<i>Less favourable</i> – reserves level is relatively low in comparison with other countries.

Risk factors

- i. **Geopolitical risk** – the recent turbulence in Bahrain’s political and social arenas suggests that production activities could be at stake, and this can have material impact on GDP growth.

The continued unrest stems from years of simmering discontent among the Shi’a majority with the ruling Al-Khalifah family (of minority Sunni origin), with the former alleging that the government has been discriminating against them in areas such as employment, housing, education and public services. The Shi’a protesters are calling for constitutional reform and a more representative parliament.

The uprising in Bahrain has raised concerns among other Arab leaders about unrest in other parts of the region, notably Saudi Arabia, which also has a sizeable Shi’a minority of about 20% of the populace, as the Saudi Shi’a may be influenced by the Bahraini Shi’a to protest for more rights and governmental reforms as well. The political stability of Saudi Arabia is of major global concern, as the Saudi Shi’a are situated primarily in the eastern part of the country, near Bahrain, and virtually above oil giant Saudi Aramco’s biggest fields such as Ghawar. Any turmoil there would indubitably wreak havoc on the world’s oil markets, and could inflict considerable damage on the already frail momentum of the global economy.

- ii. **Weak domestic demand** – slower loan growth amidst higher liquidity and weak job creation suggests that domestic demand is still relatively weak. Should this persist, it will have a negative implication on Bahrain’s fiscal management at a time when the country is striving to control its deficit level. Persistent weaknesses in domestic demand call for an expansionary fiscal policy which, if implemented, can delay its fiscal normalisation process.
- iii. **Monetary policy independencies** – moving away from a fixed exchange rate regime to gain greater control of monetary policy would perhaps be more ideal when the country moves toward a more developed status. This is particularly true when inflationary pressure starts to build up and requires active intervention by the central bank. Such a task will become difficult if the Fed maintains its ultra-accommodative stance.

Appendix

	2007	2008	2009	2010E	2011F
Gross Domestic Product	8.4%	6.3%	3.1%	4.00%	4.70%
By expenditure					
Consumption	2.5%	5.6%	-1.4%	na	na
Government	2.5%	6.8%	2.2%	na	na
Private	2.5%	5.1%	-2.9%	na	na
Gross Fixed Capital Formation	15.2%	8.2%	-19.2%	na	na
Government	12.7%	3.6%	-15.9%	na	na
Private	16.2%	10.0%	-20.4%	na	na
Exports of Goods & Services	10.2%	16.2%	-17.8%	na	na
Imports of Goods & Services	10.6%	16.9%	-27.2%	na	na
By industry					
Agriculture & fishing	28.6%	2.1%	3.0%	na	na
Mining & quarrying	2.8%	2.8%	-1.1%	na	na
Manufacturing	6.5%	7.3%	-1.3%	na	na
Construction	23.7%	8.5%	-19.2%	na	na
Services	8.3%	6.4%	0.4%	na	na
Balance of payments					
Current account (BD Million)	1092.9	848.6	210.6	na	na
% of GDP	15.7%	10.3%	2.7%	5.2%	5.5%
Capital & financial account (BD Million)	-1096.7	-837.2	-185.9	na	na
% of GDP	-15.8%	-10.2%	-2.4%	na	na
Government finances (BD Million)					
Revenues	2,036.7	2,677.6	1,708.2	1,463.9	2,192.9
Oil & gas	1,630.5	2,284.5	1,417.8	1,123.6	1,902.9
Non-oil	406.2	393.1	290.4	340.3	290.0
Expenditure	1,818.1	2,130.3	2,154.2	2,192.7	2,565.6
Overall balance	218.60	547.38	-446.01	-728.81	-372.67
Overall balance (% of GDP)	3.1%	6.6%	-5.8%	-8.7%	-4.1%
Money, banking & prices					
M1	22.3%	20.7%	13.7%	12.5%	na
M2	40.8%	18.4%	5.8%	14.0%	na
M3	36.1%	20.8%	4.5%	12.4%	na
Loan growth	37.9%	40.7%	0.0%	0.5%	na
Non-bank loans to total deposit	56.8%	62.0%	61.8%	55.7%	na
Non-performing loans (% of total loans)	6.0%	2.3%	3.9%	na	na
Capital adequacy ratio	21.0%	18.1%	19.6%	na	na
Consumer Price Index (CPI)	3.3%	3.5%	2.8%	2.6%	2.5%

Sources: Central Bank of Bahrain, CIO, IMF, MOF

Note: E = Estimate; F = Forecast

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