BAHRAIN

Table 1	2017
Population, million	1.5
GDP, current US$ billion	34.5
GDP per capita, current US$	23565
School enrollment, primary (% gross)[a]	101.2
Life expectancy at birth, years[a]	76.9

Source: WDI, Macro Poverty Outlook, and official data.
Notes:

(a) Most recent WDI value (2015)

Continued economic growth has been achieved despite low oil prices, but it has come at the expense of fiscal and external stability. The exchange rate peg is a regular feature of debate given the perceived structural weaknesses. Despite recently enacted austerity measures, Bahrain remains the most vulnerable Gulf country in the face of lower oil and commodity prices due to its limited savings and sharply rising debt levels, leaving it exposed to financing risks.

Recent developments

The consequences of lower hydrocarbon prices continued to weigh heavily on the economy. Bahrain sustained an expansionary fiscal stance in 2017, resulting in a double-digit deficit for the third year in a row (down to an estimated 13.2 percent of GDP). Fortunately, due to slightly elevated global oil prices and lower spending on domestic subsidies, the budget deficit narrowed markedly. Although deficit spending helped maintain economic growth within a range of 2-3 percent, it also drew down international reserves to a low level of 1.2 months' worth of imports and increased general government debt to over 90 percent of GDP.

Bahrain has introduced a series of initiatives aimed at fiscal consolidation. Revenue enhancing measures such as higher tobacco and alcohol taxes, removal of subsidies on housing utilities, and government services fees were initiated. The introduction of VAT was postponed in the wake of public opposition, but is expected later this year when there is greater assurance about mitigation measures. Inflation has risen in tandem with the lifting of subsidies and imposition of new taxes but this is expected to be temporary.

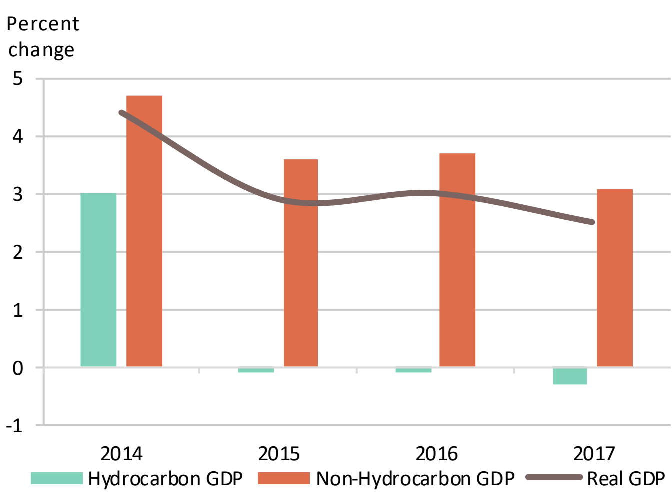
Financial sector assessments by the IMF and rating agencies indicate that the banking sector has remained resilient with adequate capitalization and liquidity levels as regulation and supervision of the sector were strengthened by the Central Bank. Growth in the balance sheet of the international financial center has been muted since the political climate tightened in 2011, but new sources of growth are emerging in fintech and innovative financing instruments.

The economy grew by an estimated 2.5 percent in 2017, which was driven by an expansion of non-hydrocarbon GDP at a rate of 3.1 percent. A raft of project spending, ranging from an airport expansion to social housing developments, has lifted activity in the wider economy. The downside of relying on fiscal stimulus to generate growth, however, has been manifested in persistently high financing needs met via debt issuances, despite the sovereign credit rating being well below investment grade.

Recently, infrastructure spending has been bolstered by the allocation of funds under the Gulf Development Program – a pledge by Bahrain's neighbors in 2011 to provide some US$10 billion in grants over 10 years to boost investment in infrastructure and housing. The government's investment program is linked to an industrial strategy based on downstream energy-intensive sectors and digital development, and hence is focused on aluminum sector, utilities, roads, renewable energy and telecommunications.

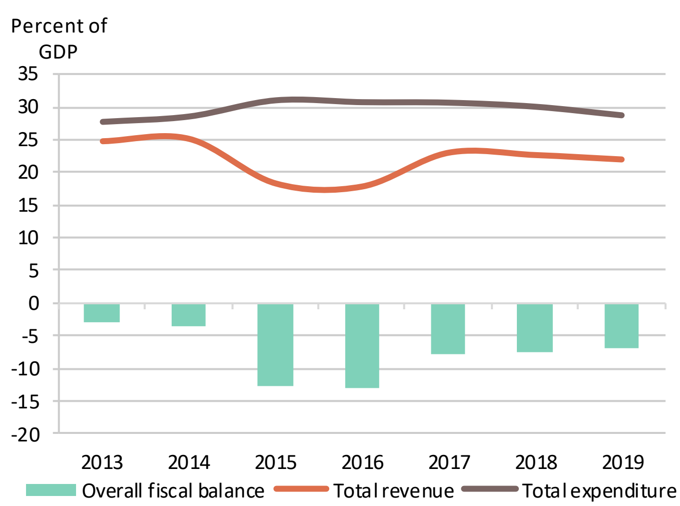
Bahrain's external position faces acute vulnerabilities which are mitigated by implicit backstops from regional partners. Due to the drop in global oil prices since late 2014, Bahrain has run continual current account deficits averaging nearly 4 percent of GDP through the end of 2017. As a consequence of this, paired with large draws on its international reserves,

FIGURE 1 **Bahrain** / Growth in GDP and its components



Sources: Bahraini Authorities and World Bank staff estimates.

FIGURE 2 **Bahrain** / Government balances



Sources: Bahraini Authorities and World Bank staff estimates.

the exchange rate peg has come under significant pressure (visible in the 12-month forward foreign exchange rate). Proceeds from the US$3 billion bond from September 2017 were important to replenish reserves, which subsequently rose to a more than two-year high of US$3.4 billion (from US$1.4 billion in August).

Absolute poverty is believed not to exist in Bahrain, at least for Bahraini nationals. Little comprehensive welfare analysis is available due to restricted access to household survey data and limited capacity. Existing and planned measures on subsidy reform and taxation are likely to require more attention to mitigation of household level impacts.

Outlook

Economic growth is expected to moderate over the forecast period. Real GDP growth projections have been revised down to 1.7 percent in 2018 and 2.1 percent 2019, as low oil prices weigh on domestic demand and market uncertainties prevent the economy from performing at its full potential. However, project spending is foreseen to increase thanks to multilateral and private sector commitments. In addition, oil GDP is expected to expand again over the forecast horizon once the OPEC+ deal terminates at the end of 2018 and the new 350,000 b/d offshore oil pipeline connecting to Saudi Arabia is completed.

Average inflation is expected to increase to 3.4 percent in 2018 due to a raft of one-off measures including the institution of new tax measures and reduction of subsidies, and then moderate to 2.4 percent in 2019. The current account deficit will partially narrow to 4.1 percent of GDP in 2018 and then again to 3.5 percent of GDP in 2019, driven by improved export performance. General government debt is projected to near 100 percent of GDP in 2018 and reach nearly 107 percent of GDP in 2019, as debt issuances are foreseen to continue.

Risks and challenges

Despite efforts to diversify and boost non-oil fiscal revenues, hydrocarbons account for approximately 75 percent of government revenues in Bahrain. Delays in implementing proposed fiscal consolidation and structural reforms, or an unexpected decline in oil prices or wider market uncertainties could trigger additional sovereign rating downgrades making access to external financing harder and intensifying pressure on international reserves and the currency peg. Fiscal solvency and liquidity risks remain high, despite the recent successful public debt issuance in September 2017. Key elements of the social contract—public employment and subsidies—are unaffordable in this context. Yet a key component of Saudi Arabia Vision 2030—the liberalization of the entertainment sector—will undermine Bahrain's appeal as a weekend destination for Saudis. Meanwhile, Brexit is likely to intensify competition among international financial centers. Some combination of more radical structural reform (which will need more political consensus than exists at present) and explicit GCC financial support is likely to be needed.

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

	2015	2016	2017 e	2018 f	2019 f	2020 f
Real GDP growth, at constant market prices	2.9	3.0	2.5	1.7	2.1	2.1
Private Consumption	1.9	1.8	1.7	1.6	2.0	2.2
Government Consumption	0.3	-1.0	-1.9	-1.4	0.4	0.4
Gross Fixed Capital Investment	-12.1	5.0	4.7	1.2	4.8	5.1
Exports, Goods and Services	1.3	2.5	3.0	3.1	2.0	2.2
Imports, Goods and Services	-5.6	0.2	2.4	2.6	2.5	2.6
Real GDP growth, at constant factor prices	..	..	..	..	..	..
Agriculture	..	..	..	..	..	..
Industry	..	..	..	..	..	..
Services	..	..	..	..	..	..
Inflation (Consumer Price Index)	1.8	2.8	0.9	3.4	2.4	2.4
Current Account Balance (% of GDP)	-2.4	-4.7	-4.5	-4.1	-3.5	-2.7
Fiscal Balance (% of GDP)	-18.4	-17.8	-13.2	-11.5	-10.2	-8.8

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