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Bahrain

SEB Group – COUNTRY RISK ANALYSIS **April, 30 2019**

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A generous $10bn loan from neighbors has saved the sovereign of Bahrain from the threat of imminent default but under unclear terms about its future budget implementations. A looming oil price collapse should US shale production continue at present pace, could undo much of recent economic advances

Country Risk Analysis

The non-oil economy continues steady: Last year, the oil sector suffered a steep contraction mainly for technical reasons, and brought overall economic growth down to 2% from a 3,5% spurt of the year before. For the current year a decent recovery is expected seeing annual expansion of GDP rising to 2,3% as oil production keeps steady at some 0,2mbpd (million barrels per day). The non-oil economy, by contrast, has continued to perform relatively well, growing in line with the 3-4% average annual trend over recent years but still clearly below its historical average from times of higher oil prices.

The oil sector is an economic arbiter: While the oil sector in Bahrain is relatively moderate with less than a quarter of GDP, its significance for the government budget is at par with neighbors presenting the government with more than three quarters of all its revenues. As such, austerity policies tend to follow lower oil prices even though with a variable lag. Because this is a well-known reaction in businesses circles, the more bearish medium to long term outlook for the global oil market is already weighing in on private sector sentiment. That will limit the expansion of the non-hydrocarbon sector to no more than 2,3% in the current year and the same into the next decade.

Government oil revenues. The last time the oil price plunged in 2014-15 it made a deep cut into government coffers. A relatively slow budget reaction ratcheted up the fiscal deficit to 13,5%/GDP in 2016. Two years later despite a higher oil price it was still above 11%/GDP as the government dithered and postponed a major initiative to introduce a value added tax (VAT). Eventually that happened at the beginning of this year with the rate set at 5% and relatively few exceptions. This and other measures under the Fiscal Balance Program (FBP) unveiled last fall including means tested subsidy reforms and cuts to pension entitlements for public sector employees, are estimated to curb the budget shortfall to 7,4% of GDP with estimates varying depending on oil price projections.

Government debt continues rising: Such large deficits have accumulated into a sharp rise of the government debt/GDP ratio to almost 90% from only 15% a decade ago mainly reflecting fast acceleration since 2015. As this became clear for financial markets in early 2018 and seemed to entail little reaction from the government while the oil-price remained depressed, market concerns escalated rapidly and drove CDS prices up sharply to more than 600 bsp.in mid-year. Although that turned out to be a short-lived spike one rating agency, Moody's, already acted without delay and hiked its risk assessment up to B2.

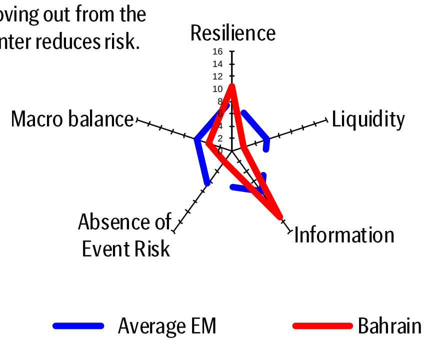
$10bn loan from neighbors: : Eventually that prompted the government to get its act together and subsequently prepare a new fiscal austerity package which in turn was instrumental in garnering support among its wealthy neighbors for a $10bn support package. Although its exact terms have not been fully disclosed this is formally a loan aimed at financing infrastructure projects. It is widely believed, however, to be used for securing coming government debt repayments estimated at $9,4bn up to 2022. There are strings attached to this loan in terms of government budget implementation with the goal of consolidating the budget by the end of the loan disbursement period. Nevertheless, these are less strict than under an alternative IMF program. As such and given everything goes to plan the likelihood of a sovereign default should have been much reduced at least in a medium term scenario.

The oil price going forward: A main qualification underlying this assessment of the preceding paragraph is the stability of the oil market for coming years. While the risk of military confrontation in the Middle East, in particular between Iran and Saudi Arabia, is likely incorporated into market prices, what could prove an additional uncertainty is US oil production. According to US Energy Department statistics this rose rapidly by the end of last year to 12mbpd, making US output the world's largest by any measure. Projections from the same agency also show further increases by somewhere between 2mbpd and 6mbpd over coming years which is likely to produce a significant glut in global oil supply above projected demand unless output is reduced elsewhere. Should that have a marked negative effect on the oil price, perhaps as large as in 2014/15 it might impact the willingness of the three donor countries, Saudi Arabia, Kuwait and the UAE, to stand by their generous commitments without further concessions from Bahrain in terms of fiscal austerity. However, lax fiscal policies of recent years have much helped to mute the open opposition to the government among the Bahrain's Shia majority since the violent demonstrations in 2011. That is likely to limit any fiscal space for the government in coming years.

Ratings: The government's new fiscal package, the recent introduction of a VAT and the $10bn. support program from Bahrain's regional donors have much helped calm market concerns since late 2018. Moody's downgraded the sovereign in last August but has since corrected its negative outlook to "stable". If all goes to plan, one could hope ratings to crawl upward from present low levels as regards the sovereign. Because of the close relationship between the latter and the private sector, country risk will likely follow a parallel path.

Key ratios	**2019**
Population (mill.)	1,4
GDP/capita ($)	29,4
GDP (%chg.)	2,3%
Inflation	2,8%
Curr.Acc. Balance/GDP	-5,3%
Reserves/imports (months)	0,0
Budget balance/GDP	-7,1%
Government debt/GDP	89%

Chart key:
Moving out from the center reduces risk.



External ratings:	**Peers:**
Fitch: BB- Moodys: B2 S&P: B+	Bolivia Kazakhstan Croatia

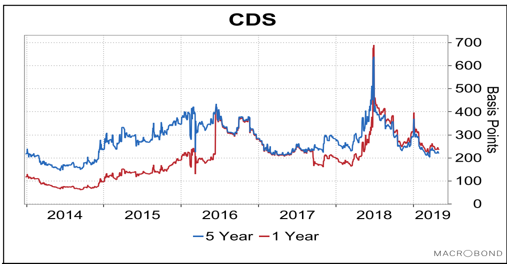
Graph: The graph shows Bahrain's relative strength on resilience and its weakness on event risk when compared with the average of our rated countries. Then in turn, the information base appears good with the possible exception for social relations.

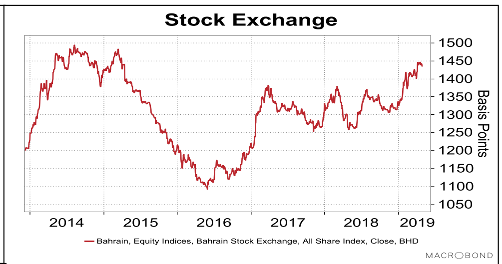
Key data:	**2011**	**2012**	**2013**	**2014**	**2015**	**2016**	**2017**	**2018**	**2019**	**2020**
GDP (bn US$)	29	31	33	33	31	32	35	39	42	44
GDP/capita (US$)	24	25	26	25	23	24	26	28	29	31
GDP (change)	2,0%	3,7%	5,4%	4,4%	2,9%	3,5%	3,7%	1,9%	2,3%	2,4%
Investments/GDP	22%	26%	27%	22%	24%	26%	29%	28%	27%	25%
Budget balance/GDP	-0,3%	-2,0%	-3,4%	-3,6%	-13,0%	-13,5%	-10,8%	-8,6%	-7,1%	-6,1%
Govt debt/GDP	44%	44%	44%	44%	66%	81%	89%	89%	89%	92%
CPI inflation (%)	0,0%	2,8%	3,3%	2,7%	1,8%	2,8%	1,4%	2,1%	2,8%	2,0%
Money demand (%)										
Stock prices (%change)										
Interest rates	0,43%	0,30%	0,20%	0,33%	0,73%	1,25%	1,95%	2,42%	2,40%	2,25%
Exch. Rate ($)	0,376	0,376	0,376	0,376	0,376	0,376	0,376	0,376	0,376	0,376
Trade/GDP (%)	142%	139%	144%	130%	104%	82%	89%	85%	80%	77%
Oil price (Brent)	$109	$99	$52	$44	$54	$71	$61	$66	$67	$69
Billions US $										
Export of goods	22,9	23,1	25,6	23,5	16,5	12,8	15,4	16,6	16,4	16,9
Imports of goods	18,0	19,7	21,3	19,8	15,7	13,6	16,1	16,7	17,1	17,3
Other:	-2,1	-0,8	-1,9	-2,2	-1,6	-0,7	-0,9	-1,2	-1,5	-1,5
Current account	**2,8**	**2,6**	**2,4**	**1,5**	**-0,8**	**-1,5**	**-1,6**	**-1,3**	**-2,2**	**-1,9**
as % of GDP	9,9%	8,4%	7,4%	4,6%	-2,4%	-4,6%	-4,5%	-3,2%	-5,3%	-4,2%
FDI	-1,7	0,7	-0,5	-4,2	2,8	0,4	0,3	0,4	0,4	0,4
Loan repayments (gross)	-13,8	-13,5	-13,2	-12,9	-12,3	-22,5	-27,1	-29,9	-32,8	-35,5
Net other capital flows	11,8	10,9	11,4	16,4	7,6	22,7	28,6	30,2	34,7	37,0
Balance of payments	**-0,8**	**0,7**	**0,1**	**0,7**	**-2,6**	**-0,9**	**0,2**	**-0,6**	**0,0**	**0,0**
Reserves	4,9	5,0	5,8	3,1	2,2	2,3	1,7	1,8	1,8	1,8
Total debt	34,4	33,7	33,1	32,3	30,8	56,3	67,9	74,7	82,1	88,8
o/w short term debt	8,6	8,4	8,3	8,1	7,7	14,1	17,0	18,7	20,5	22,2

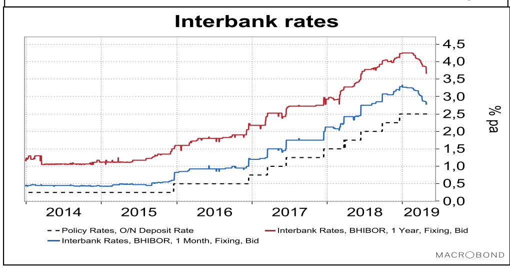
Source: OEF (Oxford Economic Forecasting) and SEB estimates

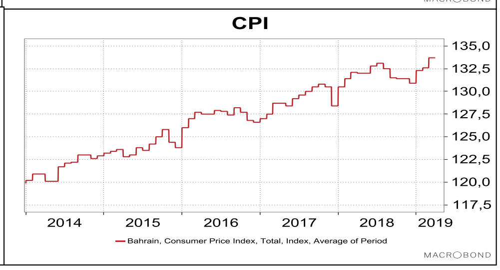
Rating history								
Fitch (eoy)	BBB	BBB	BBB	BBB	BBB	BBB-	BB+	B+
Moodys (eoy)	Baa1	Baa1	Baa1	Baa1	Baa2	Baa3	Ba2	B1

Type of government: Constitutional hereditary monarchy
Next elections Parliamentary elections 2018
Other:
Latest PC deal
Latest IMF arrangements









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