
Country Report

Bahrain

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The Economist Intelligence Unit

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Highlights

Editor: **Robert Powell**

Forecast Closing Date: **April 16, 2013**

Outlook for 2013-17

- The Economist Intelligence Unit expects that simmering political discontent will persist in Bahrain but that the royal family and security services will remain in control.
- Despite signs of a softening in the government's hardline stance, the gulf between it and the Shia-led opposition will prevent meaningful progress in talks, with the risk that dissidents will revert to violence to further their aims.
- The government will maintain high levels of spending on social programmes in an effort to avoid provoking further unrest. We expect the government to run fiscal deficits in 2013-17, averaging 5.1% of GDP.
- Bahrain will continue to participate in the development of a Gulf monetary union, but a single currency remains at least several years off. The Central Bank of Bahrain will keep the dinar pegged to the US dollar in the meantime.
- Real GDP growth was restrained in 2012 by a fall in oil output. However, we expect this to be reversed in 2013, lifting growth to 4%. Growth is likely to accelerate to 4.7% in 2016-17 as new aluminium capacity comes on stream.
- Global foodstuff prices are set to stabilise in 2013, resulting in a small dip in consumer price growth. However, we expect inflation to edge up over the remainder of the forecast period as global industrial raw materials prices rise.
- High oil prices in 2013-17 will contribute to current-account surpluses, although they are set to narrow as the invisibles deficit widens. The services account will perform poorly owing to concerns about domestic politics.

Review

- The king has appointed Crown Prince Salman bin Hamad al-Khalifa to the new post of first deputy prime minister. The move could well be a signal that the relatively dovish Sheikh Salman is regaining influence.
- A court has overturned the conviction of 21 medics who were charged with misdemeanors—mostly related to attending illegal gatherings—in 2011.
- Dozens of protesters, and two policemen, have been injured in protests to mark the second anniversary of the dispatch of Saudi and other Gulf Co-operation Council forces to Bahrain during its bout of mass unrest.
- Bapco has completed a study to build an expanded pipeline linking Bahrain to Saudi Arabia's Eastern Province. The plan would be a key element of a broader programme to expand the capacity of Bahrain's Sitra refinery.
- The Central Informatics Organisation has revealed that real GDP growth reached 3.4% last year—below expectations, after a weak fourth quarter and a substantial downward revision to its growth figures for the first half of 2012.

Outlook for 2013-17

Political stability

The Economist Intelligence Unit expects Bahrain to experience persistent unrest caused by social and political grievances over the forecast period. The king, Hamad bin Isa al-Khalifa, will try to position Bahrain as a moderate and reforming monarchy, but his efforts will be stymied both by hardliners within the ruling Al Khalifa family and by rejectionist political groups opposed to the monarchy. Of the Gulf Co-operation Council (GCC) states, Bahrain was most affected by political unrest in 2011, with mass protests calling for political and social reform. The security services used lethal force to disperse the protesters, and we expect future protests to be met with a similarly harsh crackdown (especially in light of the authorities' decision in October to ban all public protests).

Cognisant of the volatile situation, the government relaunched its "national dialogue" on February 10th; the process, which includes the main opposition Shia political society, al-Wefaq, was convened in 2011 (and briefly in 2012) to address the underlying causes of the unrest, but ended in failure. The latest move has been welcomed by most of the opposition, but the dialogue has thus far become bogged down in procedural arguments. Although all the participants have pledged to remain in the process, we assess that fundamental policy discord, and pressure from hardliners, will make the differences between the two sides unbridgeable. With the political process struggling to regain momentum, there is a growing risk that dissidents will revert to violence to further their aims. Two foreign workers were killed in a series of bombings in November, and the second anniversary of Bahrain's uprising in mid-February was marked by two further deaths (a demonstrator and a policeman).

Economic inequality, a lack of political representation and perceived sectarian discrimination contribute to a highly charged political climate by Gulf standards. Many of the country's Shia Muslims say that they are economically and politically marginalised by the Sunni Muslim ruling family, which holds most of the important cabinet posts, contributing to strained relations between the two communities. There is also a widespread belief among Shia Bahrainis that the government has fast-tracked citizenship for Sunni expatriates in order to alter the country's demographic balance. Such claims are hard to verify, but the perception will further fuel social unrest. The dispute over citizenship will be further deepened by the government's legally questionable decision in November 2012 to strip 31 opposition activists—including two former members of parliament (MPs) from al-Wefaq—of their nationality, citing "security" reasons.

Nonetheless, despite the ongoing crackdown on protesters and the opposition (several of whose leaders remain incarcerated), there are increasing signs of a softening in the government's hardline stance. Most significantly, in March the king appointed Crown Prince Salman bin Hamad al-Khalifa to the new post of first deputy prime minister. The move could well be a signal that the relatively dovish Sheikh Salman is regaining influence, after being sidelined by more hardline members of his family since the failure of talks with the opposition in March 2011. Crucially, it appears that Saudi Arabia is also not opposed to this shift, having previously strongly backed the clampdown (notably with the dispatch of Saudi troops to Bahrain during the height of the unrest in 2011). Reinforcing the impression that the government is softening its line, in late March a court overturned the conviction of 21 medics who had been charged with misdemeanours in early 2011.

However, the opposition will remain wary. Most notably, doubts about the government's commitment to reform persist, as exemplified by the failure of the authorities to implement the vast chunk of the recommendations of the Bahrain Independent Commission of Inquiry, a commission of senior international lawyers that investigated the unrest in early 2011. Equally, more hardline establishment figures remain entrenched, personified by the king's uncle, the prime minister, Sheikh Khalifa bin Salman al-Khalifa, who has held his position since 1971 and is perceived to be less open to reform. Meanwhile, al-Wefaq will also be aware that an overly conciliatory approach could alienate the increasingly radicalised Shia youth, thus ensuring that the group is likely to shift little from its key demands, which include a fully elected government, a more powerful legislature and a move towards a constitutional monarchy. With this in mind and despite the rehabilitation of Sheikh Salman, we remain pessimistic about the prospects for the renewed dialogue, and in turn expect low-level demonstrations, occasional acts of violence and the country's deep political (and occasionally sectarian) divisions to persist.

Election watch

The last general election was held in October 2010. Al-Wefaq emerged as the largest group in the lower house of parliament, the Chamber of Deputies. All of al-Wefaq's MPs have since withdrawn from parliament in protest over the violence against demonstrators in 2011. By-elections in September 2011 to replace the al-Wefaq MPs led to the election of 18 independents. The next parliamentary election is scheduled for 2014. An al-Wefaq boycott looks probable at this stage.

International relations

The US will remain a key international ally, and the US Navy's Fifth Fleet is based in Bahrain. The US will be keen to maintain its alliance with Bahrain, particularly as tensions with Iran fluctuate, using the naval base as a deterrent against assertive Iranian foreign policy. The US has quietly criticised the government's crackdown on protesters (and the ban on demonstrations), but will be hesitant to rescind its partnership with Bahrain for fear of losing access to the base or weakening its relationship with Saudi Arabia. Good relations with European partners such as France and the UK are also a priority, although these will be harmed if the government continues its use of repressive tactics to put down internal dissent.

The deterioration in relations between the West and Iran represents an acute security risk for Bahrain. Iran could target the country, either through a direct attack on its infrastructure or the US naval base, or through subversion or sabotage against state institutions. Since the onset of the Arab Spring, senior Bahraini officials have accused the Islamic Republic of encouraging Bahraini Shias to act as a fifth column against the Al Khalifa regime, and we expect bilateral ties to remain strained, and occasionally to be outright hostile. This antagonism was evident in a row that erupted in October 2012 after Iranian diplomats visited Bahrain's leading Shia cleric, Sheikh Issa Qassim, and offered to mediate in the kingdom's internal problems—an offer angrily rejected by the Bahraini government as being tantamount to "interference".

Closer co-operation with the rest of the GCC is likely as Bahrain comes to rely on its regional partners for both security and economic stability. Bahrain will increase policy co-ordination with its larger neighbour, Saudi Arabia, although reluctance elsewhere in the GCC to cede sovereignty will stymie Saudi plans for a full political union. Most of Bahrain's crude oil comes from a Saudi-operated, shared offshore field, and the causeway to Saudi Arabia is currently Bahrain's only land link. The deployment of Saudi troops in Bahrain and the marriage of one of the Bahraini king's sons to a daughter of the Saudi king will further strengthen this relationship.

Policy trends

Economic policy will focus on restoring confidence in Bahrain's economy in spite of the ongoing unrest. Bahrain will struggle against the more attractive political and regulatory environments and market opportunities in Dubai, Qatar and even Saudi Arabia. Throughout the forecast period, Bahrain will try to diversify the economy, stimulate private-sector growth and foreign investment, and address unemployment among nationals. However, it will retain a focus on maximising the potential of its hydrocarbons sector, including by expanding the country's sole refinery and stepping up exploration. Populist spending will remain a cornerstone of government policy, and subsidies on living costs will remain in place. However, although investment in housing will be maintained, the burden of its populist spending approach will ensure that state infrastructure investment remains depressed.

The privatisation programme will remain on hold, but the appointment of Sheikh Salman as first deputy prime minister should provide renewed momentum to economic reform (although he is unlikely to tackle ruling family vested interests). Bahrain's sovereign wealth fund, Mumtalakat, will struggle to make new investments as it will be relied on to support troubled state entities, such as the loss-making national carrier, Gulf Air.

Bahrain's reputation as a safe, stable financial hub has been severely damaged by the political unrest. Although there has been no major exodus from the kingdom by international institutions, it is notable that total combined assets of investment and offshore banks have declined by one-quarter since end-2010. More sophisticated onshore financial regulation in Saudi Arabia and Dubai means that Bahrain will increasingly play the role of a financial "back office" for its neighbours, providing legal or accounting services, as well as niche financial services, such as the sharia-compliant products and fund management.

Fiscal policy

Bahrain has less fiscal flexibility than other Gulf oil producers owing to its relatively small oil reserves and a comparatively modest sovereign wealth fund. Revenue will remain linked to oil prices during 2013-17 (when oil earnings are forecast to account for 86% of fiscal revenue). Although the two-year 2013-14 budget has been portrayed as moderately conservative, in reality it does nothing to tackle the onerous subsidy system and public-sector salaries. Indeed, because of a recent deal struck in parliament, expenditure on public salaries and pensions is now set to increase at an even faster pace, at the expense of capital outlays. Consequently, we expect the fiscal deficit to widen to an annual average of 5.4% of GDP in 2013-14 (although this is slightly lower than last month, owing to an upward adjustment to our oil price forecast). The shortfall is likely to narrow slowly thereafter, although this largely reflects our expectation of a pick-up in oil prices rather than of any introduction of fiscal austerity. Nonetheless, Bahrain will make use of private-sector involvement to help to alleviate some pressure on the public finances and will launch the region's first public-private-partnership housing programme over the next three years. The government will continue to direct public money towards Bahraini households in an attempt to pre-empt political unrest, and any reform of the subsidy regime is unlikely to proceed quickly, given its political sensitivity.

The government's overall debt burden is increasing, as it seeks to finance its deficits and refinance debt by borrowing from both domestic and foreign sources through sharia-compliant and conventional securities. A new US dollar-denominated bond was successfully issued last year; Bahrain was able to raise US\$1.5bn, although at a higher coupon than on previous issues. Bahrain will also ostensibly receive US\$10bn in aid from other GCC partners over ten years for housing and infrastructure financing. Although this funding has not yet materialised, some agreements have now been signed and disbursements are likely to commence before the end of this year.

Monetary policy

To protect the currency peg to the dollar, the Central Bank of Bahrain keeps its key policy rate, the one-week deposit rate, roughly in line with US rates. Consequently, and given concerns about a slowdown in local bank lending, the policy rate is likely to remain low until the Federal Reserve (the US central bank) raises its rates, which we forecast will occur in 2015. The Central Bank kept rates low in 2011-12 to help to stimulate the economy and will maintain affordable credit to avoid choking off the commercial sector. Bahrain's modest growth outlook and continued low inflation means that it is unlikely to start raising rates ahead of the US. The Central Bank offers sharia-compliant money-market instruments to provide liquidity to an increasingly important subsector of the finance industry.

International assumptions

	2012	2013	2014	2015	2016	2017
Economic growth (%)						
US GDP	2.2	2.1	2.4	2.3	2.3	2.4
OECD GDP	1.4	1.3	2.1	2.2	2.2	2.2
World GDP	2.1	2.2	2.9	2.9	2.9	2.9
World trade	2.7	4.0	5.2	5.4	5.5	5.6
Inflation indicators (% unless otherwise indicated)						
US CPI	2.1	2.2	2.5	2.2	2.3	2.3
OECD CPI	2.2	2.0	2.3	2.3	2.2	2.2
Manufactures (measured in US\$)	-0.6	-1.8	1.3	0.8	1.0	1.9
Oil (Brent; US\$/b)	112.0	106.6	104.8	107.3	110.0	115.0
Aluminium (US\$/tonne)	2,018	2,071	2,188	2,155	2,300	2,350
Non-oil commodities (measured in US\$)	-10.8	-1.5	-0.1	-0.8	3.5	2.4
Financial variables						
US\$ 3-month commercial paper rate (av; %)	0.2	0.2	0.2	0.3	1.2	2.2
Exchange rate BD:US\$ (av)	0.38	0.38	0.38	0.38	0.38	0.38
Exchange rate US\$:€ (av)	1.29	1.33	1.31	1.27	1.26	1.26

Economic growth

Economic growth rose to 3.4% in 2012, although this was lower than we had originally estimated owing to an unexplained fall in oil output at the Abu Saafa field (shared with Saudi Arabia). We expect growth to rise to 4% in 2013, on the back of the ongoing recovery in the services sector, as tourism gradually strengthens, and on our assumption that the decline in Abu Saafa production was merely a temporary phenomenon related to maintenance, rather than reflecting any serious depletion of the field.

Modestly expanding oil production and a recovering services sector will keep economic growth at around 3.7% in 2014-15—around half the rate Bahrain witnessed in the five years prior to the onset of the global recession. Growth will pick up to an average of 4.7% in 2016-17 as the new pipeline comes on stream at Aluminium Bahrain (Alba), the majority state-owned aluminium company (although this will require the construction of a liquefied natural gas terminal, as new gas supplies are a pre-requisite for the Alba expansion). The financial sector, the cornerstone of the country's diversification strategy, will suffer because of the recent unrest, which has undermined Bahrain's long-cultivated business-friendly image. We expect hydrocarbons to remain a major contributor to growth, and a planned move to build a larger oil pipeline from Saudi Arabia (and a simultaneous move to expand the capacity of Bahrain's Sitra refinery) will secure the importance of oil, despite the country's relatively low reserves. The government increased spending on subsidies and housebuilding in 2011-12, but we expect GCC donor aid to supplement (and to an extent replace) public investment later in the forecast period. However, foreign businesses may be less interested in investing in Bahrain given the small size of the market and the insecure domestic political scene.

Export growth will be driven mainly by goods, including rising aluminium output, as services exports will have to compete with the UAE and Qatar. Import growth will remain strong, given Bahrain's limited domestic production base.

Economic growth

%	2012 ^a	2013 ^b	2014 ^b	2015 ^b	2016 ^b	2017 ^b
GDP	3.4	4.0	3.7	3.7	5.2	4.3
Private consumption	5.3	4.5	5.1	5.0	5.2	4.9
Government consumption	5.9	2.0	3.5	2.5	3.0	3.5
Gross fixed investment	8.2	5.9	5.7	6.5	5.2	4.1
Exports of goods & services	3.3	5.7	4.9	4.5	7.5	6.0
Imports of goods & services	7.6	7.4	7.7	7.0	7.8	7.0
Domestic demand	5.8	4.5	5.0	5.0	4.8	4.4
Agriculture	1.5	2.5	3.0	4.0	4.0	3.0
Industry	1.8	3.5	2.4	4.3	6.6	5.7
Services	4.6	4.3	6.5	5.7	4.6	2.6

^a Economist Intelligence Unit estimates. ^b Economist Intelligence Unit forecasts.

Inflation

Inflation averaged 2.8% in 2012, as higher foodstuff prices were largely offset by continued depressed rents. Global foodstuff prices are set to stabilise in 2013, resulting in a small dip in consumer price growth. However, inflation is expected to creep higher over the remainder of the forecast period as global industrial raw materials prices rise, although the maintenance of public subsidies will keep any increases in check. The official consumer price index is widely believed not to reflect actual spending patterns and to understate inflation.

Exchange rates

Bahrain intends to enter into a currency union with Kuwait, Qatar and Saudi Arabia, and a first meeting of a joint monetary council was held in 2010. The introduction of a single currency will be delayed, as the member states pursue convergence on policies and observe the fallout from the euro zone crisis. In the unlikely event that the single currency does proceed in the forecast period, the currency will probably be pegged to the dollar, but this arrangement could be reviewed at a later stage. Meanwhile, the Central Bank of Bahrain will maintain the Bahraini dinar's peg to the dollar at the rate of BD0.376:US\$1, which has been in place for over three decades.

External sector

The current account will record surpluses throughout the forecast period, but the services sector will struggle to compete with other hubs in the region. Perceptions of domestic political instability and the continuing weakness of the major international banks will hinder tourism and financial services earnings, both key non-merchandise sectors for Bahrain. Bahrain's trade balance relies on adding value to imported raw materials and on exporting refined hydrocarbons products and aluminium. Bahrain imports crude from Saudi Arabia (oil imports account for roughly half of the import bill), but further exploration is under way. Overall, the trade balance will reflect movements in oil prices. The current-account surplus is forecast to decline from an estimated 10.9% of GDP in 2012 to just 1.8% of GDP in 2017, with widening income deficits offsetting an improvement in the trade balance as profit repatriation and debt interest payments outweigh dividends from foreign assets.

Forecast summary

Forecast summary

(% unless otherwise indicated)

	2012 ^a	2013 ^b	2014 ^b	2015 ^b	2016 ^b	2017 ^b
Real GDP growth	3.4	4.0	3.7	3.7	5.2	4.3
Oil production ('000 b/d)	177	189	190	192	196	194
Petroleum exports (US\$ m)	17,394	16,692	16,499	17,252	18,010	19,530
Consumer price inflation (av)	2.8 ^c	2.5	2.6	3.0	3.3	3.5
Consumer price inflation (end-period)	2.6 ^c	2.6	2.8	3.2	3.7	3.4
Money-market rate	1.6	1.6	1.6	2.3	3.8	5.5
Government balance (% of GDP)	-1.1	-4.8	-6.0	-5.5	-5.0	-4.2
Exports of goods fob (US\$ bn)	21.4	20.8	20.8	21.8	23.2	25.2
Imports of goods fob (US\$ bn)	15.2	15.0	14.8	15.3	15.9	17.2
Current-account balance (US\$ bn)	3.1	1.8	1.1	0.8	0.9	0.7
Current-account balance (% of GDP)	10.9	6.2	3.7	2.6	2.4	1.8
External debt (end-period; US\$ bn)	16.9	17.0	17.6	17.8	18.0	17.9
Exchange rate BD:US\$ (av)	0.376 ^c	0.376	0.376	0.376	0.376	0.376
Exchange rate BD:¥100 (av)	0.471 ^c	0.400	0.395	0.391	0.386	0.390
Exchange rate BD:€ (av)	0.483 ^c	0.498	0.494	0.478	0.474	0.475
Exchange rate BD:€ (end-period)	0.492 ^c	0.498	0.491	0.472	0.474	0.474

^a Economist Intelligence Unit estimates. ^b Economist Intelligence Unit forecasts. ^c Actual.

Data and charts

Annual data and forecast

	2008 ^a	2009 ^a	2010 ^a	2011 ^a	2012 ^b	2013 ^c	2014 ^c
GDP							
Nominal GDP (US\$ m)	22,151	19,620	25,713	29,157	28,023	29,198	30,310
Nominal GDP (BD m)	8,329	7,377	9,668	10,963	10,537	10,979	11,397
Real GDP growth (%)	6.2	2.5	4.3	1.9	3.4	4.0	3.7
Origin of GDP (% real change)							
Agriculture	0.2	11.1	-7.9	1.6	1.5	2.5	3.0
Industry	4.7	0.1	2.3	1.5	1.8	3.5	2.4
Services	7.8	5.0	6.3	2.2	4.6	4.3	6.5
Population and income							
Population (m)	1.1	1.2	1.2	1.3 ^b	1.3	1.4	1.5
GDP per head (US\$ at PPP)	24,580	23,809	24,028	24,224 ^b	24,149	24,203	24,947
Fiscal indicators (% of GDP)							
Central government revenue	32.1	23.2	22.5	25.7	29.9	27.7	26.7
Central government expenditure ^d	25.6	29.2	27.3	26.0	31.0	32.5	32.7
Central government balance ^d	6.6	-6.0	-4.8	-0.3	-1.1	-4.8	-6.0
Public debt	28.3	41.7	45.9	47.8	54.3	58.3	62.6
Prices and financial indicators							
Exchange rate BD:US\$ (end-period)	0.376	0.376	0.376	0.376	0.376 ^a	0.376	0.376
Exchange rate ¥:BD (end-period)	241.46	247.55	219.61	208.29	230.42 ^a	252.66	255.32
Consumer prices (end-period; %)	5.1	1.6	1.0	0.2	2.6 ^a	2.6	2.8
Stock of money M1 (% change)	19.8	13.7	6.7	14.5	10.9	7.0	8.9
Stock of money M2 (% change)	19.7	5.8	10.5	3.4	8.5	6.3	8.3
Lending interest rate (av; %)	8.3	7.9	7.2	6.8	6.3	6.8	6.8
Current account (US\$ m)							
Trade balance	3,245	2,439	2,643	7,800	6,232	5,845	5,976
Goods: exports fob	17,491	12,052	13,833	19,906	21,397	20,843	20,823
Goods: imports fob	-14,246	-9,613	-11,190	-12,106	-15,165	-14,998	-14,846
Services balance	1,710	1,912	2,142	1,261	1,162	1,101	1,046
Income balance	-924	-2,400	-2,373	-3,765	-2,703	-3,473	-4,178
Current transfers balance	-1,775	-1,391	-1,642	-2,050	-1,634	-1,649	-1,725
Current-account balance	2,257	560	770	3,247	3,057	1,823	1,119
External debt (US\$ m)							
Debt stock	10,184 ^b	10,748 ^b	14,703 ^b	15,133 ^b	16,875	16,973	17,562
Debt service paid	1,088 ^b	1,235 ^b	1,443 ^b	1,856 ^b	1,963	2,245	2,393
Principal repayments	601 ^b	703 ^b	773 ^b	1,033 ^b	1,049	1,286	1,277
Interest	487 ^b	531 ^b	670 ^b	823 ^b	914	959	1,116
International reserves (US\$ m)							
Total international reserves	3,803	3,540	4,789	4,245	4,853	5,144	5,350

^a Actual. ^b Economist Intelligence Unit estimates. ^c Economist Intelligence Unit forecasts. ^d No data published on net lending since 2001. This line includes allocations for strategic projects when they occur.

Source: IMF, International Financial Statistics Central Bank of Bahrain.

□

Quarterly data

	2011				2012			
	1 Qtr	2 Qtr	3 Qtr	4 Qtr	1 Qtr	2 Qtr	3 Qtr	4 Qtr
Prices								
Consumer prices (2006=100)	111.8	109.8	111.4	113.2	113.7	114.1	115.5	115.5
Consumer prices (% change, year on year)	0.1	-2.0	-0.6	0.8	1.6	3.9	3.6	2.0
Financial indicators								
Exchange rate BD:US\$ (av)	0.376	0.376	0.376	0.376	0.376	0.376	0.376	0.376
Exchange rate BD:US\$ (end-period)	0.376	0.376	0.376	0.376	0.376	0.376	0.376	0.376
3-6 months deposit rate (end-period; %)	1.1	1.0	1.0	1.1	1.1	1.1	1.1	n/a
Lending rate (end-period; %)	7.1	7.1	6.8	6.3	6.3	6.1	5.8	n/a
Money-market rate (av; %)	0.3	0.6	0.3	0.3	0.5	0.5	0.4	n/a
3-month Treasury-bill rate (av; %)	1.0	1.0	0.8	1.0	1.3	1.2	1.3	n/a
M1 (end-period; BD m)	2,435	2,471	2,471	2,637	2,663	2,730	2,785	n/a
M1 (% change, year on year)	10.3	3.0	6.7	14.5	9.4	10.5	12.7	n/a
M2 (end-period; BD m)	7,917	7,919	7,763	8,135	8,378	8,379	8,454	n/a
M2 (% change, year on year)	9.4	3.2	1.2	3.4	5.8	5.8	8.9	n/a
Wholesale banks (end-period; US\$ bn)^a								
Total assets	134.9	134.6	131.9	129.7	130.9	123.1	129.2	n/a
Foreign assets	124.6	124.5	120.2	119.7	122.4	114.8	121.2	n/a
Total liabilities	134.9	134.6	131.9	129.7	130.9	123.1	129.2	n/a
Foreign liabilities	122.0	122.4	118.2	116.9	120.5	112.9	118.5	n/a
Foreign trade (BD m)								
Oil & products ^b	1,267.7	1,426.4	1,532.0	1,598.4	1,475.2	1,476.8	n/a	n/a
Crude oil	579.4	686.1	777.5	765.5	692.6	772.7	n/a	n/a
Foreign reserves (US\$ m)								
Central Bank of Bahrain reserves	4,053.2	4,168.6	4,319.2	4,238.6	4,401.1	4,789.9	4,430.1	n/a

^a Previously "offshore banking units". ^b Including Abu Saafa field.

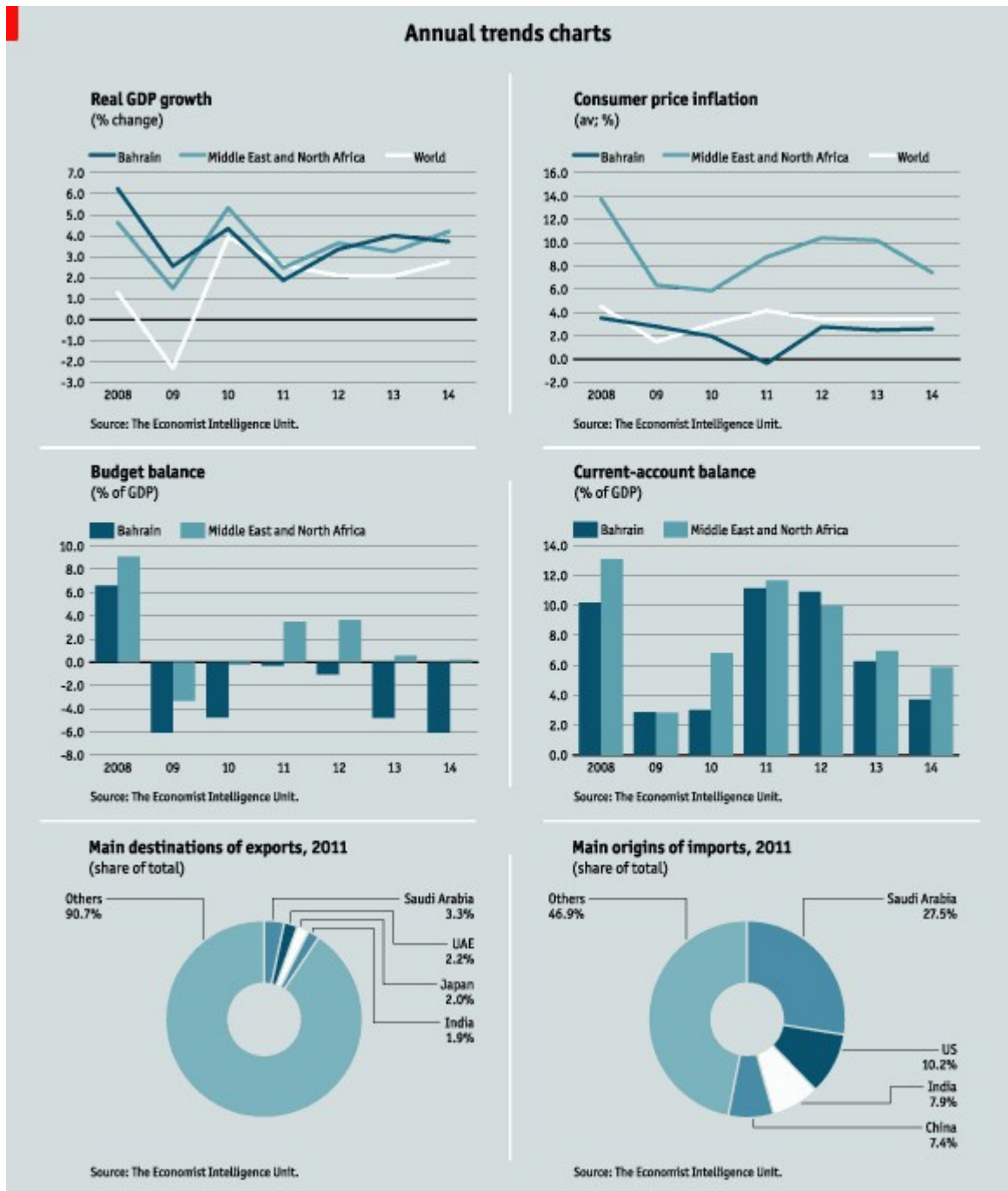
Sources: IMF, International Financial Statistics; Central Bank of Bahrain, Statistical Bulletin; Economic Indicators.

Monthly data

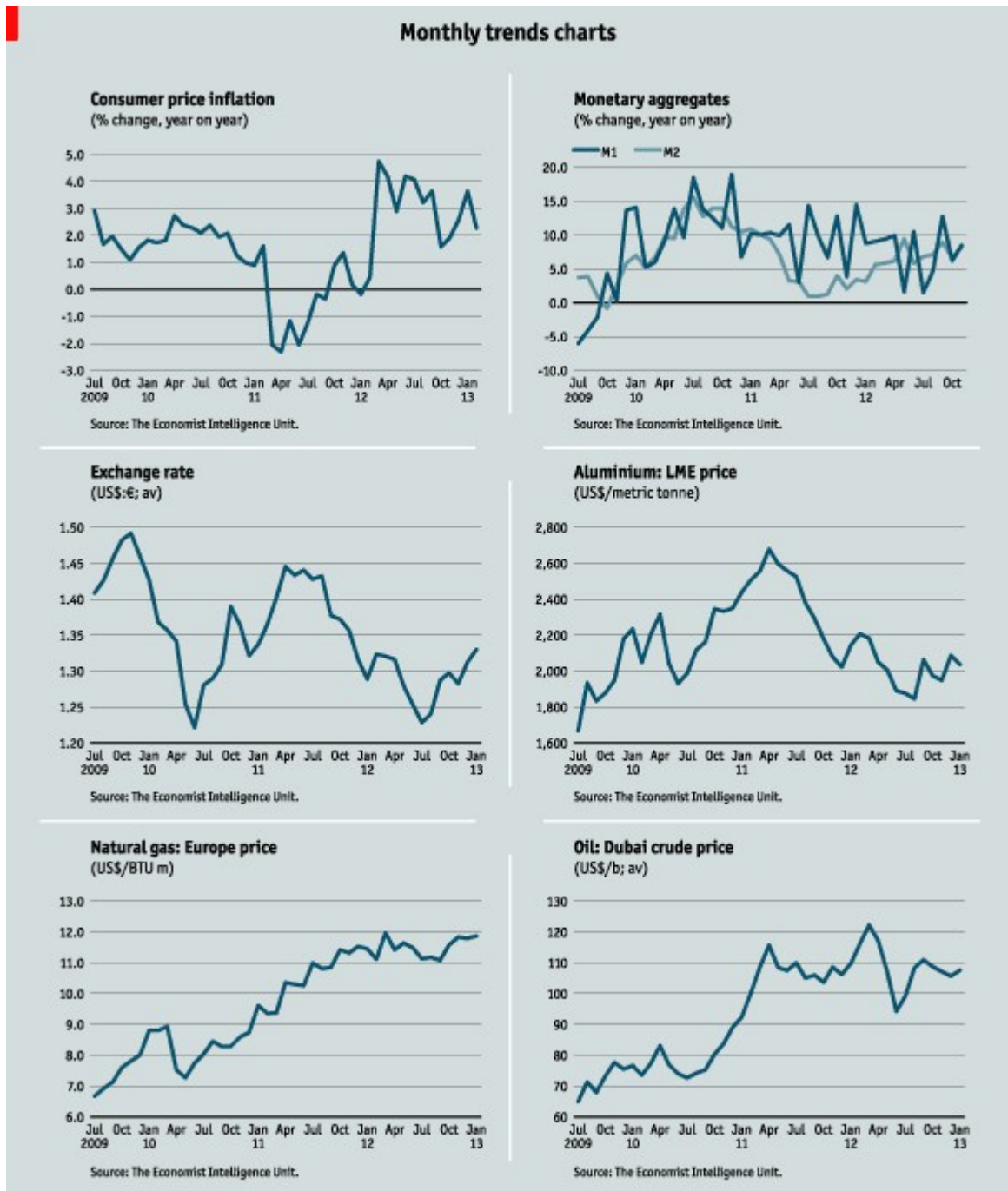
	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
Exchange rate BD:US\$ (av)												
2010	0.376	0.376	0.376	0.376	0.376	0.376	0.376	0.376	0.376	0.376	0.376	0.376
2011	0.376	0.376	0.376	0.376	0.376	0.376	0.376	0.376	0.376	0.376	0.376	0.376
2012	0.376	0.376	0.376	0.376	0.376	0.376	0.376	0.376	0.376	0.376	0.376	0.376
Exchange rate BD:¥100 (av)												
2010	0.343	0.339	0.341	0.351	0.346	0.341	0.329	0.321	0.317	0.307	0.310	0.313
2011	0.311	0.310	0.307	0.313	0.305	0.302	0.298	0.289	0.289	0.288	0.292	0.293
2012	0.289	0.295	0.310	0.306	0.300	0.298	0.297	0.296	0.294	0.297	0.305	0.315
M1 (end-period; % change, year on year)												
2010	14.1	5.2	6.0	9.2	13.9	9.6	18.5	13.8	12.5	11.1	18.9	6.8
2011	10.2	10.0	10.3	9.9	11.5	3.0	14.3	9.9	6.7	12.8	3.9	14.5
2012	8.8	9.1	9.4	9.9	1.6	10.5	1.5	4.7	12.7	6.2	8.5	n/a
M2 (end-period; % change, year on year)												
2010	7.0	5.2	6.7	9.6	9.5	13.8	15.6	12.8	14.0	13.9	11.2	10.5
2011	10.9	10.1	9.4	7.1	3.2	3.2	1.0	0.9	1.2	4.0	2.1	3.4
2012	3.1	5.6	5.8	6.2	9.4	5.8	6.8	7.1	8.9	6.7	8.2	n/a
Treasury-bill rate (av; %)												
2010	1.0	0.9	0.9	0.8	0.8	1.0	0.8	0.7	0.8	0.7	0.7	0.9
2011	0.8	0.8	1.3	1.2	0.9	0.9	0.8	0.7	0.9	0.9	0.9	1.3
2012	1.3	1.3	1.3	1.2	1.2	1.3	1.2	1.3	1.3	1.1	n/a	n/a
Central Bank of Bahrain foreign reserves (US\$ m)												
2010	3,817	4,036	5,288	5,003	5,106	4,986	4,970	4,975	4,842	4,741	4,920	4,782
2011	4,762	4,270	4,053	4,522	4,530	4,169	4,205	4,278	4,319	4,156	4,536	4,239
2012	4,469	4,338	4,401	4,487	4,747	4,790	4,417	4,090	4,430	4,869	n/a	n/a

Sources: IMF, International Financial Statistics; Haver Analytics.

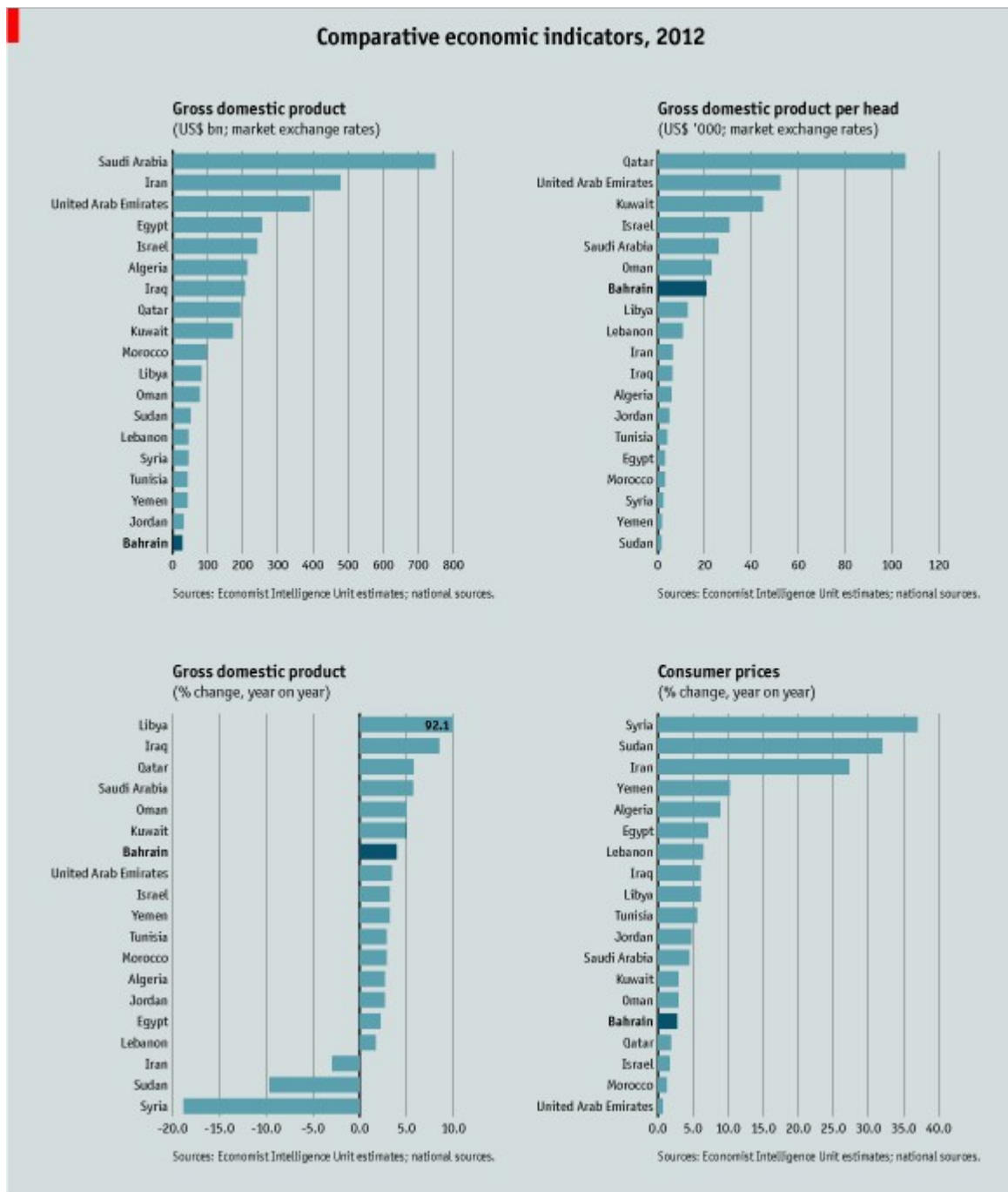
Annual trends charts



Monthly trends charts



Comparative economic indicators



Basic data

Land area

712 sq km

Population

1,234,571 (end-2010), of whom 666,172 are Bahraini nationals, according to the Central Bank of Bahrain

Main towns

Population (April 2001, official census):

Manama (capital): 153,395

Muharraq: 91,939

Climate

Hot, very humid summer (April to September); temperate December to March

Weather in Manama (altitude 5 metres)

Hottest month, August, 29-38°C; coldest month, January, 14-20°C (average daily minimum and maximum); 70 mm average annual rainfall; driest months, June-October; wettest months, November, December, February

Languages

Official language is Arabic; English also widely used

Measures

Metric system; also local measures including: 1 dhara=48.26 cm, 1 rafa=254 kg

Currency

Bahraini dinar (BD) = 1,000 fils. The dinar is pegged to the US dollar at a rate of BD0.376:US\$1

Time

3 hours ahead of GMT

Fiscal year

January 1st-December 31st

Public holidays

The dates of Islamic holidays are based on the lunar calendar and are therefore approximate. New Year's Day (January 1st 2013); Prophet Mohammed's birthday (January 24th 2013); Labour Day (May 1st 2013); Eid al-Fitr (August 7th 2013); Eid al-Adha (October 14th 2013); Islamic New Year (Muharram, November 4th 2013); Ashura (November 12th 2013); National Day (December 17th 2013)



Political structure

Official name

Kingdom of Bahrain (known as the State of Bahrain until February 14th 2002)

Form of state

Constitutional monarchy

Legal system

Based on the 2002 amended constitution. The previous constitution was drawn up in 1973

Legislature

Bahrain's bicameral legislature, the National Assembly, consists of the Chamber of Deputies, which has 40 elected members, and the Shura Council, which also has 40 members but is appointed by the king

National elections

Municipal and legislative, October 2010. By-elections were held on September 24th 2011, in which independent candidates replaced 18 al-Wefaq members of parliament (MPs). The next legislative election for a full-term parliament is expected in 2014

Head of state

Hamad bin Isa al-Khalifa succeeded to the throne in March 1999 after the death of Sheikh Isa, Bahrain's ruler since 1961; he changed his constitutional status to king from emir in February 2002; Salman bin Hamad al-Khalifa, King Hamad's son, is the crown prince

Executive

Cabinet, headed by the prime minister, appointed by the king. Most recent reshuffle: 2011

Main political parties

Political parties are not permitted, but political societies have been legal since late 2001. The largest legal opposition group is the al-Wefaq National Islamic Society, an Islamist-leaning, Shia-based movement whose 18 MPs resigned after the government used violence to quell protests in early 2011

Key ministers

Prime minister: Khalifa bin Salman al-Khalifa

First deputy prime minister: Salman bin Hamad al-Khalifa

Deputy prime ministers:

Mohammed bin Mubarak al-Khalifa

Jawed bin Salem al-Ararryed

Ali bin Khalifa al-Khalifa

Khalid bin Abdullah al-Khalifa

Communications: Ali bin Khalifa bin Salman al-Khalifa

Culture & tourism: Mai bint Mohammed al-Khalifa

Education: Majid bin Ali al-Nuaimi

Finance and energy: Ahmed bin Mohammed al-Khalifa

Foreign affairs: Khalid bin Ahmed al-Khalifa

Health: Nazar al-Baharnah

Industry & commerce: Hassan bin Abdullah Fakhro

Interior: Rashid bin Abdullah bin Ahmed al-Khalifa

Justice & Islamic affairs: Khalid bin Ali al-Khalifa

Labour: Jameel Humaidan

Minister of state for cabinet affairs: Kamal Ahmed

Prime minister's court: Khalid bin Abdullah al-Khalifa

Public works: Esam bin Abdullah

Shura Council & parliamentary affairs: Abdulaziz al-Fadhel

Social affairs: Fatima Mohammed al-Beloushi

Head of the Royal Court

Khalid bin Ahmed al-Khalifa

Central Bank governor

Rashid al-Mara

Recent analysis

Generated on April 24th 2013

The following articles were published on our website in the period between our previous forecast and this one, and serve here as a review of the developments that shaped our outlook.

Politics

Forecast updates

March 8, 2013: Political stability

Justice minister puts pressure on al-Wefaq

Event

The justice minister, Sheikh Khalid bin Ali al-Khalifa, told parliament on March 5th that there is a possibility that opposition political societies, including potentially al-Wefaq (a Shia society and formerly the largest grouping in parliament), will be dissolved after the conclusion of the recently recommenced "national dialogue".

Analysis

This is not the first time that Sheikh Khalid has made such a threat: in 2011 his ministry declared that al-Wefaq would be dissolved for violating the law governing political societies, notably by calling for constitutional change when the political societies law states that they must respect the constitution. However, the ministry quickly backtracked, seemingly as a result of pressure from the US and UK, who see al-Wefaq as the best option the government has for a negotiating partner at a time when the opposition is increasingly becoming fragmented and radicalised.

This time, it appears likely that the minister's statement is a negotiating tactic designed to mollify the pro-government camp, many of whom view the Shia opposition as Iranian stooges. In addition, it also places pressure on al-Wefaq to remain within the dialogue process and eventually strike a deal, for fear of what might happen to them if talks fail: for example, two al-Wefaq MPs were jailed in 2011, and two were made stateless last year when the authorities cancelled their Bahraini citizenship.

In this context, the mere fact that the talks have not broken down should be viewed as a relatively positive sign. It is likely that the government will seek a deal that would bring al-Wefaq back into the parliament for the 2014 election—it resigned its seats in 2011—in return for some concessions on electoral districts. Such a deal would be unlikely to satisfy the broader protest movement, however, and the government may well only step up its crackdown on the opposition if protests continue.

Impact on the forecast

The latest comments from the justice minister reinforce our view that fundamental policy discord, and pressure from hardliners, will prevent a successful conclusion to the national dialogue.

March 15, 2013: Political stability

Protests mark two-year anniversary of GCC intervention

Event

Dozens of protesters, and two policemen, have been injured in protests to mark the second anniversary of the dispatch of Saudi and other Gulf Co-operation Council forces to Bahrain during its bout of mass unrest.

Analysis

The protests appear to have been centred on a clutch of towns near the capital, Manama. Protests have been a regular feature in several of the poorer, largely Shia outskirts of the capital, and there are growing concerns that some areas are beginning to descend into a protracted cycle of unrest—with each protest resulting in casualties, which in turn thus prompt more protests. In this case, the largest opposition grouping, al-Wefaq, claimed that some 35 protesters had been injured (including three critically), and accused the police of using live ammunition to quell the demonstrations. Meanwhile, the official Bahrain News Agency and pro-government local paper, *Gulf Daily News*, blamed "thugs" and "acts of terrorism" for the trouble. According to the Ministry of Interior, protesters threw Molotov cocktails and detonated several homemade explosives—in the latter case, a growing feature of attacks on policemen, with more sophisticated bombs now becoming evident (including remotely detonated devices).

The violence is a reminder of the difficulty the parties involved in the recently resuscitated "national dialogue" will have in quelling the unrest on the ground. Despite the continuation of the talks, and the recent appointment of the dovish crown prince, Sheikh Salman bin Hamad al-Khalifa, as first deputy prime minister, a growing number of Bahraini, predominately Shia youth, appear to have become disenchanted with the political process entirely. Equally, the continued presence of Saudi troops (even though they are kept away from population centres) in the kingdom is an ever-present reminder of the crackdown in 2011, and the failure to progress reconciliation since.

Impact on the forecast

The latest protests reinforce our forecast that low-level demonstrations and occasional acts of violence will persist, undermining attempts to advance the national dialogue.

March 26, 2013: International relations

MSF cancels Bahrain conference on medical ethics

Event

Médecins Sans Frontières (MSF), a medical charity, has cancelled an international conference on medical ethics that was due to take place in Bahrain in mid-April.

Analysis

In a press release, MSF's director of operations, Bart Janssens, said that after a year of discussions, the organisation did not have the official support needed to go ahead with the conference. He also argued that "in Bahrain, it is not possible for medical professionals and international impartial participants to have a conversation about medical ethics".

Healthcare has been one of the priority sectors targeted by Bahrain's governmental Economic Development Board, and a few years ago there were ambitions to make Bahrain a regional centre for healthcare tourism, offering private facilities that could attract wealthy patients from other regional countries.

However, the healthcare sector has become a political battleground since the protests and crackdown of 2011: after the first violent crackdown, and amid reports that security forces were preventing ambulances from reaching injured protesters, demonstrators set up camp outside Salmaniya Medical Centre, the main public hospital, while some doctors told international broadcasters of their shock at what they were witnessing. The hospital was subsequently taken over by security forces, and 40 medical professionals were convicted of charges ranging from plotting to overthrow the government to inciting hatred against the ruling family. Following international pressure for retrials, most of them have now been released, although the convictions of nine were upheld in October 2012.

MSF was forced to close its clinics in Bahrain—which were operating without official permits—after they were raided by security forces. A report in the UK's *Independent* newspaper suggested that the crown prince, Sheikh Salman bin Hamad al-Khalifa, had been supportive of the MSF conference taking place. However, the event may have fallen victim to the ongoing power struggle within the royal family between the crown prince and more hardline members of the security establishment.

The Royal College of Surgeons in Ireland, which has a campus in Bahrain, has come under domestic criticism for its continued presence in the country. However, its co-operation continues. The Royal College of Surgeons and Medical University of Bahrain has also signed three agreements to co-operate with Japanese medical research institutions and companies, as part of a series of agreements signed on March 21st, during the crown prince's visit to Japan.

Impact on the forecast

The cancellation of the conference highlights the extent to which the events of early 2011 damaged Bahrain's international standing. However, the cancellation itself is not expected to have any impact on our wider forecast.

March 28, 2013: Political stability

Bahraini medics are acquitted

Event

A court has overturned the conviction of 21 medics who were charged with misdemeanours—mostly for attending illegal gatherings—in 2011.

Analysis

The medics' incarceration came about after protestors set up camp outside Salmaniya Medical Centre, the main public hospital, during the 2011 protests. When a wide-ranging crackdown on the protest movement began in March 2011, the hospital was taken over by security forces, and there were reports that some wards were used for torture. Some 40 medical professionals were imprisoned.

The 21 had already been released from prison last June, and human rights groups say many had already served the three-month sentence their convictions would have entailed. However, in a separate case related to the 2011 protests and the controversies around Salmaniya Hospital, two doctors and a nurse, including a high-profile surgeon, Ali Al Ekri, remain in prison.

While the announcement of the acquittal was welcomed by the US and UK, the news came as part of a pattern of slow and piecemeal implementation of recommendations of the Bahrain Independent Commission of Inquiry (BICI), a royally appointed commission of international lawyers that published a report into Bahrain's unrest in November 2011. The commission had recommended dropping criminal charges against protestors when charges these related purely to non-violent political expression, as well as retrying cases where civilians had been convicted in military courts and dropping evidence extracted through torture (the BICI found torture had been systematic in Bahrain in 2011).

The news of their successful appeal came after the cancellation of an international conference on medical ethics that Médecins Sans Frontières (MSF) had hoped to hold in the kingdom. This is not to suggest that the two events are directly related. Rather, the contrast between the two pieces of news illustrates the complexity and uncertainty of the current situation. Moreover, according to reports, the president of the Bahrain branch of the Royal College of Surgeons in Ireland (RCSI), Tom Collins, has resigned over the cancellation of the conference. The RCSI has come under heavy criticism in Ireland for maintaining its presence in Bahrain, despite the treatment of the medics, three of whom were RCSI graduates.

Overall, the acquittal of the medics reinforces the recent indications of a more conciliatory approach on the part of the government, exemplified by the appointment of the dovish crown prince, Sheikh Salman bin Hamad al Khalifa, as first deputy prime minister. Although unlikely to be sufficient to presage a breakthrough in relations between the government and the opposition, it at least provides a more helpful backdrop to the ongoing efforts to restart talks between the two sides.

Impact on the forecast

Although the latest news was welcomed by the opposition, we still believe the gap between the opposition and the government remains too wide to allow a breakthrough in the revived National Dialogue.

Analysis

March 13, 2013

Crown prince appointed as first deputy prime minister

The king has announced the appointment of his son, Crown Prince Salman bin Hamad al-Khalifa, to the new post of first deputy prime minister. The move could well be a signal that the relatively reformist Sheikh Salman is regaining influence, after being largely sidelined by more hardline members of his family since the failure of talks with the opposition in March 2011. The move also partly restores Sheikh Salman's powers over economic policymaking, which have been weakened over the past two years. The larger question is the political impact of the move.

The role of first deputy prime minister is a new one, although there are already four deputy prime ministers. The title echoes a role in Saudi Arabia, where the king is prime minister, and the crown prince the first deputy prime minister. It

is possible that the title is intended to send a signal that the crown prince could eventually be in line to succeed his great uncle, Sheikh Khalifa bin Salman al-Khalifa, who is the only prime minister Bahrain has ever had, having assumed the role upon the country's independence in 1971. Sheikh Salman has explicitly been given responsibility for overseeing the performance of several government agencies, partly restoring his powers over economic policymaking, which have been gradually weakened over the past two years as the agency he heads, the Economic Development Board, has had its wings clipped.

First among equals

Sheikh Salman's appointment would appear to place him in front of other candidates to succeed Sheikh Khalifa as prime minister, including another deputy prime minister, Sheikh Mohammed bin Mubarak al-Khalifa, a former education minister who is not closely associated with any of the three main camps within the royal family: the prime minister and his supporters; the crown prince and his backers; and the "Khawalid" (descendants of Prince Khaled bin Ali), which includes the head of the royal court and the army. The Khawalid are seen as the driving force behind the crackdown of 2011 and their role has been thrust into the limelight by a recent front-page article in *The Wall Street Journal* that quoted unnamed sources from the crown prince's camp complaining about their influence—an unusual degree of publicity for an internal family rivalry.

Another of the existing deputy prime ministers is Sheikh Ali bin Khalifa al-Khalifa, one of the sons of the prime minister. The prime minister has long been a focus of opposition grievances. When King Hamad came to power in 1999, the prime minister was widely seen as a brake on the king's relatively reformist tendencies, having previously overseen wide-ranging crackdowns on opposition uprisings in the 1980s and 1990s. As a result, one of the key demands of protesters in 2011 was the resignation of the prime minister. This personal focus was one of several elements of the protests that backfired; Sheikh Khalifa had a long-standing alliance with the then Saudi interior minister, Prince Nayef bin Abdel-Aziz al-Saud, and in any case Saudi Arabia and other Gulf Co-operation Council countries would not have wanted a precedent created by the removal of such a senior figure in the face of street protests.

However, it is not inconceivable that a graceful way out will be found for Sheikh Khalifa, especially now that almost all of his contemporaries—including Prince Nayef—have passed away or been pushed out of power. The longer-term question is whether his departure would create space for the crown prince to succeed, or whether it would have more benefits for the Khawalid, who represent a younger generation of ruling-family hardliners that are rooted more in the military than Sheikh Khalifa (whose support base comes more from the Ministry of the Interior, and parts of the business community).

Promise but little progress

All this remains speculation. In the short term there is still uncertainty about how the crown prince's appointment will affect the nascent political dialogue with the opposition (which is in the process of recommencing, after a year's hiatus). Al-Wefaq, the main opposition group, which resigned from parliament in early 2011, has cautiously welcomed the move, but has said it will wait to see whether actual policy changes result. One possibility is that the crown prince may now more actively participate in the dialogue process. Al-Wefaq has repeatedly called for him to take a higher-profile role in the talks—reflecting Sheikh Salman's dovish image—but the official argument against it has been that the crown prince does not have a defined political role in the constitution.

There have been other events in recent days that the opposition could interpret as confidence-building measures. A human rights activist, Said Yousif al-Muhafdhah, from the banned Bahrain Centre for Human Rights, won his appeal against charges of tweeting false news, and two policemen were convicted of torture and sentenced to ten years in prison. Numerous other political and human rights activists, including the head of the BCHR, Nabeel Rajab, remain in prison, however. Moreover, there is still no attempt to address command-level responsibility for the systematic torture that was detailed in the royally commissioned Bahrain Independent Commission of Inquiry in 2011.

Nonetheless, it appears that momentum may be shifting. Notably, it appears that important elements in both the Bahraini government and its key regional ally, Saudi Arabia, are becoming increasingly aware of the need for a political solution to Bahrain's troubles. The UK-based *Financial Times* recently reported on contacts taking place between al-Wefaq and a younger-generation (unnamed) Saudi prince. The Bahraini authorities will be hoping that the dialogue can foster a deal that will bring al-Wefaq back into the parliament after the 2014 election and will help to end the ongoing protests. However, achieving such a deal will require significant political concessions on the part of the government, including various measures that it has in the past deemed as red lines—notably revising the constitution. Despite the signs of movement, the gap between the opposition and the government remains wide.

Economy

Forecast updates

March 5, 2013: Fiscal policy outlook

Parliament agrees 2013-14 budget deal

Event

A stand-off between the upper and lower houses of parliament over the two-year 2013-14 budget appears close to resolution, after the two sides agreed to a host of new spending measures.

Analysis

The agreement, although positive for fiscal clarity (especially given that the country is already three months into the 2013 fiscal year), does not bode well for the health of the state finances. The deal struck between the financial and economic affairs committees of both houses of parliament would see a 15% increase in public-sector wages, a 20% rise in pensions, and a broadening of allowances to compensate for inflation (despite the fact that inflation is exceptionally low at the current time). The measures agreed on will not only place an extra near-term burden on the state finances, but will also have long-term implications, given the political difficulty of reversing the agreed salary rises. Parliament's call for higher salaries and pensions also comes despite the massive increase to both announced in August 2011, when the government handed a pay rise of up to 36.5% to the civil service and the military, and a 37.5% rise for pensioners. In addition, parliament does not seem to have taken on the challenge of reducing the massive subsidy burden, which is budgeted to reach BD960.6m (US\$2.55bn, or 27% of total spending) in 2014.

If the government does consent to the measures, it will add to the trend of a rapidly expanding recurrent expenditure bill (of which wages and subsidies constitute the lion's share), at the expense of state investment in capital projects. Even according to the Ministry of Finance's present budgetary projections (which do not include parliament's new wage and pension demands), the recurrent expenditure outlay will grow by over 60% between 2010 and 2014. In contrast, the allocation for capital projects will have shrunk by 30% (although the latest parliamentary proposal does include an extra BD20m for housing renovation and BD5m to build new jetties around the coastline). Such a dislocation is negative both for the health of the state finances and the country's productivity, although the possible inflow of large amounts of Gulf donor aid could help mitigate the impact of lower capital spending to a degree.

Impact on the forecast

The higher spending outlay agreed by parliament, if enacted, may lead us to revise higher our forecast for the budget deficit in 2013-14, which at present we forecast at an average of 5.6% of GDP.

March 7, 2013: Policy trends

Mumtalakat plans to step up domestic investment

Event

At a *Euromoney* conference in Bahrain, Mahmood al-Kooheji, the chief executive of Mumtalakat, the kingdom's sovereign wealth fund (SWF), announced that it would invest US\$150m in the country this year.

Analysis

Although Mr Kooheji did not provide a substantial amount of detail, he specifically mentioned real estate, the aluminium sector and tourism as potential areas of focus. According to Mr Kooheji, Mumtalakat's real estate arm, Edamah, is likely to prioritise part-finished projects, including possibly Bahrain Bay and the Villamar residential complex, especially given that much of the infrastructure is already in place. The property market in Bahrain has slumped in recent years: initially because of the global economic downturn in 2009, and subsequently after the wave of unrest that swept the kingdom in early 2011. However, there have been signs of undersupply in the sector recently, with consumer price inflation figures revealing a sharp 9% rise in rents in December 2012 compared with end-2011. As a result, assuming no more political or economic shocks in the kingdom, this may be a propitious time for the fund to expand its role in the sector.

More broadly, the ramping-up of Mumtalakat's role in the economy is in keeping with the trend of recent years, with the SWF especially prominent in the financial support it has provided for the perennially struggling national airline, Gulf Air. Mumtalakat's interest in the aluminium sector is also noteworthy, especially given that it sold a 10% stake in Aluminium Bahrain (Alba) in late 2010. In particular, it will be interesting to see if it becomes involved in Alba's forthcoming fund-raising to finance its sixth potline, for which France's BNP Paribas is the financial adviser.

Impact on the forecast

The latest announcement by Mr Kooheji reinforces our forecast that Bahrain's SWF will prioritise supporting troubled local state entities over acquiring assets abroad.

March 22, 2013: Policy trends

Bapco plans for new Saudi-Bahrain pipeline

Event

The Bahrain Petroleum Company (Bapco) has completed a study to build an expanded pipeline linking the kingdom to Saudi Arabia's oil-rich Eastern Province.

Analysis

The plan to build a larger pipeline with a capacity of 450,000 barrels/day (b/d), compared with the present pipeline's capacity of 260,000 b/d, would be a key element within a broader programme to expand the capacity of Bahrain's Sitra refinery. The export of Saudi oil to the Sitra refinery (Bahrain's only such facility) began as long ago as the 1940s, with the 61.5-km pipeline opening in 1945. Currently around 80-85% of the oil going to the plant is from Saudi Arabia, and thus the coming on stream of new, larger pipeline, projected for 2015, would necessitate a substantial expansion of Sitra. A front-end engineering and design (FEED) tender is expected to be released shortly, with the whole project estimated to cost around US\$6bn. Among other things, it is anticipated that a new unit to handle heavy crude will be built, and, potentially, further down the line, a petrochemicals unit to produce olefins will also be included.

The expansion of the Sitra refinery would provide a considerable economic boost, with the bulk of the refined fuel sold to Asian markets. However, the project has long been in the planning stage, and the study itself is no guarantee that the project will get the final go-ahead (although, crucially, Saudi acquiescence appears to have been gained).

Elsewhere, a series of other major industrial projects also appear to be close to kick-off. Notably, Aluminium Bahrain (Alba) is in the process of drawing up its financing plan for the construction of the company's sixth potline. However, progress on this front will require the construction of a gas importation terminal (natural gas is a crucial feedstock for the aluminium process): according to the Cyprus-based *Middle East Economic Survey*, Bahrain's National Oil and Gas Authority is in the process of drawing up a plan to build a floating regassification liquefied natural gas (LNG) terminal, which would come on line in 2016. However, again, the project remains in the planning stage.

Impact on the forecast

We had anticipated an expansion of the Sitra refinery in the second half of the forecast period, and, as a result, the news of a new, expanded pipeline from Saudi Arabia will not change our forecast.

Analysis

April 2, 2013

Economic growth disappoints in 2012

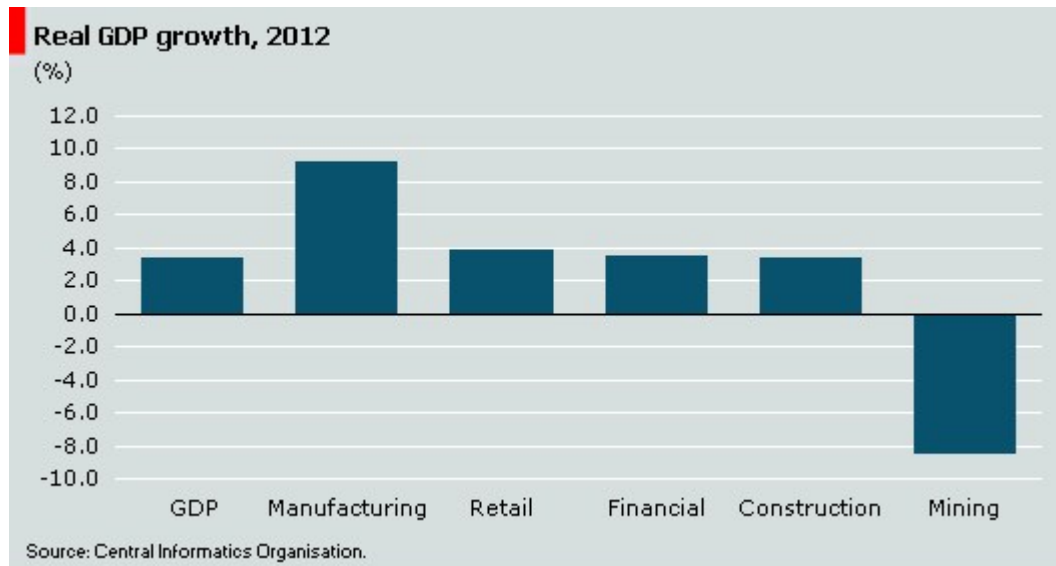
The Central Informatics Organisation (CIO) has revealed that Bahraini real GDP growth reached 3.4% last year—below expectations, after a weak fourth quarter and a substantial downward revision to its growth figures for the first half of the year. The figure compares poorly with some of Bahrain's regional peers—especially Saudi Arabia—and highlights the extent to which the economy is suffering from the after-effects of the national unrest that swept the country in 2011.

Although substantially better than the 1.9% growth rate the economy recorded in 2011, in reality the economic performance in 2012 was disappointing. The economy was affected in 2011, especially in the first half of the year, by the disruption caused by large-scale unrest, and, in normal circumstances, a more pronounced economic bounce-back would have been envisaged in 2012.

Oil sector suffers

The underperformance of the economy can largely be blamed on the oil sector and the continued impact of ongoing social unrest. The oil sector, which is the third-largest component of GDP, shrank in real terms by 8.5% last year. Although full-year oil production data are not yet available, according to the Central Bank of Bahrain oil output fell by 10.2% in the first half of the year, led by a decline at the Abu Saafa oilfield (shared with Saudi Arabia). The explanation for this decline has not been made available; however, it is not believed to reflect any serious depletion of the field, and may instead be attributable merely to temporary issues related to maintenance at Abu Saafa (which has been on stream since the early 1970s).

Of even more importance, the financial sector, the country's second-largest, also had a sluggish year, expanding by just 3.5%, compared with an annual average of 5.5% in 2007-10 (a figure all the more impressive given the global financial crisis of 2008-09). Bahrain has struggled to maintain its position as the regional financial hub in the wake of the domestic unrest, with some international financial firms redirecting their resources to Dubai and other, more quiet regional locations. The relatively modest performance of the retail sector and of construction (which grew by 3.9% and 3.4% respectively) also seems to reflect a general lack of investor and consumer confidence (although cuts in state capital spending are also probably a factor in the weak construction figure). More positively, however, both the manufacturing sector and the hotels and restaurant sector bounced back after a weak 2011, lifted in part by record high production at Aluminium Bahrain (Alba) and, in the latter case, the return of Formula One motor racing to the kingdom.



A weaker first half

The downward revision to the CIO's real GDP growth figures for the first half of last year was relatively dramatic, with the average rate of expansion lowered from 5.1% to 3.9% (although this is still above the 3% growth rate recorded in the second half of 2012). This largely explains why the full-year growth figure came in below the Economist Intelligence Unit's estimate of 3.9% for 2012: the fourth-quarter rate of expansion in Bahrain, of 2.7%, was very close to our expectations. Nevertheless, the trend is clear: the first two quarters' figures were flattered by the fact that they were compared with the first half of 2011, when the country was wracked with unrest and violence, and thus this helpful base effect dissipated in the second half of last year.

We expect real GDP growth to remain broadly stable in 2013, at 3.6%, in the wake of a continued slow recovery in the financial services sector and on the assumption that oil output will stabilise. This is slightly below the Central Bank's figure of 4%, although considerably below the seemingly optimistic growth forecast, of 6.2%, of the Economic Development Board (responsible for overseeing the country's economic development). However, even our relatively modest growth projection for 2013 will not be achieved if the country's Gulf Arab allies fail to begin to disburse the US\$10bn (spread over ten years) in aid promised in 2011.