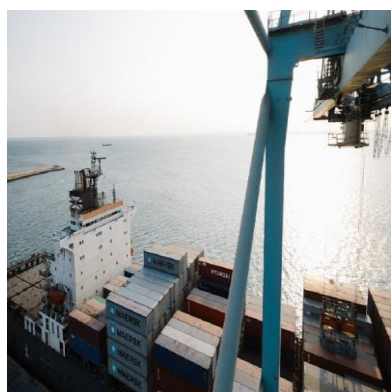
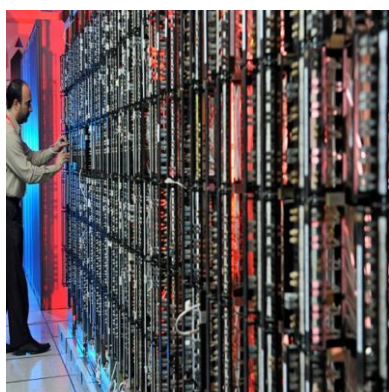
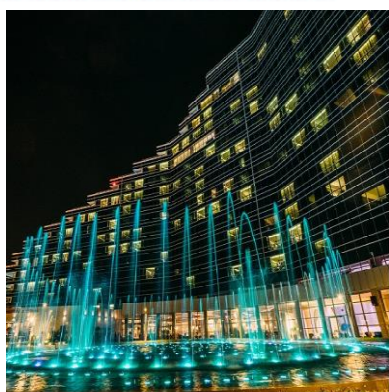
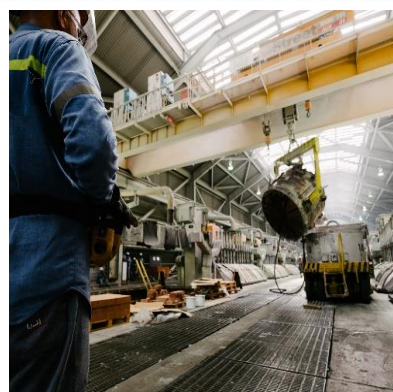


Bahrain Economic Quarterly

December 2015



SUMMARY

A VOLATILE YEAR-END

Global economy activity has been characterized by considerable volatility during the closing months of 2015. With the monetary stances of the leading economies diverging, markets have lacked clear direction. The GCC economies have been affected by renewed downward pressure on oil. In the case of Bahrain, this challenge is being significantly countered by substantial progress in implementing a substantial infrastructure project pipeline.

- ▶ **Bahrain's non-oil growth decelerated in Q3 but the structural drivers appear robust.** Non-oil growth in Q3 moderated to an annual 3.3% from 4.7% in 1H15. Cumulative growth for the first three quarters on the whole was 3%, with oil down by 1.7% and non-oil up by 4.2% as compared to Q1-3 of 2014
- ▶ **Substantial headway is being made in infrastructure project implementation.** In spite of challenges created by oil price volatility, large infrastructure projects remain largely on track. Particularly significant headway is being made with the GCC Development Fund, with nearly USD6bn worth of projects allocated and USD3.7bn worth tendered to date. USD1.3bn worth of projects have commenced, up from USD0.3bn in 4Q14
- ▶ **The GCC economies remain in an expansionary mode even as governments are working to reform their fiscal systems.** Project delays aside, the non-oil growth drivers across the region remain resilient and forward-looking indicators point to continued strong expansion. Governments are working to modify subsidies, diversify revenues, and boost efficiency
- ▶ **Oil prices have remained under persistent downward pressure in the face of high-production levels.** While concerns persist about the pace at which the supply overhang can be absorbed, a significant market rebalancing is underway. The industry has seen one of the sharpest cutbacks in investment in years at a time when spare capacity is low and demand is continuing to grow

Bahrain economic outlook

	2014	2015f	2016f	2017f
Real GDP growth, %	4.5%	3.2%	3.2%	3.0%
Non-hydrocarbons sector	4.9%	3.8%	3.9%	3.6%
Hydrocarbons sector	3.0%	0.5%	0.5%	0.5%
Nominal GDP growth, %	2.9%	-6.9%	8.4%	5.3%
Inflation (CPI %)	2.8%	2.1%	2.5%	2.5%
Current account (% of GDP)	3.3%	-4.9%	-2.6%	-2.5%
Fiscal balance (% of GDP)	-3.6%	-10.0%	-6.4%	-6.1%
Crude Oil Arabian Medium (USD)	96.0	50.0	60.0	60.0

Source: Bahrain Economic Development Board

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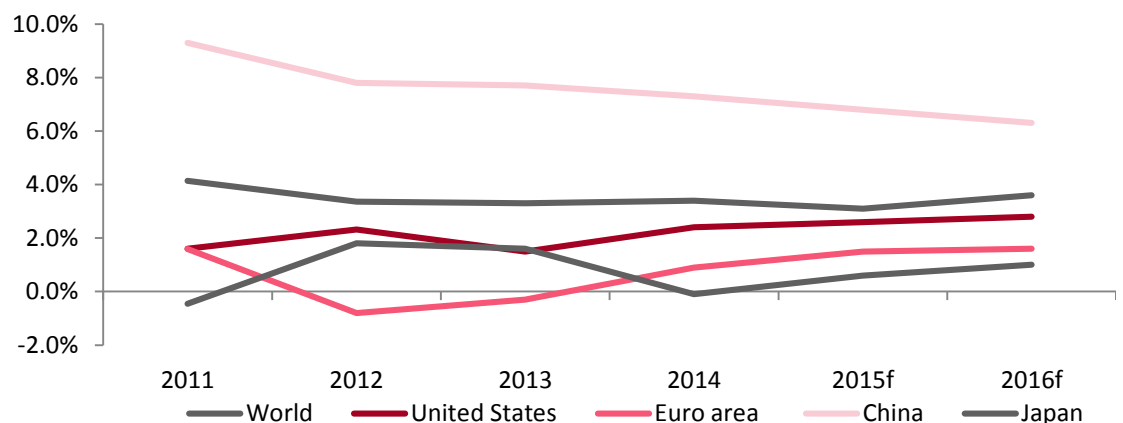
GLOBAL ECONOMY

TURNING A NEW LEAF

The year 2015 will likely go down in history books as one of dashed expectations. Hopes of a global rebound were repeatedly tested by factors ranging from worries over China's growth to market volatility in response to recurrent speculation about a US rate increase. Commodity prices have remained generally weak, while recurrent volatility has hit the equity as well as currency markets. Overall, the period of uncertainty has led to increased caution about the near-term outlook for the global economy. The US economy seems to be a relatively isolated case of a generally improving performance, although the Euro-zone has also experienced a slight pick-up in growth.

In its October *World Economic Outlook* (WEO), the International Monetary Fund (IMF) projected global growth of 3.1% in 2015, which represents a clear deceleration from the 3.4% pace seen in 2014. In a marked departure from the pattern seen in recent years, global growth is expected to be driven by a gradual pick-up in the advanced economies, whereas emerging markets appear to be losing steam. Overall global growth is expected to pick up somewhat in 2016 to reach 3.6%. The Organisation for Economic Co-operation and Development (OECD) reduced its global growth forecast for this year from 3.1% to 3% and the 2016 figure from 3.8% to 3.6%.

Real GDP growth, select economies (%)



Source: International Monetary Fund, *World Economic Outlook*, October 2015

Going separate ways

Speculation about possible monetary tightening in the US has been one of the recurrent themes of global economic policy debates for several years. The protracted waiting game formally ended on 16 December when the Federal Open Market Committee (FOMC) decided to push up the cost of borrowing by 0.25 percentage points to a range of 0.25-0.5%, its first rate hike since June 2006. By bringing to a close a near-decade of ultra-low interest rates, the Fed begged the question about the future trajectory of rates in the US while also underscoring the divergence that has emerged between the monetary stances of the US and most other economies.

The pace of global growth in 2015 fell short of expectations, but an acceleration is projected for 2016

The decision by the US Federal Reserve marks a potential paradigm shift for monetary conditions and paves the way for global divergence in the near term

Opinions still differ on the pace at which the Fed can tighten monetary conditions. Most observers expect rates to remain below 1% into 2017, although FOMC members seem to expect somewhat faster tightening with four quarter-point increases projected in 2016. The Fed has explicitly itself linked further increases to the trajectory of core inflation and financial market conditions. In practice, several challenges continue to confront policymakers with respect to further tightening:

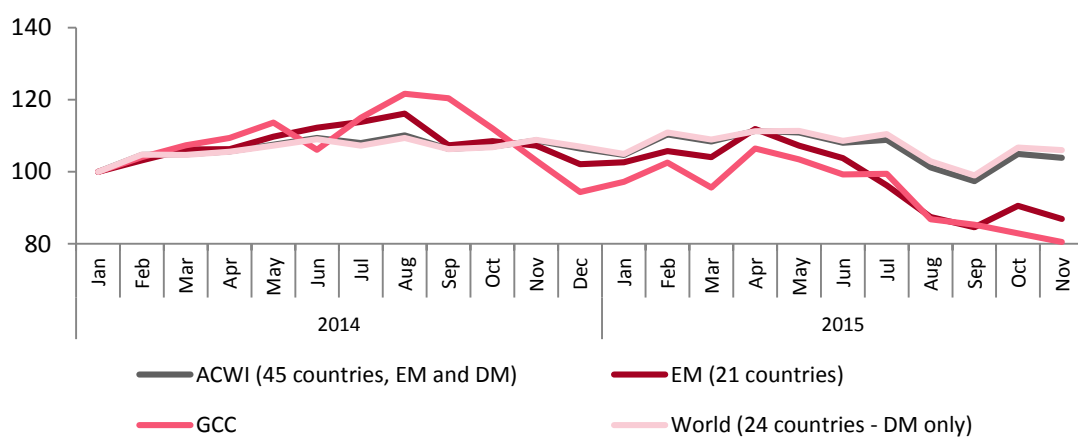
- ▶ While the initial rate hike passed with surprisingly little market turmoil, there is widespread worry that further tightening could trigger new “taper tantrums” along the lines of the market chaos that materialized in response to indications of monetary tightening in the summer of 2013
- ▶ The era of low interest rates has boosted leverage, both in the US and globally, and there is concern about the ability of many debtors to adjust to new market conditions. US high-yield corporate debt, especially, has seen significant redemptions of late. The IIF puts emerging market debt as of the first half of 2015 at nearly 200% of GDP
- ▶ While economic conditions in the US have steadily improved, it is not clear that inflationary pressures have materially increased. Even the decline in open unemployment has coincided with record numbers of people existing in the labor force altogether, which means that there may be more spare capacity in the labor market than the headline figures would suggest. The rate of unemployment is projected by the Fed to remain in the 4.6-4.8% range in the medium term while inflation looks likely to hover around 1.6% next year

But perhaps the greatest concern has to do with the growing divergence between the monetary stance of the US and that of (broadly speaking) the rest of the world which is unlikely to reverse in the near term. The other leading economies have taken steps toward loosening monetary conditions further:

- ▶ The European Central Bank has pushed its policy rates below zero, most recently to -0.3%, and extended quantitative easing by another six months, with President Mario Draghi reiterating that there are no formal limits to expanding the ECB’s balance sheet. Similar steps have materialized in Japan with additional and longer-term security purchases announced by the Bank of Japan. In both cases, economic growth remains subdued and inflationary pressures minimal
- ▶ The People’s Bank of China has pursued gradual easing and, in early December, cut its reference rate to its lowest level in four years. China has increased its policy options by moving toward a more market-determined exchange rate model while also shifting from Dollar guidance to a trade-weighted basket of 13 currencies as the basis for exchange rate determination. This has gone hand in hand with a gradual depreciation in the value of the Renminbi. With the new exchange rate regime and the inclusion of the Renminbi in the IMF basket of reserve currencies, likely further depreciation will likely be gradual while. Indeed, further stimulus measures are expected to be introduced through other channels

The widening interest rate differential between the US and other major economies is expected to keep several currencies under further downward pressure in the near future, which is something that policymakers are likely to welcome in many cases. However, further appreciation of the US Dollar would tighten monetary conditions in the US and weaken the competitiveness of US exports. Given the divergent economic cycles between the US and much of the rest of the world, this constitutes potential risk. Several central banks have raised rates in recent years, only to be forced to reverse course soon afterwards. The FOMC also indicated that the Fed stands ready to intervene should market conditions suddenly deteriorate. Indeed, higher rates will increase the policy buffer at its disposal should that happen.

MSCI regional indices (Base Jan 2014=100)



Source: MSCI

Oil: lower for longer?

Following a brisk recovery in oil prices during the spring, prices relapsed again during the summer months and the pressure has intensified toward the end of the year with a 15% drop in the first three weeks of December alone. The Brent benchmark price by 21 December dropped to its lowest level since mid-2004 before rebounding slightly. The total drop since the June 2014 peak of USD115 has reached nearly 70% and the decline this year alone has been close to 40%.

A number of factors account for this weakness which for now is likely leaving the oil price below the levels needed for long-term market stability:

- ▶ There is continued concern of a persistent glut in the market. Few producers have meaningfully scaled back their output while the key OPEC producers have continued to exceed their quota. The OPEC meeting on 4 December effectively concluded without a clear commitment to the previous 30 mbd ceiling which had at any rate been consistently exceeded. OPEC production rose by 230,100 b/d in November to just under 31.7 mbd, the highest production level since April 2012. This level is some 900,000 b/d higher than the projected 'call on OPEC' next year
- ▶ Further supply increases are possible due to the pending end to Iranian sanctions

Investments in upstream oil are being cut aggressively, which is raising concern about long-term market stability

and the decision by the US Congress to end a 40-year embargo on exports. The decision to lift the US export ban has reduced the spread between Brent and WTI to an 11-month low but is unlikely to materially affect the supply situation in the near term. Iran's ability to substantially boost production is complicated by the heavy investment needs of its fields. Any prospect of stabilization in countries such as Libya could further increase the oversupply

- ▶ There is concern that the brisk pace of global oil demand growth will not be sustained into 2016, which risks perpetuating the situation of oversupply. Global demand has also been hit by an unusually mild winter in the northern hemisphere
- ▶ The growth in global crude inventories remains brisk at more than 1 mbd. Oil stocks in advanced economies total nearly 3bn barrels, which is equivalent to more than a month of global production. US crude stockpiles have risen to around 490mn barrels - some 130mn more than their five-year average. Onshore storage facilities are nearing capacity in many cases and lower prices are required to make offshore storage economically viable
- ▶ The Paris agreement on climate change has raised some concern about the longer-term outlook for fossil fuels. However, the agreement is voluntary and unlikely to have significant impact on the market in the near term
- ▶ The continued strength of the US Dollar is negative for commodity prices. Global commodity prices have shed more than a quarter this year and benchmark indices are at their lowest point since the turn of the century

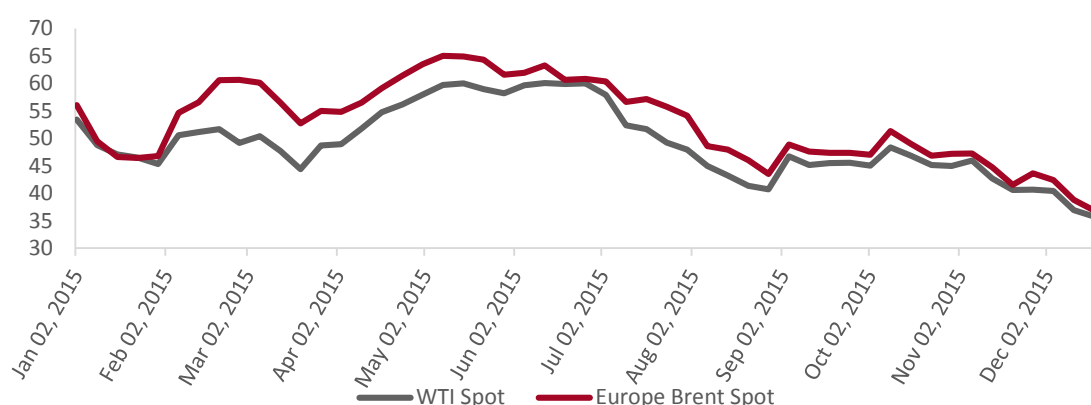
Even as oversupply concerns dominate the scene at the moment, the current market environment may well be slowing the seeds of its own undoing. The current situation is characterized by historically low levels of spare capacity – some 2 mbd – in the face of significant geopolitical risks. Having until recently overpriced these concerns, the market may at the moment be underpricing them.

At the same time, oil demand is expected to continue growing even as substantial investments are needed to maintain output. The annual output decline rate of oil fields globally is some 4 mbd while annual demand growth is expected to remain in excess of 1 mbd for the foreseeable future. OPEC estimates that investments of USD10trn are needed by 2040 to ensure relative market stability – a rate of some USD400bn a year. Yet the oil and gas industry has cut USD200bn – more than 20% – from its planned investments this year. Projects with an aggregate capacity of close to 5 mbd have been shelved. Further investment cuts of 3-8% are expected in 2016. This would represent the first instance of two consecutive years of investment cutbacks since the 1980s.

In line with OPEC's stated ambitions, the current price environment is putting pressure on higher-cost producers, even though companies across the spectrum have benefitted from lower costs and substantial efficiency gains. Non-OPEC supply is expected to contract by as much as 600,000 b/d next year, which would mark the first such drop in years. The US rig count, in spite of some volatility, has fallen to its lowest level since the turn of the century. After a year of unexpected resilience in unconventional oil production, a transition now likely beckons for the sector. The US

Energy Information Administration predicts that companies operating in the US shale fields will cut production by some 570,000 b/d in 2016. The International Energy Agency now expects OPEC's strategy to have an enduring impact on the balance of power in the oil market. It projects an increase in OPEC's market share to 44% by 2020 and 49% by 2040. The main output gains are expected from Iraq (from 3.4 mbd in 2014 to 4.4 mbd in 2020 and 5.7 mbd in 2025) and Iran (from 3.5 mbd in 2014 to 4.4 in 2020). Global demand in turn is expected to peak at some 103 mbd in the 2030s. OPEC sees demand growing to 109.8 mbd by 2040.

Weekly crude oil prices (USD/barrel)



Source: US Energy Information Administration

Global oil demand and supply dynamics (mbd)

	IEA	OPEC	EIA
2013 Global oil demand (mbd)	91.9	90.4	89.9
Advanced economies	46	46	45.2
Emerging economies		29.2	
China	10.3	10.1	10.7
2014 Global oil demand (mbd)	92.8	91.3	91.1
Advanced economies	45.7	45.7	45.1
Emerging economies		29.9	
China	10.6	10.5	11.1
2015 Global oil demand (mbd)	94.6	92.9	92
Advanced economies	46.2	46.2	45.5
Emerging economies		30.6	
China	11.3	10.8	11.3
2013 Global oil supply (mbd)	91.3	90.2	90.6
OPEC	36.6	30.3	36.5
Non-OPEC	54.6	54.2	54.1
2014 Global oil supply (mbd)	93.7	91.1	91.5
OPEC	36.6	29.4	36
Non-OPEC	57	56	55.4
2015 Global oil supply (mbd)		92.3	92
OPEC		28.9	35.6
Non-OPEC		57.3	56.4

Source: International Energy Agency, Organization of the Petroleum Exporting Countries, US Energy Information Administration

Implications for Bahrain

The main implications of the current global situation for Bahrain are linked to US interest rates and the oil market.

- ▶ The increased Fed funds rate will push up the policy rates in the GCC as well, draining some liquidity from the system
- ▶ A stronger Dollar is likely to contain import price pressures, although unusual weather patterns this winter may have a bearing on some food crops
- ▶ In spite of the ongoing oil market rebalancing, the near-term outlook for prices remains challenging

THE GCC REGION

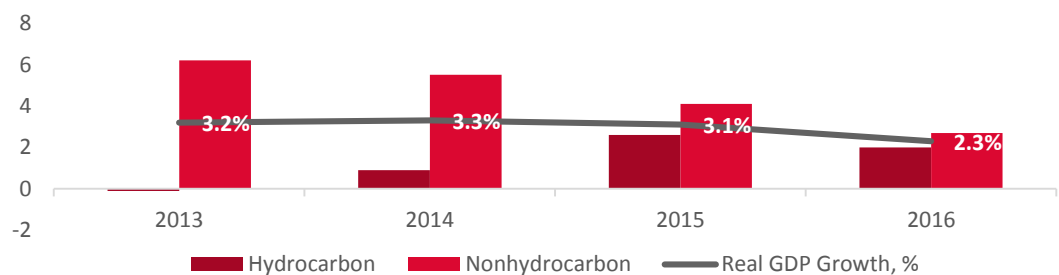
BEGINNING TO ADJUST TO LOWER OIL PRICES

A longer-than-expected period of depressed oil prices is prompting new measures to diversify government revenues and rationalize expenditures

The remarkable economic resilience of the GCC economies has been tested in 2015 by a longer and sharper correction in oil prices than generally expected. While confidence and key signs of activity in the non-oil sector have held up fairly well, the oil market uncertainties have prompted regional governments to undertake a growing number of measures to re-engineer their fiscal systems in order to reduce their dependence on oil-related revenues. New initiatives have ranged from spending cuts to steps designed to boost government efficiency as well as to diversify revenues. The most impactful measures to date have tended to involve capital expenditure cuts and modifications to government subsidies.

The inevitably gradual introduction of many fiscal reform initiatives is driving a near-term build-up in public sector debt across the region. For instance, the International Institute of Finance projects an increase in aggregate GCC government debt to 42% of the region's total GDP in 2016, up from 28% in 2014. At the same time, savings have continued to be drawn down with an estimated USD160bn drop in total GCC foreign reserves in 2015. The diminished role of government expenditure is expected to dampen regional growth somewhat in the near term, even if continued record production in the oil sector will counter the effect somewhat. While expecting overall GCC growth to remain above 3% this year, the IMF has revised down its 2016 projection to 2.8%. The IIF forecast is an even more cautious 2.3%.

GCC real GDP growth, %



Source: International Institute of Finance

Non-oil growth drivers remain resilient

The ongoing fiscal consolidation measures notwithstanding, growth across the GCC is continuing to be led by the non-oil sector, a pattern that is not expected to change in the foreseeable future. Following robust 5.5% non-oil growth in 2014, the IIF projects a deceleration to 4.1% this year, followed by a further drop to 2.7% in 2016. By contrast, the IMF expects greater resilience and continuity with region-wide non-oil sector expansion of 3.8% this year and next alike.

The non-oil momentum tends to be strongest in economies with significant infrastructure investment pipelines. In the cases of the UAE and Qatar, a commitment to high-profile

international events (the 2020 World Expo and the 2022 FIFA World Cup, respectively) is underpinning the project investments. In general, much of the infrastructure spending across the region is seen as necessary for economic diversification and is strategically anchored.

Qatar is expected to post the fastest non-oil growth in the region: some 9% and 8% in 2015 and 2016, respectively. Qatari non-oil growth in Q2 reached an annualized 9.1% led by a 19.7% rate of expansion in construction which in turned helped contribute to a 10.2% YoY increase in population growth as of August. Overall headline growth in Qatar picked up somewhat to an annual 4.8% in Q2 compared to 4.0% in 2014. With new gas output coming from the Barzan field in the coming years, Qatari growth is expected to accelerate further in the medium term.

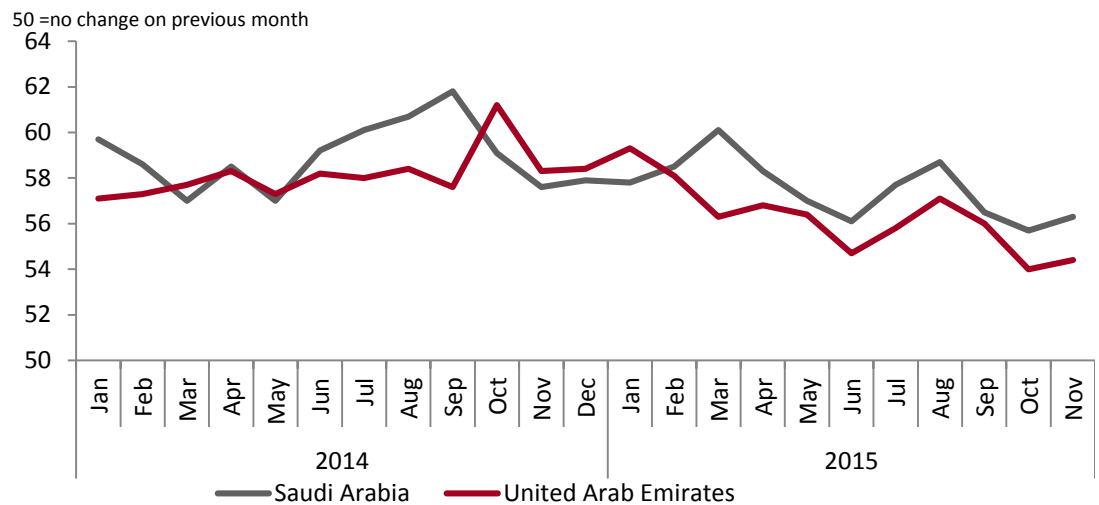
Economic growth in the UAE has been hurt by some loss of momentum in the travel and tourism sector. The UAE Central Bank's Economic Composite Indicator has declined from a YoY 4.5% increase in 2015 to 3.1% in the first half of this year and to 2.7% in Q3. Only 18% of firms responding to the Emirates NBD Dubai Economy Tracker survey reported increased business activity in October with new orders growing at their slowest pace since 2010. Only 3.1% of companies reported employment gains even as new business creation remained fairly brisk with a 7.7% YoY increase in licenses in January-September. Some seasonal improvement was recorded in November. Beneath the volatility, non-oil momentum remains healthy, however. While growth may moderate below 3.5% this year, it is generally expected to rebound toward 4% in 2016. Also Oman is expected to see non-oil growth of close to 5% this year and next.

Saudi Arabia posted headline real growth of 3.35% in 2015, according to Government estimates. Growth was fairly broad-based with the oil sector expanding by 3.06%, the Government sector by 3.34%, and the private sector by 3.74%. Telecommunications, transport and storage was the fastest growing sector at 6.1%, followed by building and construction at 5.6%. With public expenditure growth expected to moderate in the near term, the Government has worked on a range of reforms to stimulate private sector activity. Among other things, the private sector can play a large role in funding the Kingdom's massive projects pipeline which, according to MEED estimates, stands in excess of USD1trn. The IMF expected Saudi non-oil growth to accelerate marginally from 3.1% in 2015 to 3.3% in 2016. Non-oil private sector growth is projected to accelerate from 3.4 to 3.8%.

The main forward-looking indicators of economic activity in the region, the Emirates NBD/Markit Purchasing Managers' Indices (PMI) attest both to the resilience of the structural growth drivers but also the fact that the recent oil price volatility has tested confidence. The Saudi PMI saw a modest decline from the August reading of 58.7 and stood at 55.7 in October, driven by weaker expansion in new business. The UAE PMI recorded a somewhat sharper decline from 57.1 in August down to 54 in October, although this still suggests that the non-oil economy remains in a clearly expansionary mode. Both indices recorded a slight improvement in November with the Saudi PMI rising to 56.3 driven by an increase in new export businesses. The UAE index gained 0.4 points to 54.4.

In spite of increased volatility, forward-looking indicators of economic activity in the region have remained consistently positive

Emirates NBD Purchasing Managers' Index



Source: Emirates NBD, Markit

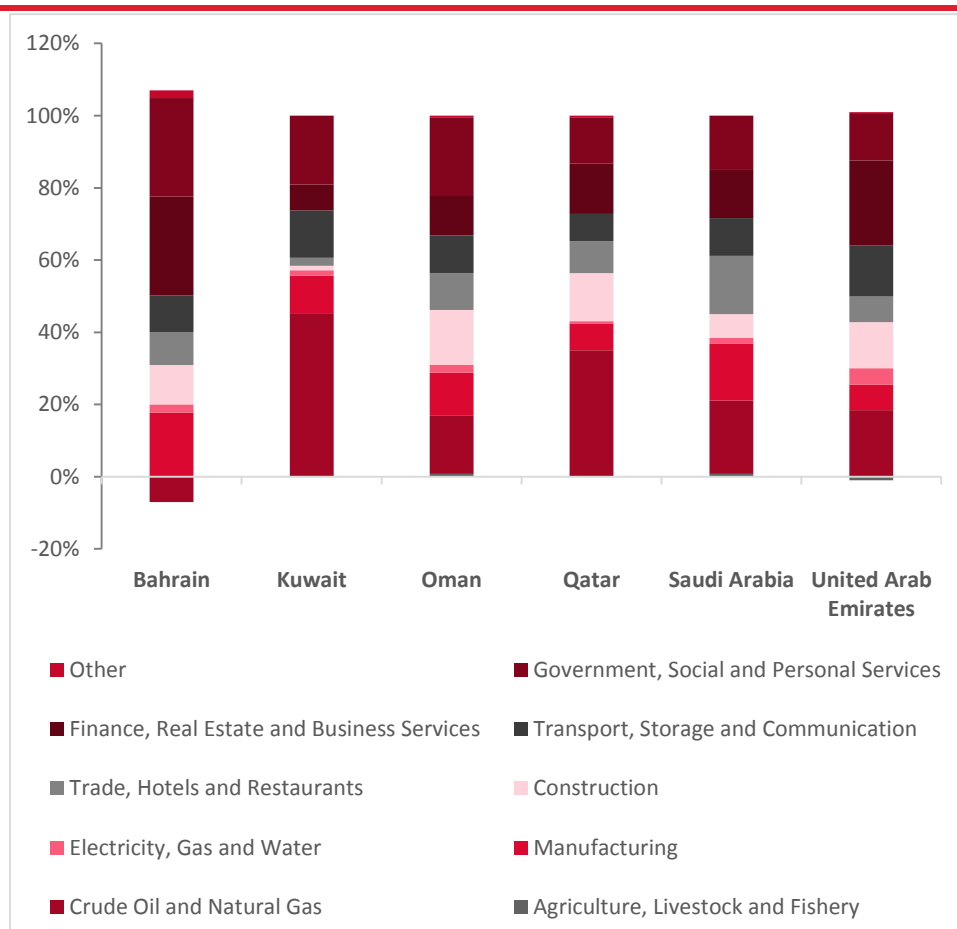
Diversification moves to the fore

Economic diversification has been a key strategic objective for all the GCC countries for decades. Significant progress has materialized in terms of empowering the development of the private non-oil sector, but elevated oil prices during much of the time period since the turn of the millennium has served as an important counterpoise. The high hydrocarbons price environment in connection with what until recently was referred to as the commodities super-cycle has boosted activity in oil and gas extraction. Even the recent commodity price reversal has done little to fundamentally change the picture because of the commitment of the GCC OPEC producers to defend their market share in an increasingly contested oil market.

Looking at the composition of GDP growth across the GCC region over the past decade or so, the hydrocarbons sector has made the largest contribution to growth in all regional economies bar Bahrain and the UAE. In Kuwait, the sector contributed almost half of new GDP over a decade and the figure in Qatar was also in excess of a third, largely in reflection of the massive natural gas build-up in the country. Bahrain was the sole regional economy where the hydrocarbons sector contracted over the decade, whereas the UAE, largely as a result of its ambitious real estate development, saw fastest growth in finance, real estate and business services than in hydrocarbons.

Part of the challenge for diversification in much of the Gulf region is due to the reality that the oil and gas sector development is effectively a precondition for further expansion of other sectors such as manufacturing and power generation. Capturing more of the hydrocarbons value chain locally or supporting energy-intensive manufacturing remains one of the most compelling diversification opportunities in the region but is also conditional on a steady increase in feedstock. Regional power generation, which fuels the development of much of the non-oil economy, is almost entirely dependent on hydrocarbons. Indeed, the Middle East, partly because of subsidies but to a large extent thanks to its development model, has become a leading source of incremental hydrocarbons demand globally.

In spite of significant progress in many areas, economic diversification in the GCC has been countered by a period of high oil prices and the role of hydrocarbons as an enabler of diversification in many countries

Composition of real GDP growth (2003-2013), %

Source: National statistical agencies

The role of capital markets is likely to grow in the near term in terms of supporting private sector involvement in project finance

The renewed oil price volatility underscores the urgency of economic diversification but also throws up new challenges in its way. The historically heavy dependence on government capital spending is in many cases threatening the timeliness of execution of large projects. At the same time, bank liquidity conditions in many regional economies are beginning to constrain private alternatives. Pushing the diversification story forward will therefore require redoubled efforts in terms of harnessing new capital sources. A regional credit squeeze following the onset of the global crisis in 2008 was followed by a greater interest in capital, and especially bond and sukuk, market development. Encouragingly, this time around, these markets and structures are more mature and recognized.

To date, the impact of lower oil prices on the diversification narrative has been ambiguous. Several countries have seen some delays or cutbacks in projects. As of early December, the GCC project pipeline, as measured by the MEED Gulf Projects Index stood at USD2.64trn, down 5% YoY. The value project pipeline in Saudi Arabia has declined by some 17.6% YoY, whereas the Qatari figure is down by 4.4%. While the UAE and Oman have seen some gains at 4.7% and 8.1%, respectively, the most pronounced rebound has been observed in Kuwait and Bahrain. The turnaround in Kuwait is partly reflective of a new government impetus to drive the implementation of the

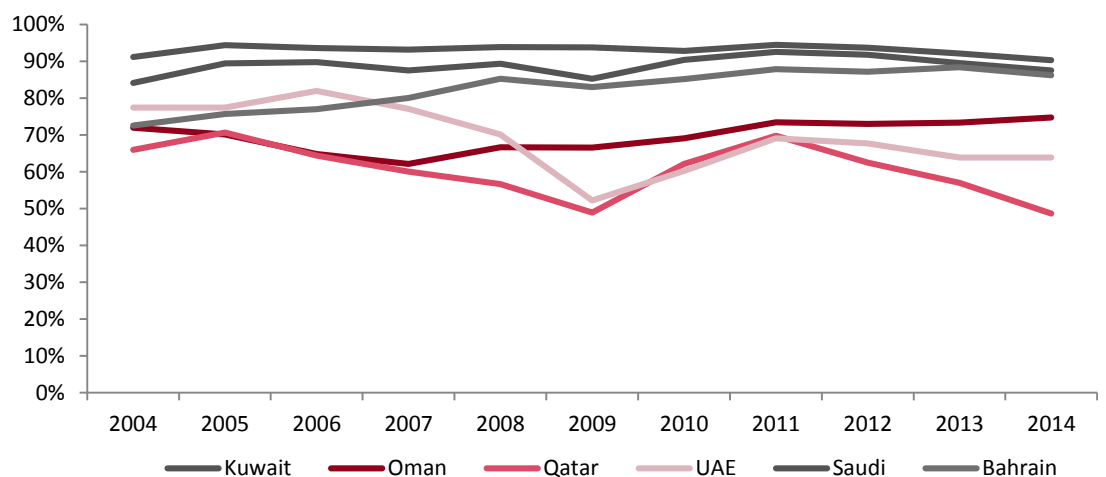
national development plan. New project awards for the region as a whole look likely to be down by about 10% as compared to last year.

In reflection of the challenging environment facing infrastructure projects, the oil price-related volatility has tested sentiment in some of the regional real estate markets. Especially the UAE markets, which led regional price gains earlier, have seen some reversals. Dubai apartment prices declined by an annual 14.2% in October while villa prices fell 16.5%. As usual, premium properties have tended to outperform the rest of the market. In general, the market has shown tentative signs of stabilizing again since the summer. Rental prices have some upward momentum. In Qatar, real estate deals saw a decline by 24.4% YoY in October and stood at QAR3.4bn. In Kuwait, the first nine months of 2015 saw a 26% YoY drop in real estate sales. Total sales during the first three quarters of the year reached KD1bn.

Fiscal re-engineering gathers momentum

The drawn-out period of oil price weakness since late last year has underscored a key limitation of the GCC diversification story. Even in cases, where indicators such as the GDP composition or non-oil exports have improved, the regional fiscal systems have remained heavily dependent on hydrocarbons-related revenues. In most regional economies, the recent years of high output levels and prices have actually increased the dependency of the fiscal systems on oil.

Hydrocarbons-related revenues as a proportion of total government income, 2004-2014



Source: International Monetary Fund, national agencies

The new oil price environment has prompted governments across the region to redouble their efforts to remodel their fiscal regime in ways that will reduce their vulnerability to oil price variations. While the GCC economies are in a position to draw down reserves and raise money in the capital markets, the need to put government spending on a more sustainable footing is widely recognized and the oil price dynamics have strengthened the political will to act.

The IIF expects the GCC to face a fiscal deficit of 10% this year as oil prices have dropped below USD50. This marks a sharp reversal from the 4% fiscal surplus registered in 2014. Kuwait and Qatar are now expected to be the only Gulf states to post surpluses this year at 7% and 1.5% of GDP,

Fiscal reform is increasingly recognized as a key government priority in the years ahead

respectively. Even these figures stand in marked contrast to a 21% surplus in Kuwait and 16% in Qatar in the preceding year.

In a sign of the region-wide paradigm shift, the 2016 Saudi budget, announced in late December, included several important steps to contain expenditure growth and diversify revenues. Having posted a deficit of SAR367bn (USD97.9bn) in 2015, equivalent to approximately 15% of GDP, the Government intends to reduce the shortfall to SAR326.2bn. Saudi Arabia's public debt is estimated to have risen from SAR44.3bn in 2014 to SAR142bn in 2015 but remains low by global standards at 5.8% of GDP. Saudi Government revenues in 2016 are projected at SAR513.8bn, down from SAR608bn in 2015 (SAR715bn budgeted). Non-oil revenues actually rose by 29% to SAR163.5bn, a quarter of the total. The Government is planning gradual revisions to energy, water and electricity prices "over a five-year period." The projected spending of SAR840bn is down from the SAR975bn total seen in 2015 (SAR860bn budgeted) and even more from the 2014 total of SAR1,140bn total seen in 2014. A SAR138bn buffer is included in the budget to provide for flexibility in fiscal management.

Similar steps are being considered across the region with particularly important steps with respect to subsidy reform as well as broader expenditure cuts. Oman lifted all subsidies on industrial gas use this year. The UAE has cut general government spending by 16.4% YoY in Q1 and 10.2% in Q2. Subsidies on water, electricity, and energy are being gradually withdrawn and for instance the prices of petroleum products have been linked to international market conditions. Total spending on subsidies fell by more than 90% in 1H15, according to the consolidated budget. Kuwait is reportedly hoping to save KWD500mn a year by increasing the cost of transportation fuels. The plan is to compensate lower and middle-income nationals for the impact of such a move.

At the same time, in order to reduce their reliance on hydrocarbons-related revenues, regional governments are seeking alternative income sources. There is a GCC-wide plan to introduce a value-added tax. Saudi Arabia recently announced that it would be imposing an annual 2.5% fee on undeveloped urban land designated for residential or commercial use. Kuwait is reportedly considering the introduction of a business profit tax in its upcoming budget. Dubai expects its planned 12% increase in Government spending, envisaged under the AED46.1bn (USD12.6bn) budget for 2016, to be entirely covered by a commensurate increase in revenues. Several governments are eyeing privatisations.

Oil production

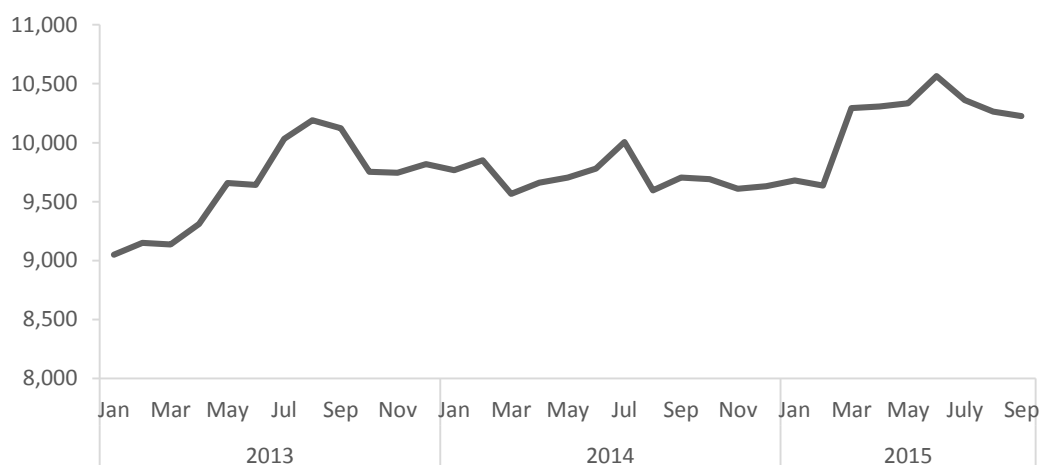
In spite of lower oil prices, the regional economies have continued to produce at historically high levels in line with OPEC's strategy of defending its market share. Saudi Arabia, the largest GCC producer, accounts for some 8.1% of global crude exports and has maintained its production above 10 mbd since March. Saudi Arabia, along with Iraq, saw the largest YoY increases in OPEC supply in Q3 of this year. In reflection with its increased focus on the Asian market, the Kingdom was the main supplier to Japan in September, accounting for 34% of the country's total crude exports. It was the second largest supplier to China with a 14% share.

The IMF expects GCC total oil production to reach 18 mpd in 2015 and 2016, respectively. September YoY oil production growth varied across the region. Oman and Saudi Arabia registered

Regional oil output levels have remained historically high and little near-term change is expected in this regard

positive growth at 3% and 5% respectively, while Qatar and the UAE showed a decline by 4% and 2% during the same period.

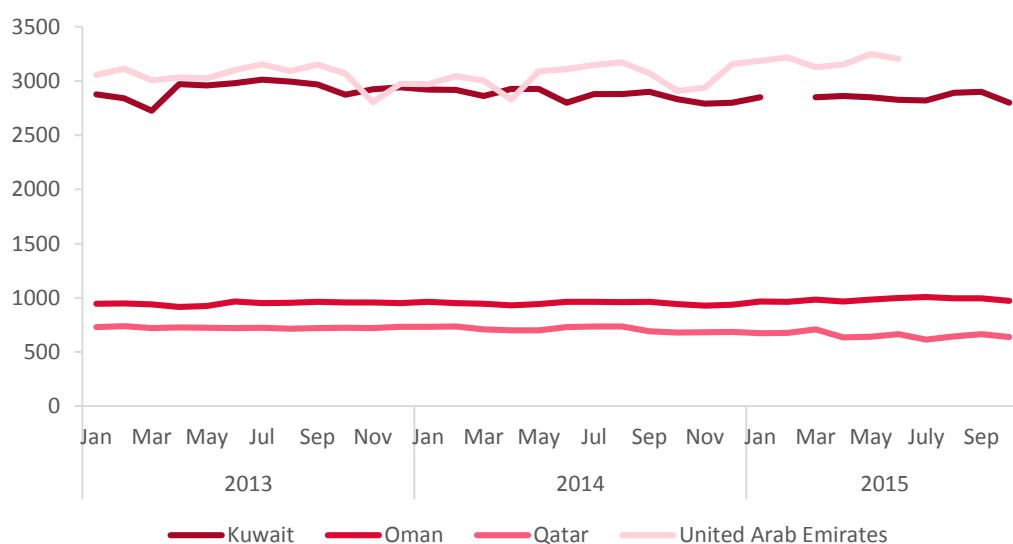
Monthly oil production by Saudi Arabia ('000 b/d)



Source: Joint Organisations Data Initiative

While the development of the regional upstream sector is underpinned by the market share-driven strategy, it also reflects rapidly growing domestic demand. Due to air conditioning needs in the summer as well as increased refinery capacity, Saudi refinery intake increased by 9% in Q3, and total crude consumption averaged at 3.1 mbd. In September, overall oil demand increased by 8% YoY due to the growth in transportation fuels.

Crude oil production in GCC countries, '000 b/d



Source: Joint Organisations Data Initiative

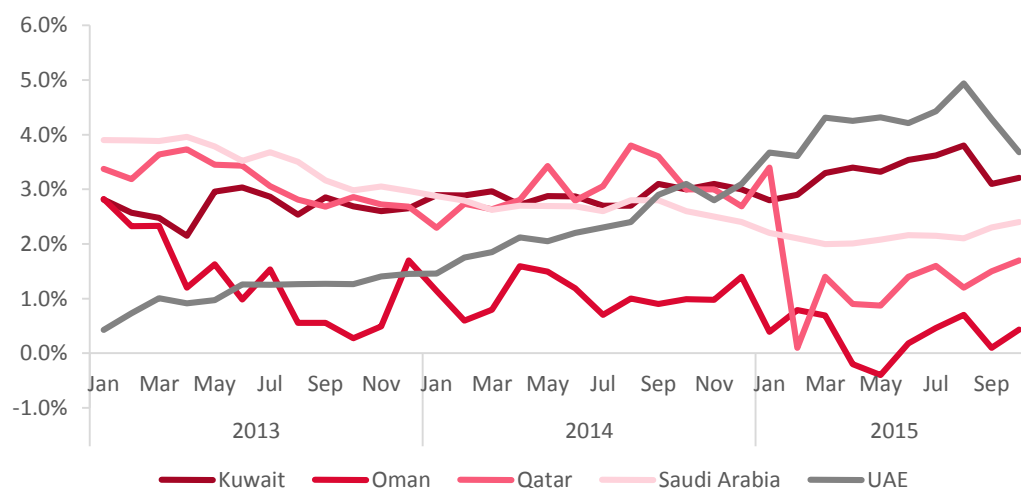
Inflationary pressures diverging again

Consumer price inflation across the region has remained relatively stable throughout the year and import price pressures have been very subdued due to the strength of the US Dollar. In spite of this, there has tended to be some build-up in price pressures during the summer, albeit with fairly significant intra-regional variation.

Inflationary pressures across the region remain moderate, although a clear divergence can be observed among the GCC economies

The UAE ended the third quarter with the highest inflation rate in the region at 4.3% followed by Kuwait at 3.1%. Consumer prices in Saudi increased by 2.3% in September and by 2.4% in October to record its highest level this year so far. Inflation in the Kingdom was largely driven by education which grew by 5.4%. Similarly, education was the fastest growing category in Qatar in October, rising by 18%. Oman had the lowest inflation rate in September at 0.1%, although this rebounded to 0.4% in October.

Consumer price inflation, %



Source: National statistical agencies

Credit growth holding up across the region

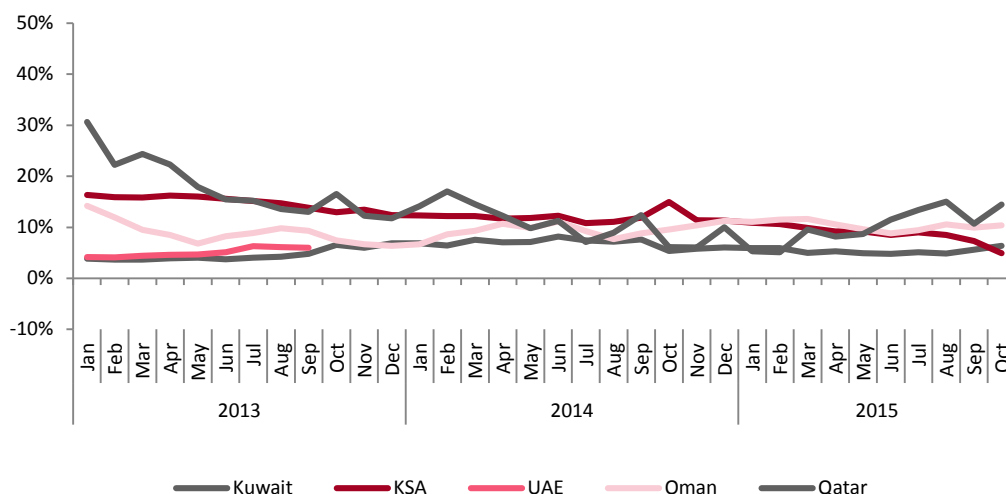
A period of low oil prices has historically tended to entail tighter liquidity conditions in the GCC and there are some tentative indications of this happening in parts of the region, typically countries with high loan-to-deposit ratios. Overall, the IMF expects growth in bank credit to the private sector for the region as a whole to slow down from an annual 12% in 2014 to 8% in 2015 and 2016, respectively. The US Dollar pegs of the Gulf currencies will serve as another restraint on bank lending as the cost of borrowing will have to edge up in response to the US interest rate stance.

In practice, the situation with respect to bank lending varies across the region. Qatar has continued to see the fastest pace of total credit growth as of the end of Q3: an 11% YoY gain driven by a 23% increase in private sector credit as investments in the run-up to 2022 FIFA World Cup continue to drive the demand for loans. Total bank credit in Oman rose by 10%, which in fact marked a slight acceleration from the 9% YoY pace registered at the end of Q2. Credit growth in Saudi Arabia, by contrast, slowed down to 7% from a pace of 9% in Q2.

Bank lending is holding up generally well in spite of worries about tighter liquidity

Loan growth in the UAE has continued to hold up well in spite of some volatility and slower deposit growth (1.6% YoY in October). Loan growth attained 7.7% YoY in October, which led the gross loan-to-deposit ratio at 103.2%.

Bank credit growth, %



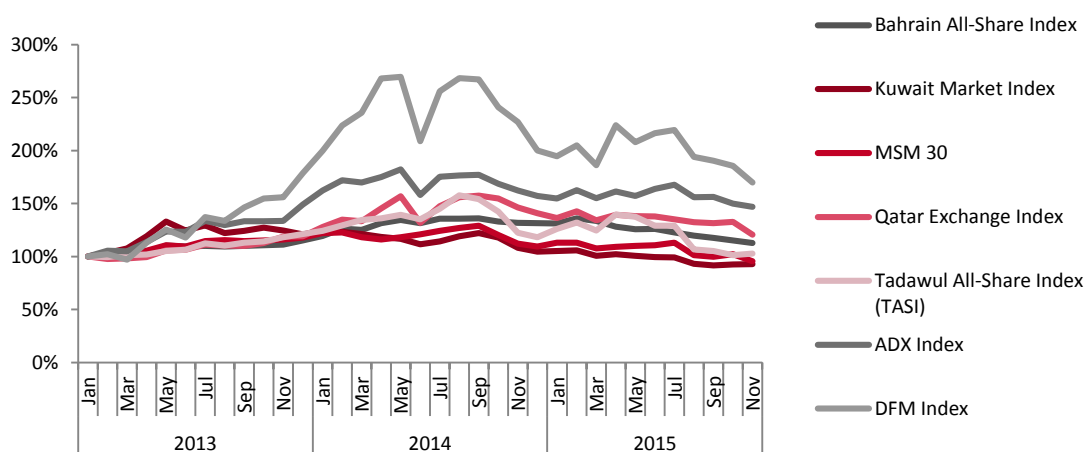
Source: Regional central banks

Stock markets remain under pressure

Region stock markets have been hit by depressed oil prices and new issuance activity has been minimal

The decline in oil prices has kept the GCC equity markets under recurrent downward pressure and left all regional benchmark indices in the red during year to date. Prices have generally mirrored oil price dynamics fairly closely. Saudi Arabia led the declines with a 17.1% correction, followed by a 16.5% drop in Dubai. The Qatari market has fallen by 15.1%. The Oman market has shed 14.8%, followed by a 14.1% drop in Kuwait and a 4.9% correction in Abu Dhabi.

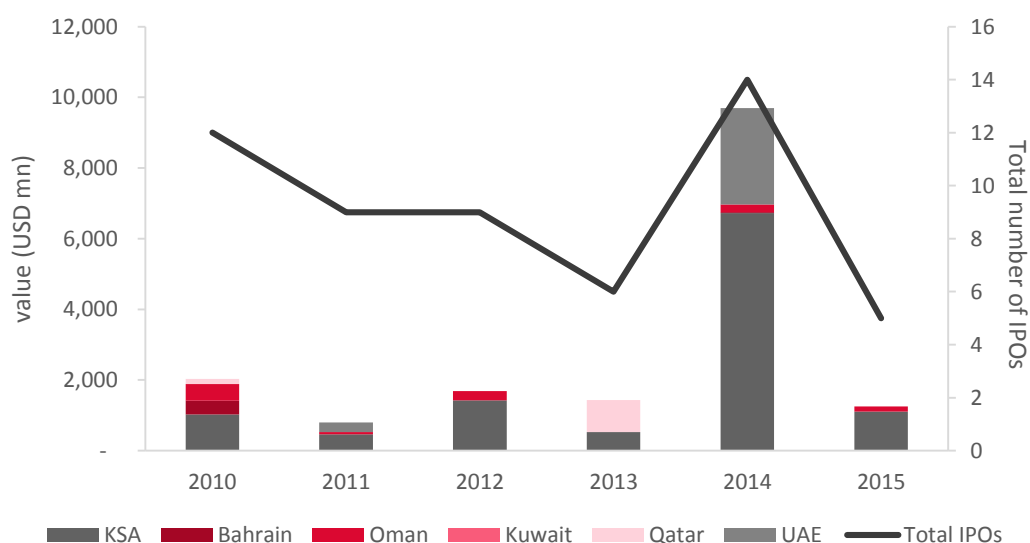
GCC equity market indices (January 2013 = 100)



Source: Regional stock exchanges

This environment of volatility and elevated risk aversion has deterred listing activity. Only one IPO took place during the final quarter of the year, that of Saudi Arabia's Al Andalus Real Estate Company which floated 21mn shares – 30% of its capital – for SAR378mn. Overall IPO activity in the GCC this year was confined to four Saudi offerings and one Omani IPO which fetched a total of USD1.25bn. By contrast, 2014 witnessed 14 IPOs on regional exchanges which raised USD9.7bn. By contrast, some secondary rights issues by listed companies have taken place, most recently by Takaful Emarat which successfully placed an AED68.25mn offering in December.

GCC IPO activity



Source: Zawya

Sovereigns come to the fore in the regional fixed income markets

The period of lower oil prices, along with recurrent bouts of speculation regarding monetary tightening in the US, has created a challenging backdrop for the regional bond and sukuk markets. At the same time, however, primary activity has received a substantial boost from the increased funding needs of the regional sovereigns. The turnaround has been particularly pronounced in Saudi Arabia, which this year began issuing bonds for the first time since 2007. Total fixed income issuance by the Government has reached SAR98bn this year.

Q4 has seen a total of 18 outstanding conventional bond issuances worth just over USD21bn. Sovereign issuance dominated the scene with a total of 13 issuances. Saudi Arabia placed USD16bn of 5- and 10-year paper. Qatar made a total of four fixed income issues this quarter.

Seven conventional corporate bonds issues reached the market in Q4. The issuers included National Bank of Kuwait, National Bank of Oman, International Bank of Qatar, National Bank of Abu Dhabi, and Commercial Bank of Dubai. The largest single offering was a USD500mn five-year note issued by the International Bank of Qatar. Total corporate issuance reached USD1.8bn highlighting the dominance of sovereigns which made up around 90% of total conventional bond issuance during the quarter. Total conventional bond issuance in the GCC reached USD57.9bn

Sovereign issuance has continued to dominate the regional fixed income markets, especially in the conventional space

during 2015. This was up by 141% on the corresponding total of USD24bn in 2014 and further underscores the transformative impact of sovereign issuance on the market this year.

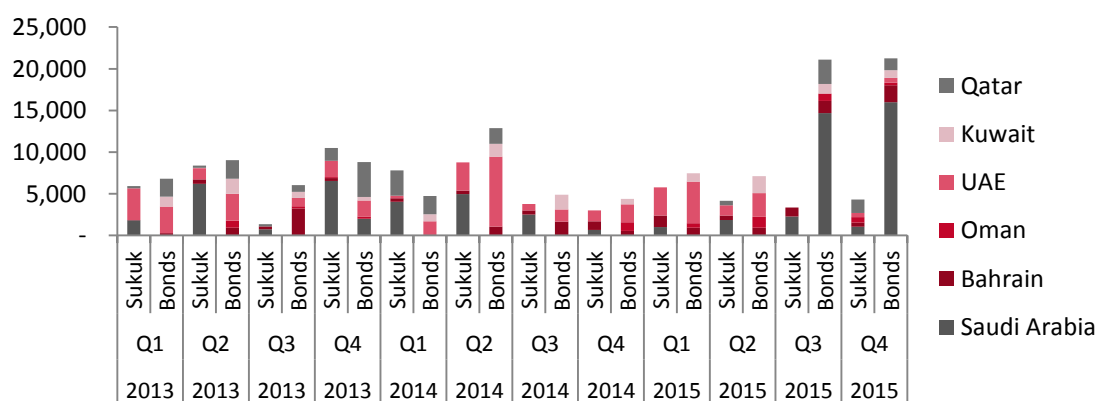
In the sukuk market, the Kuwait Capital Market Authority released rules covering the issuance of sukuk to facilitate their sale by both the Government and by corporate names. The set of rules outline conditions that sukuk have to meet in order to be traded, as well as describing their specific formats. The issuances of sukuk must be approved by the Capital Market Authority and the Central Bank.

In total the region saw 16 primary sukuk issues during Q4. Their aggregate value reached just over USD4.3bn. Unlike the conventional space, sovereign issuance was eclipsed by corporate offerings, albeit far less decisively. There were a total of 10 sovereign issues by the governments of Bahrain, Qatar, and Oman. Oman's first-ever sovereign sukuk in October raised OMR250mn (USD649.4mn). It has a tenor of five years and pays a rental rate of 3.5%. The offering was 1.7 times oversubscribed.

Corporate sukuk offerings numbered six. The largest issuers were Qatar Islamic Bank (USD750mn), Arab National Bank (USD533.3mn), APICORP (USD500mn), and Majid al Futtain Group (USD500mn). In addition, Saudi Arabia's National Commercial Bank in late December announced the completion of a subordinated Additional Tier 1 Capital Sukuk worth SAR2.7bn (USD719.5mn) through private placement.

Overall GCC sukuk issuance in 2015 reached USD18bn, down 22.7% on USD23.3bn in 2014.

GCC bond and sukuk issuance, USD mn



Source: Zawya

Implications for Bahrain

The performance of the GCC economies has been characterized by a high degree of continuity in the closing months of the year. Fiscal consolidation efforts notwithstanding, forward-looking indicators of economic activity point to continued expansion. This provides a favourable backdrop for Bahrain's highly regionally integrated economy:

- ▶ Regional visitor flows are likely to remain robust, supporting the hospitality and retail sector
- ▶ Investor interest in new real estate and infrastructure projects looks likely to continue, especially as regional investors see relative value in the Bahraini market

BAHRAIN

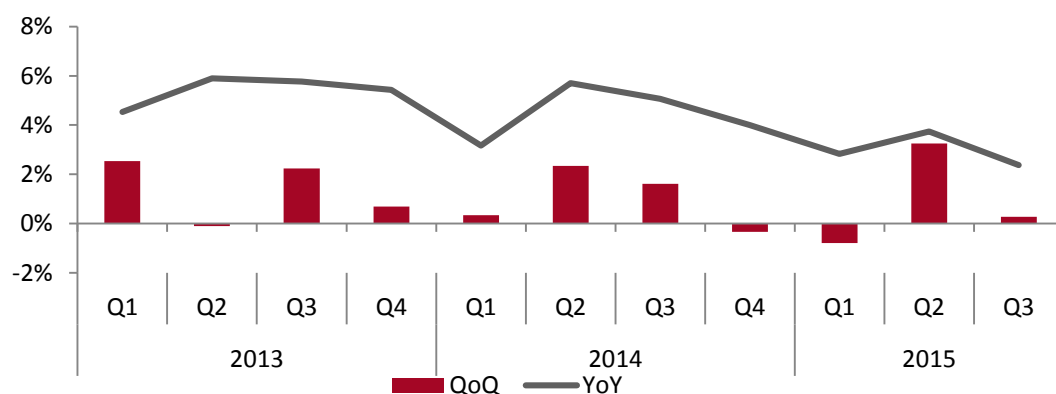
PROJECT IMPLEMENTATION MOVES TO THE FORE

Economic growth decelerated in Q3, primarily due to continued contraction in the oil sector

Economic growth in Bahrain has held up in line with regional trends in spite of the exceptionally uncertain global backdrop. Nonetheless, the lengthy period of low oil prices, especially in the second half of the year, has tested investor sentiment and is likely to account for some of the loss of momentum in terms of non-oil growth that became evident in the third quarter of 2015. Annual headline real GDP growth decelerated fairly markedly to 2.4% from the 3.7% YoY pace seen in Q2. QoQ growth increased by a mere 0.3%, a considerable deceleration from the 3.3% rate seen in Q2. The non-oil economy expanded by an annual 3.3% in Q3, down from 4.4% in Q2. The oil sector contracted by an annual 1% in a reversal of 1.4% growth in Q2.

In spite of the evident slowdown in Q3, the growth dynamics of the economy have remained quite resilient. Overall, Bahrain's real GDP grew by an annual 3% during the first three quarters of 2015. The non-oil economy expanded by a healthy 4.2% and the headline rates were primarily held back by the oil sector failing to match its stronger-than-expected performance during the first three quarters of last year. The oil sector contracted by an annual 1.7% in Q1-3.

Real GDP growth



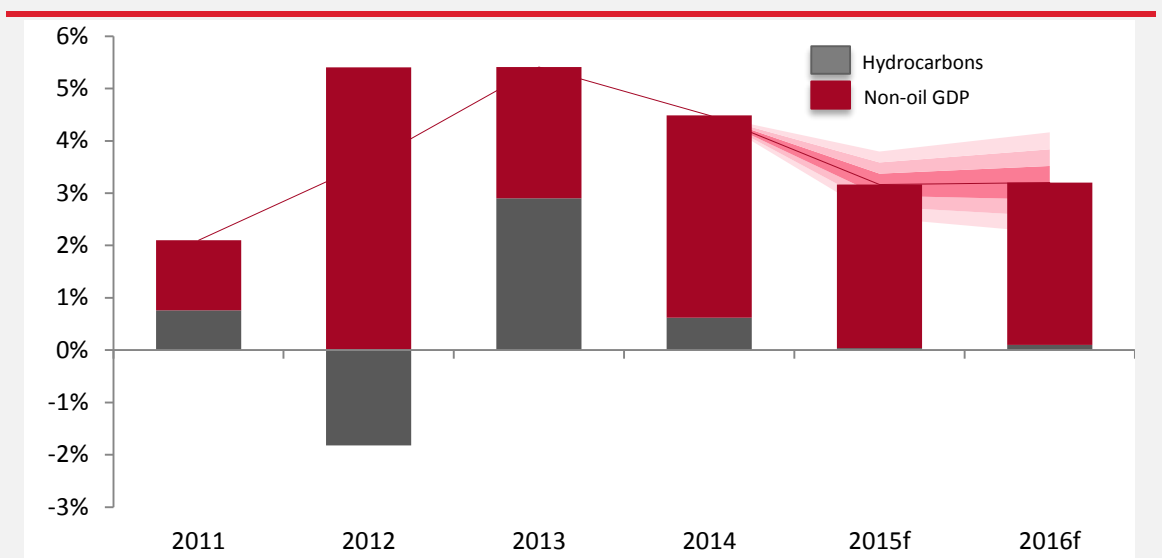
Source: Central Informatics Organisation

Forecasts: Non-oil sector-driven growth

	2014	2015f	2016f	2017f
Real GDP growth, %	4.5%	3.2%	3.2%	3.0%
Non-hydrocarbons sector	4.9%	3.8%	3.9%	3.6%
Hydrocarbons sector	3.0%	0.5%	0.5%	0.5%
Nominal GDP growth, %	2.9%	-6.9%	8.4%	5.3%
Inflation (CPI %)	2.8%	2.1%	2.5%	2.5%
Current account (% of GDP)	3.3%	-4.9%	-2.6%	-2.5%
Fiscal balance (% of GDP)	-3.6%	-10.0%	-6.4%	-6.1%
Crude Oil Arabian Medium (USD)	96.0	50.0	60.0	60.0

Source: Bahrain Economic Development Board

Projected real GDP growth contribution



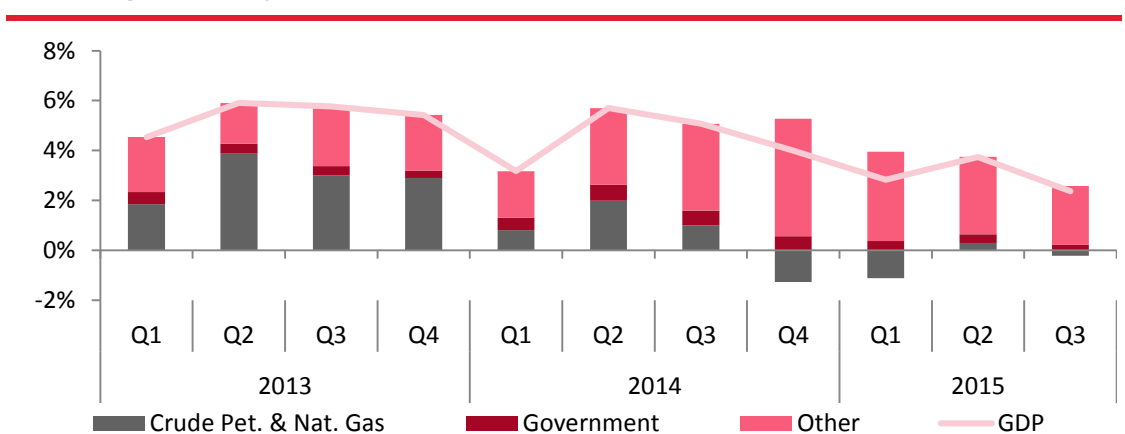
Source: Central Informatics Organisation, Economic Development Board

The slowdown in growth during Q3 has prompted us to revise down our growth projection for 2015 as a whole. While we expect both oil and non-oil growth to rebound somewhat in Q3, headline real GDP growth now looks like to fall fairly clearly short of 3.5%. Our current projection for overall growth is 3.2%.

Non-oil growth drivers remain firm

Largely in line with the pattern seen during the past three years, economic growth in Bahrain remains firmly fueled by the non-oil private sector. In Q3, it contributed 2.4 percentage points of headline growth, down slightly from 3.1% in Q2. Government services accounted for only 0.2 percentage points of overall growth, a figure that was in keeping with several past quarters but nonetheless the smallest absolute contribution made by the government in several years. The proportions contributed by the oil sector stood at a -0.2%, making this a second quarter of negative oil sector growth this year.

Real GDP growth composition



Source: Central Informatics Organisation

Growth in the non-oil economy has remained broad-based and especially Hotels & Restaurants as well as Social & Personal Services continue to post strong figures

Continuing the pattern established during the first half of the year, growth in the non-oil economy was fairly broad-based. After a slight deceleration in Q2, the Hotels and Restaurants sector picked up momentum once again and expanded by an annual 8.4%, making it the fastest growing sector in Q3. Reflecting the strong and sustained momentum of the sector, its annual growth rate over the first three quarters of this year taken together was a robust 8%. The second fastest growing sector in Q3 was the Social and Personal Services sector (primarily private education and private health care) which expanded by 6.3% YoY. This continued an established pattern of clearly above-average growth in the sector which has been among the most dynamic components of the non-oil economy for several years. Manufacturing, Construction, and Transportation & Communications posted robust growth in spite of a slight deceleration in Q3. They expanded by an annual 3.3%, 4.9%, and 5.8%, respectively. Financial services grew by 2.1%, much in line with Q2.

YoY real growth of key sectors, 2014-2015

YoY growth	Annual	2014				2015		
		Q1	Q2	Q3	Q4	Q1	Q2	Q3
Crude Pet. & Nat. Gas	3.0%	4.1%	9.9%	4.7%	-5.9%	-5.6%	1.4%	-1.0%
Manufacturing	3.8%	0.4%	3.8%	3.5%	7.4%	5.9%	4.1%	3.3%
Construction	7.1%	1.2%	3.4%	12.1%	12.3%	7.7%	6.4%	4.9%
Trade	4.0%	3.9%	3.1%	4.4%	4.4%	2.7%	2.8%	0.2%
Hotel & Rest.	4.1%	1.1%	5.5%	2.7%	7.1%	9.4%	5.7%	8.4%
Trans. & Comm.	6.5%	5.3%	6.9%	4.4%	9.7%	6.9%	6.7%	5.8%
Social & Pers. Serv.	7.7%	7.4%	8.2%	6.7%	8.7%	7.6%	6.2%	6.3%
Real Est. & Bus. Act.	4.0%	3.7%	3.8%	3.9%	4.6%	3.8%	3.7%	1.7%
Finance	3.6%	2.2%	4.1%	3.8%	4.3%	1.6%	2.1%	2.1%
Government	4.5%	3.9%	4.9%	4.6%	4.4%	2.8%	2.8%	1.7%
Other	7.6%	4.7%	4.8%	10.7%	10.2%	11.6%	11.4%	4.3%
GDP	4.5%	3.2%	5.7%	5.1%	4.0%	2.8%	3.7%	2.4%

Source: Central Informatics Organisation

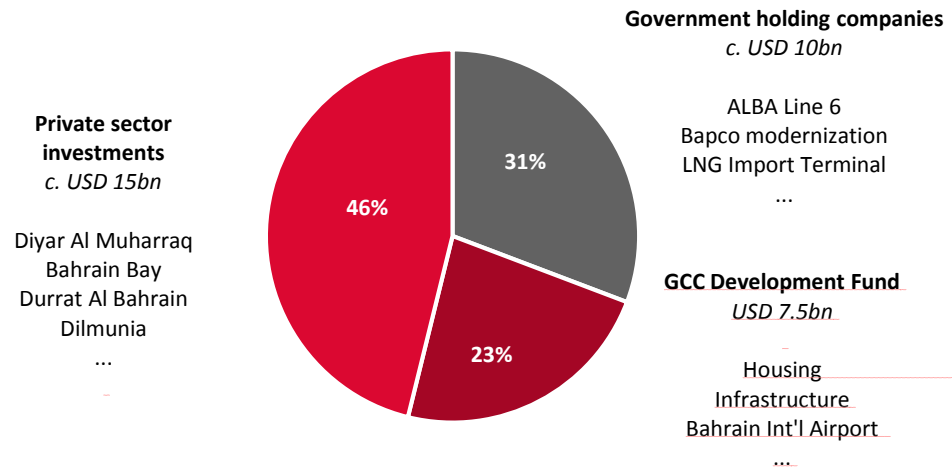
Project implementation underpins non-oil dynamics

Despite a slight slowdown recorded by the Construction and Real Estate & Business Activities sectors in Q3, a large pipeline of projects provides a robust underpinning for near- to medium-term growth in the Kingdom. The overall pipeline of projects in the Kingdom is estimated by MEED Projects at USD72.3bn as of mid-December, a figure that represents at 17.2% YoY increase.

The pipeline of strategically significant infrastructure projects undertaken by the GCC Development fund, government holding companies, and the private is currently estimated at some USD32bn.

A sizeable pipeline of infrastructure projects provides a strong underpinning for non-oil growth in the near to medium-term

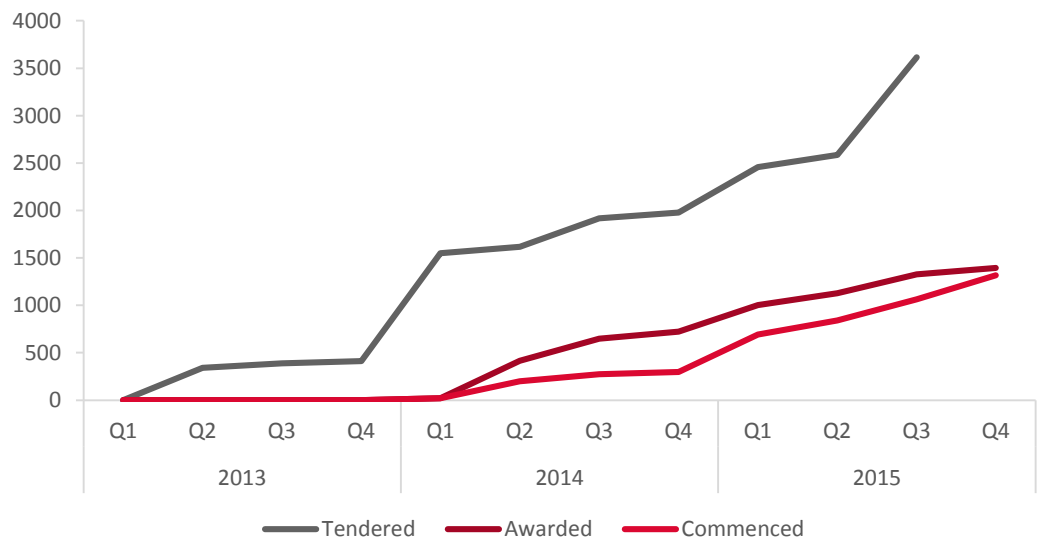
Composition of strategically significant key infrastructure projects by investor type



Source: Government sources, Economic Development Board estimates

The GCC Development Fund projects have especially seen a pronounced pick-up in implementation in the closing months of 2015. The total value of projects awarded by the end of 2015 reached some USD1.6bn, effectively doubling since late 2014. There has been a particularly sharp increase in project tenders, from a cumulative total of just under USD2bn as of late 2014 to more than USD3.7bn as of 4Q15. To date, work has commenced on just over USD1.3bn worth of projects. The significant difference between tendered and commenced projects suggest that GCC Fund spending is likely to have a substantial impact on the construction section in 2016 and beyond.

GCC Development Fund overview, USD mn (cumulative totals)

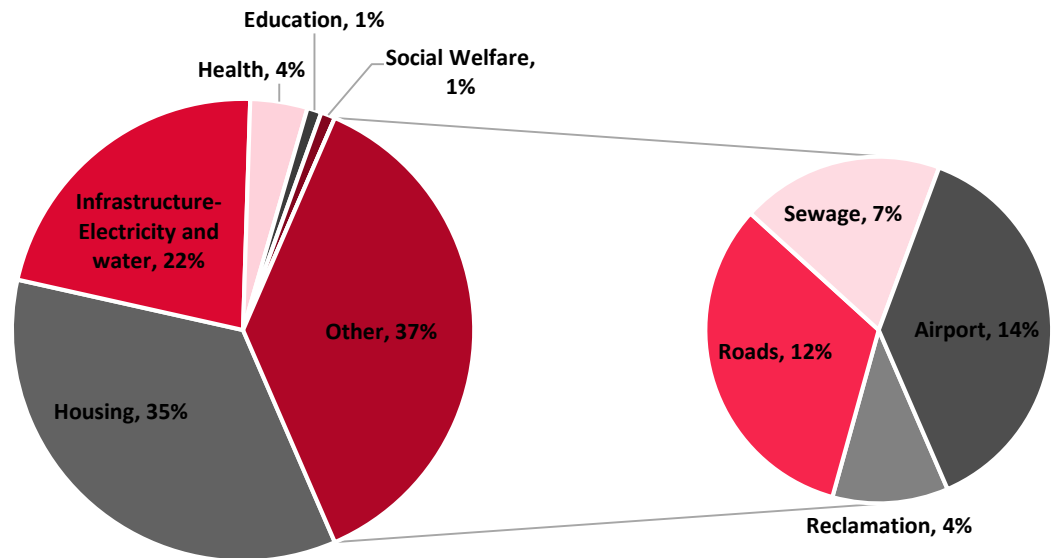


Source: Government sources

The GCC Development Fund spending is very heavily focused on housing and infrastructure projects. Of the approximately USD6bn worth of developments allocated to date, housing

accounts for 35%, electricity and water projects for 22%, the airport expansion for 14%, and roads for 12%.

Allocation of GCC Development Fund investments by sector (projects allocated to date)



Source: Government sources

But the overall project pipeline is diverse with several important private sector and government holding company-funded projects making headway. In the hydrocarbons sector, the National Oil and Gas Authority (NOGA) and nogaholding, the government holding company for hydrocarbons assets, signed an agreement in early December for a liquefied natural gas import and regasification terminal. The project includes a floating storage unit, and offshore LNG receiving jetty and breakwater, as well as an onshore gas receiving facility. The work will be undertaken by a joint venture of nogaholding (30%), Teekay LNG (US, 30%), Samsung C&T (Korea, 20%) and Gulf Investment Corporation (Kuwait, 20%). The project is expected to cost around BHD250mn and is designed to increase flexibility in terms of available energy options and ensure security of supply for Bahrain's natural gas needs. The project will have an initial capacity of 400mn standard cubic feet per day (mmscfd) (expandable to 800 mmscfd) and will be owned and operated under a 20-year agreement commencing on 15 July 2018.

The retail sector continues to display a strong positive momentum with several important developments:

- ▶ Diyar Al Muharraq with Chinamex Middle East Investment & Trade Company opened the Dragon City mall at the end of December. With its nearly 800 shops, the facility is expected to accommodate some 500 Chinese and 90 Bahraini companies
- ▶ Dadabhai Group's MD Holding Company's Galleria mall is beginning operations by the beginning of 2016
- ▶ First Bahrain recently announced the launch of construction of the Al Mercado mall

Apart from a BOT deal for the new LNG terminal, significant investments are underway in the retail and real estate sectors

in Janabiya and the project is expected to be completed in 2016

Work is progressing on several private sector real estate developments. Diyar al Muharraq has entered into a joint venture with Abu Dhabi's Eagle Hills to build a development called Marassi al Bahrain in the north of the island. A new development called Al Bareh Seafront Plots was announced for the western coast of Diyar. Naseej, one of Bahrain's leading real estate development companies, has announced the signing of an agreement with Ithmaar Development Company to acquire a plot of land in Dilmunia to develop its latest project "Canal View." The project is valued at BHD24mn.

Eskan Bank, the Government's housing bank, intends to announce design tenders for the Bander Al Seef residential project in early 2016 with construction tenders due to be released in September. Construction is due to commence by the end of 2016 and is expected to be completed within two years. The mixed-used development will be built on reclaimed land in Muharraq and will supply 2,600 housing units. Bander al Seef is part of Eskan Bank's strategy to develop social and affordable housing in partnership with the private sector.

Oil production still somewhat short of last year's levels

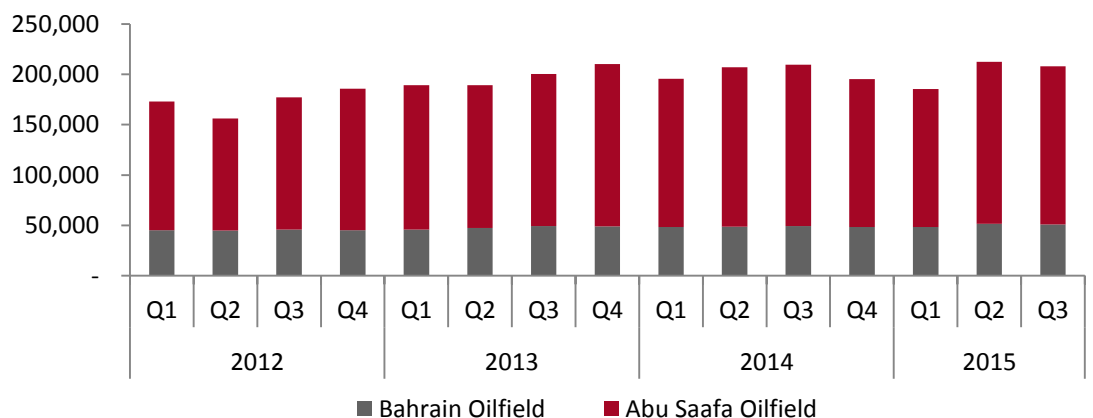
Since the seasonal maintenance-related activities in the first quarter of the year, oil production from the offshore Abu Sa'afah field has rebounded with average output of 156,738 b/d in Q3. This was slightly short of the Q2 peak of 160,840 b/d. The average output of Abu Sa'afah during Q1-3 was 151,578, which marked a 2.8% drop vis-à-vis the corresponding period of 2014.

The onshore Bahrain field has continued to see gradual output gains. Following a 4% YoY increase in output, total extraction reached 51,002 b/d in Q3. The Bahrain Field average output in Q1-3 was 50,235 b/d, up 2.6% on the corresponding period of 2014.

Overall, Bahrain's aggregate oil production for the first nine months of the year reached 55mn barrels, which translates into a daily average of 202,000 barrels. The Q3 output levels were ahead of this average at 207,740 b/d but nonetheless 1% below the output levels reached in 3Q14.

Natural gas output in Q1-3 rose by an annual 3.9% to 2,100 mn cu ft.

Crude oil production, b/d



Source: National Oil and Gas Authority

In spite of strong output levels, seasonal factors have kept oil production slightly below last year's level

Fiscal re-engineering makes headway

In line with developments in the other GCC economies, Bahrain is pursuing a multi-pronged strategy of rationalizing government expenditure and diversifying revenues. Significant steps have taken place in recent months.

Subsidy reform. Following the adoption of a new natural gas pricing policy in the spring, meat became the next category of subsidies to be overhauled. Total Government spending on universal meat subsidies reached BHD46mn in 2014, which marked a 360% increase from around BHD10mn in 2007. All subsidies on meat were removed as of October, although Bahraini households are compensated for the price increase through a monthly meat allowance. The Cabinet in late December agreed to implement new prices for diesel, kerosene, and aviation fuel as of the beginning of 2016. Exemptions were provided for bakeries and fishermen

Efficiency of government. The government is continuing with its long-standing efforts to streamline and increase the efficiency of public sector operation. Mergers of ten government entities were announced in early October. The objective of these steps is to increase productivity and efficiency of public entities. The laws included transferring responsibilities of the Supreme Council for Vocational Training to the Tamkeen labour fund, amalgamating the eGovernment Authority with the Central Informatics Organisation, merging the General Organisation for Youth and Sports with the Ministry of Youth and Sports, and incorporating the National Health Regulatory Authority into the Supreme Health Council.

The Government also formed six task forces to identify areas where government expenditure can be reduced. The areas range from building maintenance to travel expenses, medical expenses, property rentals, and IT and administration.

Cost recovery for government services. Several reforms are underway to recover costs for the various services provided by the Government. The Cabinet in October approved a law on reclaiming the cost of providing infrastructure for new developments. Rents and license fees are being reviewed.

In connection with the ongoing fiscal reforms, the Parliament recently approved a proposal to increase the Government's borrowing limit from BHD7bn to BHD10bn.

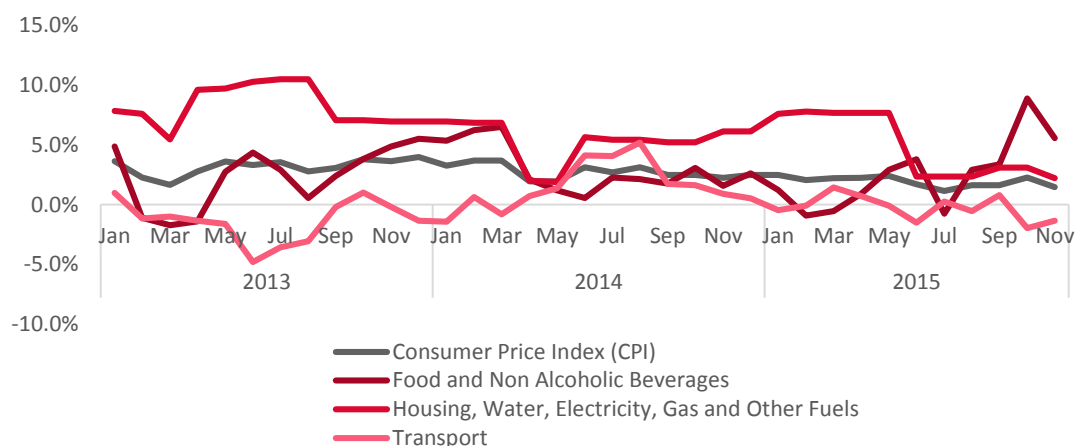
Price pressures moderate somewhat

Inflationary pressures in Bahrain have moderated slightly during the year and headline consumer price inflation reached a reading of 1.5%. This compared to 2.3% a year earlier and an average rate of just over 1.9% during the first eleven months of the year. While food prices have been a pick-up towards the end of the year, with a reading of 5.6% in November, most other components have remained subdued. In a clear reversal to norm from the acceleration last year, housing costs rose by an annual 2.2% in November. The only other sub-categories to see above-average inflation in November were education (2.4%) and recreation and culture (2.2%). Clothing and footwear prices fell by 3.5%. The transportation category fell by 1.4% and communications by 0.5%. Both areas have seen deflation in the second half of the year.

A range of measures have been taken to rationalize public sector operations in order to increase efficiency and reduce costs

Inflationary pressures have diminished somewhat in the second half of 2015

Consumer price inflation



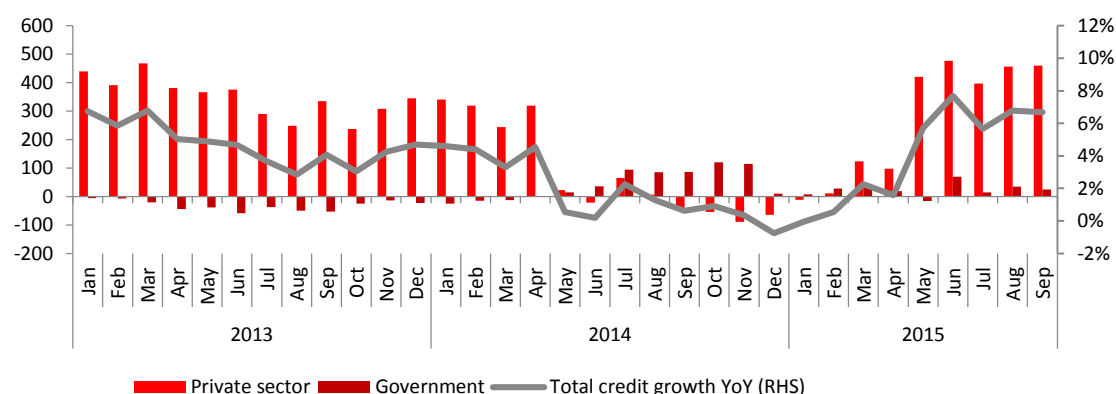
Source: Central Informatics Organisation

Credit growth remains brisk

In spite of region-wide worries about liquidity, bank credit in Bahrain has continued to grow at brisk pace. Total bank credit grew by an annual 7% as of the end of Q3.

Credit growth was fastest in the area of personal loans which rose by an annual 14% in September. Personal loans accounted for 43% of all bank lending as of September. Also lending to the government has in recent months increased somewhat faster than overall bank credit, although it remains a relatively small proportion of overall lending. As of the end of Q3, the annual pace of growth in bank lending to the Government was 9%. The business sector accounted for 53% of all bank loans as of the end of Q3.

Bank credit growth, BHD mn



Source: Central Bank of Bahrain

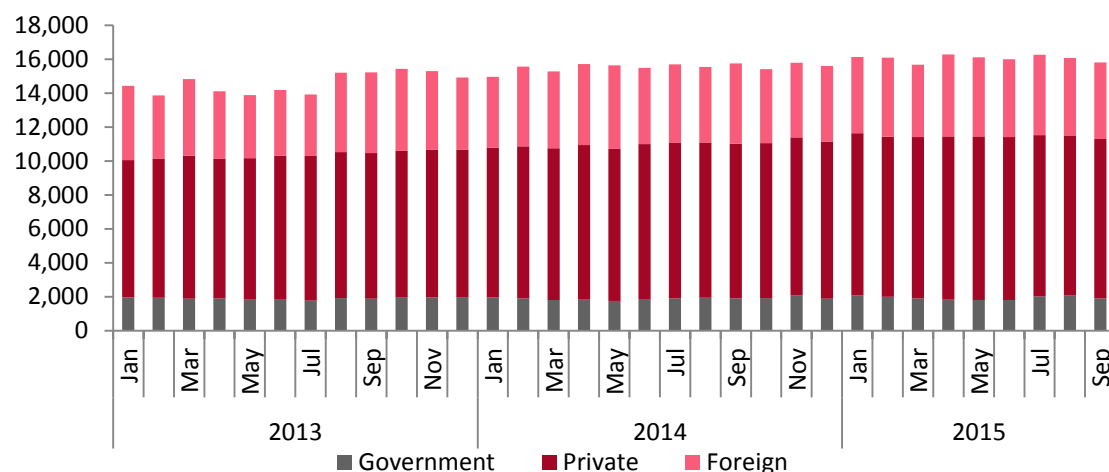
Bank deposit growth has moderated somewhat in recent months. Total deposit liabilities to non-banks dropped slightly below BHD16bn for the first time since March this year to reach BHD15.8bn in September. Private sector deposits, which represent the largest share of total deposits, grew by an annual 3% as of the end of Q3. Government deposits remained stable, while foreign deposits

Bank lending growth has remained brisk at 7% YoY as of September. Growth was fastest in the area of personal loans

Bank deposits growth has moderated somewhat but loan-to-deposit ratios remain regionally low

declined by 5%. Foreign deposits account for 29% of total deposits. The loan-to-deposit ratio in Bahrain reached 49% in September, the highest reading so far this year but reflective of continued strong liquidity in the Bahraini banking sector.

Deposit liabilities to non-banks, BHD mn

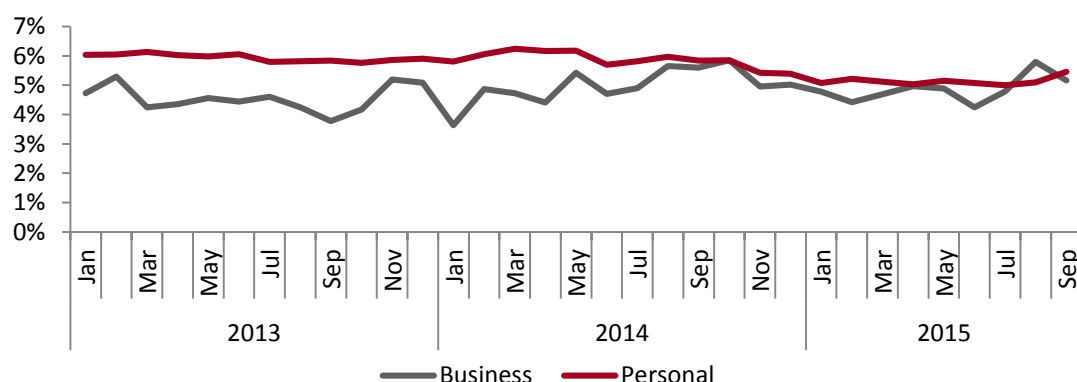


Source: Central Bank of Bahrain

Interest rates on both personal and business loans have remained generally stable this year. During the third quarter, interest rates on business peaked in August at 5.8% but slowed down to 5.2% in September. The average rate of interest on conventional personal loans stood at 5.5% in September, which was the highest rate recorded since October 2014.

The Central Bank of Bahrain followed the lead of the US Federal Reserve in mid-December and raised its overnight interest rate from 0.25% to 0.5%. The rate for the one-week deposit facility was raised from 0.5% to 0.75%. The repo and lending rates were kept at 2.25%.

Average rate of interest on credit facilities



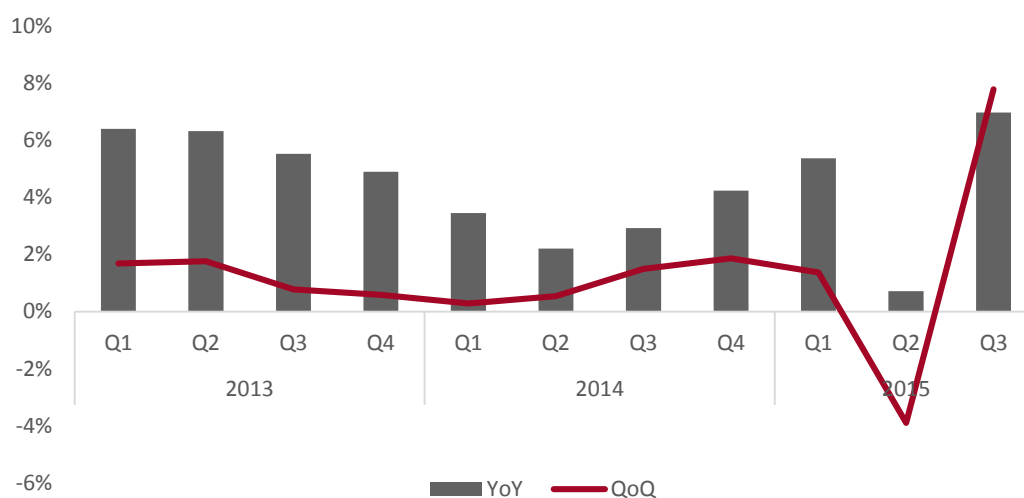
Source: Central Bank of Bahrain

Job creation reflects healthy non-oil growth

Job creation in the private sector has remained robust with open unemployment falling to its lowest level in several years

The growing pipeline of infrastructure projects along with generally favourable non-oil growth has provided a benign setting for job creation. Private sector employment has continued to increase at a healthy pace. The official labour market indicators for 2Q15 put total employment in the Kingdom at 710,296, which marked an annual increase of 6.5%. The average wages of Bahrainis increased by 3.5% in the private sector and 5.1% in the public sector.

Private sector employment growth (excl. domestic workers)

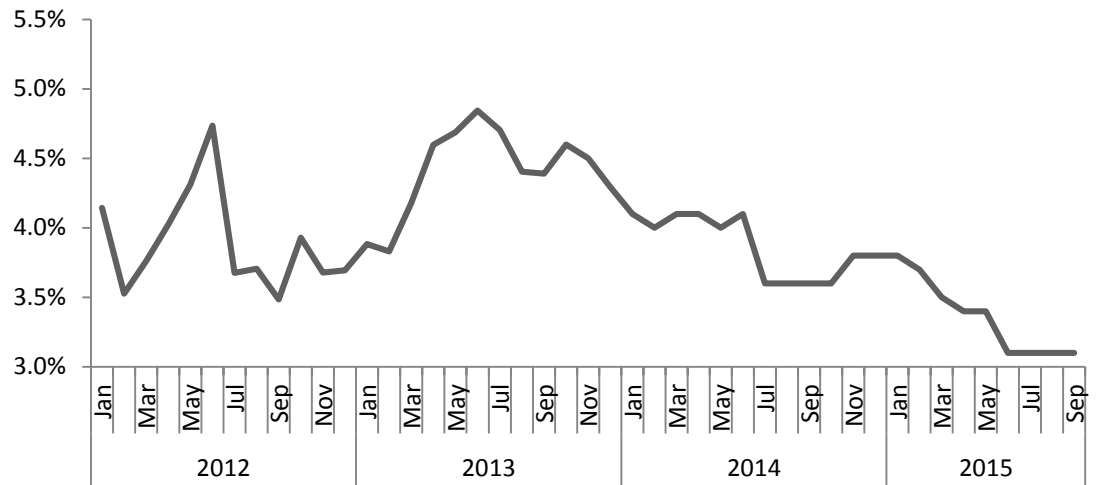


Source: Social Insurance Organisation

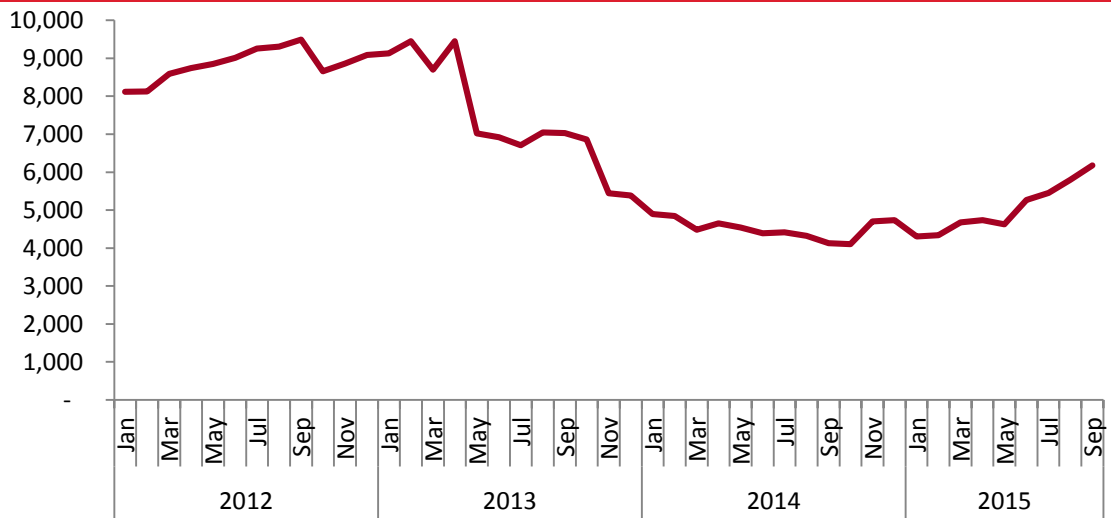
According to the Social Insurance Organisation, the total number of private sector jobs rose by an annual 7% YoY in Q3. Both Bahraini and non-Bahraini employment have increased. The number of employed Bahrainis rose by 4% to stand at 90,657. Expatriate employment saw a 7.5% YoY increase.

Consistent with the positive momentum in job creation, overall unemployment has declined to its lowest level in several years. The official unemployment rate held steady at 3.1% in Q3. There has been a sustained decline from 3.8% at the beginning of the year. The number of unemployment benefit claimants stood at 5,979 in September.

The number of vacancies in the Ministry of Labour's vacancy bank increased at the end of the third quarter by 17% QoQ -- from 5,269 in June to 6,174 in September. The share of vacancies available for both genders stood at 45%.

Unemployment rate, %

Source: Ministry of Labour

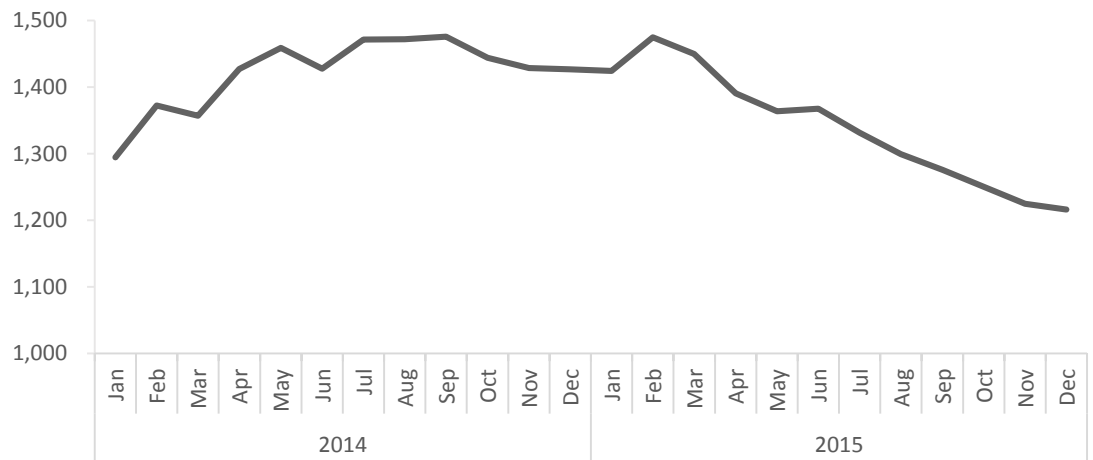
Total vacancy count

Source: Ministry of Labour

Capital markets mirror region-wide dynamics

In line with the oil-related downward pressure facing capital markets across the region, the Bahrain Bourse has seen fairly consistent declines since February this year. The Bahrain All Share Index closed at 1,215.89 by the end of 2015. Market capitalization contracted marginally at the end of December by 1.1% MoM to a total of BHD7.2bn. The value of shares traded declined by 43% to reach 6.7mn. Most of the trading took place in the Commercial Banks Sector which captured around 76% of total value of shares traded on Bahrain bourse.

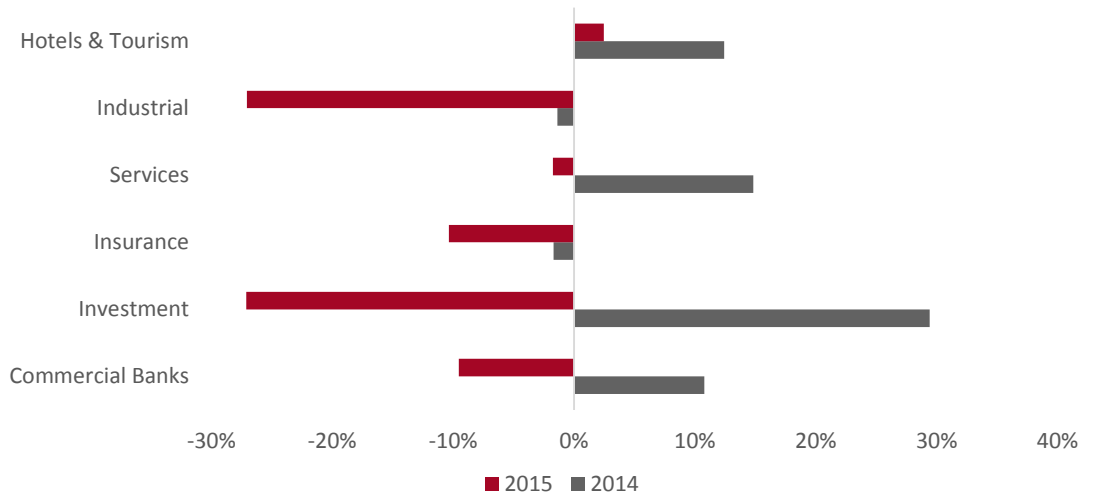
Bahrain All-Share Index



Source: Bahrain Bourse

In line with region-wide trends, the main index saw a 14.8% decline in 2015 with some retreats posted in most of the sector indices. As of end of year 2015, the Investment and Industrial Sectors Indices saw the biggest YTD drop by 27%, respectively. As for the Commercial banks and Insurance sectors, they both saw a decline of around 10%. The only sector to perform positively was Hotels and Tourism which saw a 3% increase YTD in December. The Bahrain Islamic Index, which brings together the stock for companies that operate in line with Shari'ah compliance, saw an increase in December from 806.3 to 818.3 points.

Sectoral stock market indices, December 2014 and 2015 change



Source: Bahrain Bourse

Activity in the fixed income market has been dominated by the regular issuances of treasury bills and sukuk by the Central Bank of Bahrain. The CBB issued 10 treasury bills in Q4 with a maturity of either 91 or 182 days. Average interest rates on these bills varied but have mostly seen a gradual rise since October to reach 1.75% in mid-December. In the Shari'ah-compliant space, Bahrain saw five issues of *sukuk al ijarah* or *sukuk al salam*. The typical profit rate was 1.6%.

Issue Date	Issue	Value, BHD mn	Maturity, days	Average interest/ profit rate, %	Average price, %	Over- subscription, %
23 Dec 2015	Sukuk Al Salam No. 176	43	91	1.75		100
16 Dec 2015	Treasury bill No. 1578	70	91	1.75	99.560	100
9 Dec 2015	Treasury bill No. 1577	70	91			
25 Nov 2015	Sukuk Al Salam No. 175	43	91	1.60		100
18 Nov 2015	Treasury bill No. 1574	70	91	1.63	99.589	133
15 Nov 2015	Treasury bill No. 1573	35	182	1.64	99.176	144
12 Nov 2015	Sukuk al ijarah No. 123	26	182	1.60		100
11 Nov 2015	Treasury bill No. 1572	70	91	1.54	99.613	106
Nov 2015	Treasury bill No. 1571	70	91			190
28 Oct 2015	Treasury bill No. 1570	70	91	1.58	99.601	100
21 Oct 2015	Sukuk Al Salam No. 174	43	91	1.48		100
15 Oct 2015	Sukuk al ijarah No. 122	26	182	1.60		100
14 Oct 2015	Treasury bill No. 1569	70	91	1.48	99.627	100
7 Oct 2015	Treasury bill No. 1568	70	91	1.47	99.630	100
4 Oct 2015	Treasury bill No. 1567	35	182	1.58	99.206	143

Source: Central Bank of Bahrain

The Government of Bahrain tapped the international debt markets in October with two issues under its USD2bn Euro-bond program. The first tranche, with a total value of USD700mn had a maturity of five years with a fixed coupon of 5.875%. The second, ten-year tranche, worth USD800mn, pays a coupon of 7%. The dual-tranche offering attracted an order book of approximately USD2.4bn. The issues were arranged by a consortium of ABC, BNP Paribas, Citigroup, HSBC, and JP Morgan. They are listed on the Irish Stock Exchange.

External assessments reflect key strengths

The 2016 edition of the *Doing Business* report of the World Bank and the International Finance Corporation, released in late October, ranks Bahrain second in the GCC and 65th globally out of 189 economies. This annual publication measures the efficiency and quality of business regulations and their enforcement. Bahrain's principal strengths are seen in the ease of obtaining construction permits, where Bahrain occupied the ninth position globally in this pillar, as well as in the process of paying taxes where the Kingdom is ranked eight. The ranking in the area of registering properties is 25th. Bahrain's ranking further benefited from the decision to widen the scope of the national credit bureau data on firms.

Important further steps have been taken in recent months to further enhance the business regulatory environment in Bahrain. Changes to the Commercial Companies Law have removed minimal capital requirements for a majority of businesses, including foreign companies. Moreover, investors are now able to receive their commercial registration before the issuance of the necessary licenses and approvals from relevant entities. Additionally, shelf companies are allowed on the condition of gaining necessary approvals from related entities.

The *Human Development Report*, published by the United Nations Development Programme, measures 188 economies in terms of long term progress in life expectancy, years of schooling, and national income per capita. Bahrain's score in the Human Development Index has improved from 0.815 in 2014 to 0.824 in the 2015 edition. The progress is attributed to the rise in gross national

income per capita to USD38,598.5 in 2015 from 32,072 recorded in 2014. The Kingdom's performance in mean years and expected years of schooling remains strong globally at 9.4 and 14.4 years, respectively.

Several indices have underscored the attractiveness of Bahrain in terms of its lifestyle. The 2015 Expat Explorer Survey by HSBC ranked Bahrain fourth among the 39 countries surveyed. The Kingdom moved upwards by one position and currently follows behind Singapore, New Zealand, and Sweden. Bahrain is considered a steady and affordable place for raising children as well as having a good quality of life for family and a good healthcare system. Complementing this rank was the International Expat Insider Survey where Bahrain held the "Top Expat Destination" in the MENA region and ranked 17th globally outperforming Hong Kong, Japan, UK, and Norway. Bahrain is considered as one of the most welcoming countries in the world ranking 9th globally in the ease of feeling welcome sub-indicator.

In terms of international credit ratings, Fitch Ratings has affirmed Bahrain's Long-term foreign and local currency Issuer Default Ratings (IDR) at 'BBB-' and 'BBB', respectively. Additionally, it affirmed Bahrain's Country Ceiling at 'BBB+' and Short-term foreign currency IDR at 'F3'. The rating agency has, however, revised the Kingdom's outlook to Negative. Further fiscal adjustment measures are encouraged to offset the impact of low oil prices on the economy.

KEY SECTORS

NON-OIL DRIVERS STRENGTHEN

The closing months of the year saw several important developments across the spectrum of sectors in the non-oil economy. These are reflective of the strength of the structural growth drivers linked to demographics, regulations, and the broader regional opportunity.

Financial services sector continues to see positive developments

Key indicators of financial services in Bahrain (2014)



Source: Central Informatics Organisation, Social Insurance Organisation

The Central Bank of Bahrain in collaboration with the local Benefit Company launched a pioneering Electronic Fund Transfer System (EFTS) in November. The new system connects all retail banks in the Kingdom with each other and with major billers in order to increase the efficiency of fund transfers. The EFTS is composed of three distinct services:

- ▶ *Fawri+* is an almost real-time fund transfer service which allows individuals or entities to transfer up to BHD1,000 per day in less than 30 seconds. The system is active 24 hours a day, seven days a week.
- ▶ *Fawri* is a deferred settlement fund transfer service which allows individuals or entities to transfer any amount of money within just a few hours of the business day
- ▶ *Fawateer* aggregates bills from multiple billers and presents those bills to the individuals or entities in a single interface. It provides real-time bill payments that can be settled within 30 seconds

A pioneering funds transfer system was launched in Bahrain in November

The new EFTS infrastructure significantly reduces transfer times, enhances security, and reduces costs. *Fawri+* allows customers to transfer amounts of up to BHD100 free of charge whereas amounts of BHD100-1,000 incur a flat fee of BHD0.100. A BHD0.100 fee also applies to *Fawri* transfers. *Fawateer* enables any entity with outstanding bills to be paid through the EFTS using any retail banks channels such as branches, internet banking, and mobile banking. Billers can further automate correction through a direct debit service.

In another important new infrastructure development, the Bahrain-based International Islamic Financial Market (IIFM) in November launched a standard contract template for Sharia-compliant cross-currency swaps. The objective is to better manage risks associated with large currency exposures by Islamic financial institutions. The new standard is primarily intended for inter-bank treasury placements but are also applicable for sukuk as well as trade and corporate finance deals. The risk of cross-currency swaps being used for speculation, an activity banned under Shariah law, was a key concern in motivating the development of the new standard. In an important step toward standardization, the new arrangement involves two *murabaha* contracts linked with unilateral promises (*wa'ad*). The standard was developed jointly with the International Swaps and Derivatives Association.

The CBB in November licensed Bank of Khartoum to open a branch in Bahrain. This is the bank's first branch outside of its home market of Sudan where it operates as a Shariah-compliant bank. Established in 1913, the bank's shareholders include several GCC-based Islamic banks as well as the Islamic Development Bank. The bank will use its Bahrain office for its Shariah-compliant wholesale operations.

The CBB also granted a wholesale banking license to Pakistan's JS Bank Limited in July to open a branch in the Kingdom. The license allows the bank to expand its activities as a wholesale bank from Bahrain. The Bahrain office will be the first branch outside Pakistan.

Important progress for ICT entrepreneurship infrastructure

The closing months of the year saw important steps in terms of creating an institutional ecosystem for the development of ICT entrepreneurship in Bahrain. These build on the unique advantage of the country which has been ranked first in the region in the 2015 ICT Development Index. Published by the United Nations International Telecommunications Union, the IDI measures the level of ICT readiness, intensity, and capability in 167 countries worldwide. Since 2010, Bahrain has experienced dynamic improvement in the index reflecting the increasing penetration of ICT in the country. On a global scale, Bahrain holds the 27th position.

The EDB, in collaboration with C5 Accelerate Limited and Amazon Web Services (AWS) in late November announced the launch of the first Cloud Accelerator in the Middle East and Africa region, which will be located in Bahrain. The Cloud Accelerator aims to drive growth in local and regional entrepreneurship through enabling the rapid adoption of cloud technology. The program will fund and develop business from the region that focus on technologies that align with the GCC economic priorities such as manufacturing, financial services, etc.

Important steps in developing an entrepreneurial ecosystem for ICT innovation

The Cloud Accelerator will provide business with resources to develop a cloud-based commercial strategy. A cohort of up to ten qualifying businesses will be invited to work from the Cloud Accelerator premises in Bahrain for four months. During this time, they will benefit from interactions with fellow program participants, training in strategy and business principles, and mentoring from C5 Accelerate and its network of global business leaders.

AWS will further support each of the participants with established programs including AWS Activate, AWS Grants, AWS Training and Certification, and developer-level support, which have been designed to support businesses developing on the AWS Cloud.

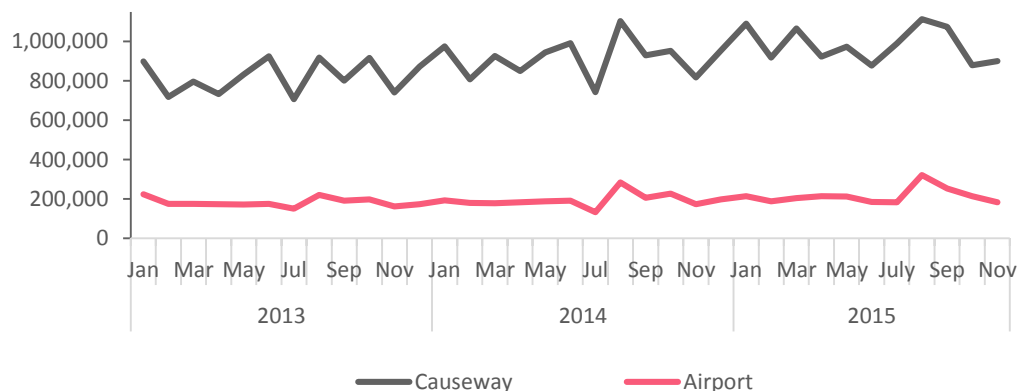
The Cloud Accelerator participants will also be eligible for funding from the USD100mn allied venture capital fund – the Gulf Technology Corporation – set up for the accelerator and to be managed by C5.

Tourism benefits from record visitor numbers

Growth in visitor numbers has remained robust throughout 2015

Some seasonal volatility aside, Bahrain has continued to see positive progress in terms of visitor numbers. The annual rate of growth in Q3 was 8.4%. Total arrivals peaked at 1,436,656 in August due to the summer holiday. The month of September, marking the Eid Al Adha holiday, saw a 15% rise in the number of arrivals via the King Fahad Causeway and 23% in arrivals through the Bahrain International Airport. Nearly 308,400 visitors entered the Kingdom during the week of 17-23 December alone. Just under 248,900 of them arrived via the King Fahad Causeway from Saudi Arabia whereas just short of 59,200 landed at the Bahrain International Airport.

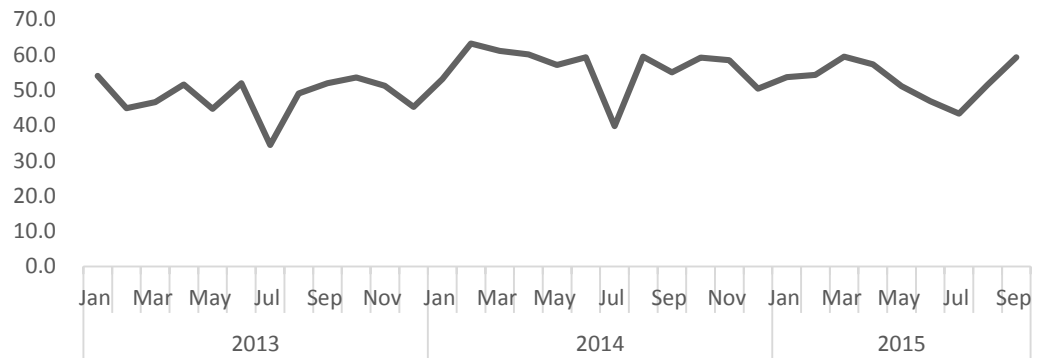
Monthly tourist arrivals by port of entry



Source: Ministry of Interior

The increased visitor numbers have boosted hotel occupancy rates with the average occupancy reading for Q3 standing at 51.4%. Hotels were 59.3% occupied in September, the highest rate of occupancy since March 2015.

Hotel occupancy rates, %



Source: STR Global

Bahrain has hosted a number of important events during the closing quarter of 2015. These included:

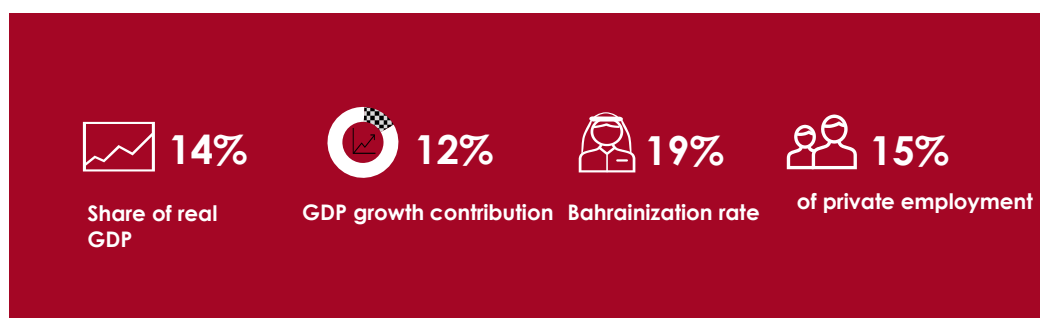
- ▶ The 11th International Institute for Strategic Studies Regional Security Summit: The Manama Dialogue took place in early November. Key speakers included the Egyptian President Abdel Fattah al Sisi.
- ▶ The Bahrain Bay Forum of the International Institute for Strategic Studies
- ▶ The 22nd World Islamic Banking Conference
- ▶ The Women in the Banking and Financial Sector conference
- ▶ The GCC eGovernment Conference
- ▶ The 10th annual Conference on Islamic Banking and Finance in Bahrain by the Bahrain-based Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) and the World Bank.
- ▶ The inaugural Middle East Heavy Oil conference
- ▶ The PreMoney MENA conference hosted by 500 startups and the EDB about the most disruptive strategies, models and technologies for the future of venture capital
- ▶ The second *Shop Bahrain* festival launched on 24 December. The event will showcase a variety of shopping experiences and provide a program of entertainment over a period of thirty days. The festival is Tamkeen initiative designed to support the retail and tourism industry through a partnership between the private and public sectors

Aluminium manufacturing getting ready for expansion

With Alba Line 6 on track for completion by January 2019, Bahrain's aluminium production capacity is expected to increase by 514,000 tn per annum, to a total of more than 1.45mn metric tonnes upon full ramp-up. This is creating a strong basis for the further development of downstream manufacturing in the Kingdom, which can capitalize on the Bahrain's long history in the sector, as well as its skilled workforce.

Mumtalakat Holding Company, the government holding company for non-oil assets, signed a joint venture with Synergies Castings Ltd to establish an aluminium casting and speciality alloy wheel manufacturing facility in Bahrain. Synergies Castings is one of the leading aluminium casters and manufactures of alloy wheels in India. The project will be located at the new molten metal park which is being developed adjacent to Alba. The USD150mn facility will take some 18 months to build and will produce the equivalent of 2mn vehicle alloys a year, an annual capacity of approximately 25,000 metric tonnes.

Key indicators of manufacturing in Bahrain



Source: Central Informatics Organisation, Social Insurance Organisation

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