



Bahrain Economic Quarterly

December 2017

SUMMARY

TOWARD A HIGHER GROWTH TRAJECTORY

The growth momentum of the Bahraini economy has continued to exceed expectations in recent months, thanks above all to the build-up of active infrastructure projects. The broader regional economy is benefiting from higher oil prices and as well as a somewhat more permissive fiscal policy stance.

- ✦ **The Bahraini economy expanded by a real 3.6% in Q3.** The YoY growth rate during the first three quarters of 2017 taken together was, similarly, 3.6%, which marked a further acceleration from the 3.2% headline growth rate recorded in 2016. This coincided with a rapid build-up in large-scale infrastructure investments
- ✦ **The robust momentum is entirely driven by the non-oil sector.** The non-oil economy expanded by an annual 4.6% in Q3. The annual pace of expansion during the first three quarters was just over 4.8%. This compares to 4.0% in 2016 and reflects above all the multiplier effect of infrastructure investments. Strong momentum in the project space is set to continue in 2018
- ✦ **The Bahraini oil sector has been virtually flat.** The oil and gas sector contracted by an annual 0.3% in Q3. The YoY rate of contraction during the first three quarters taken together was just over 1.3%. by contrast, the nominal growth of the sector has benefited from increased oil prices as well as higher gas extraction
- ✦ **The economic policy stance in the region is becoming somewhat more permissive and forward-looking.** After a period of austerity, some regional governments are looking for ways to revive growth and accelerate the economic paradigm shift toward a less oil-reliant model. The 2018 Saudi budget was the largest ever and should have positive regional spill-overs

Bahrain economic outlook

	2016	2017f	2018f	2019f
Real GDP growth, %	3.2%	3.5%	3.3%	2.9%
Non-hydrocarbons sector	4.0%	4.5%	4.1%	3.5%
Hydrocarbons sector	-0.1%	-0.7%	-0.5%	0.0%
Nominal GDP growth, %	3.4%	7.7%	7.0%	6.5%
Inflation (CPI %)	2.8%	1.4%	3.0%	3.5%
Current account (% of GDP)	-4.6%	-3.8%	-3.5%	-3.2%
Fiscal balance (% of GDP)	-13.6%	-11.0%	-9.8%	-6.4%
Crude Oil Brent (USD)	44	53	60	61

Source: Bahrain Economic Development Board

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GLOBAL ECONOMY

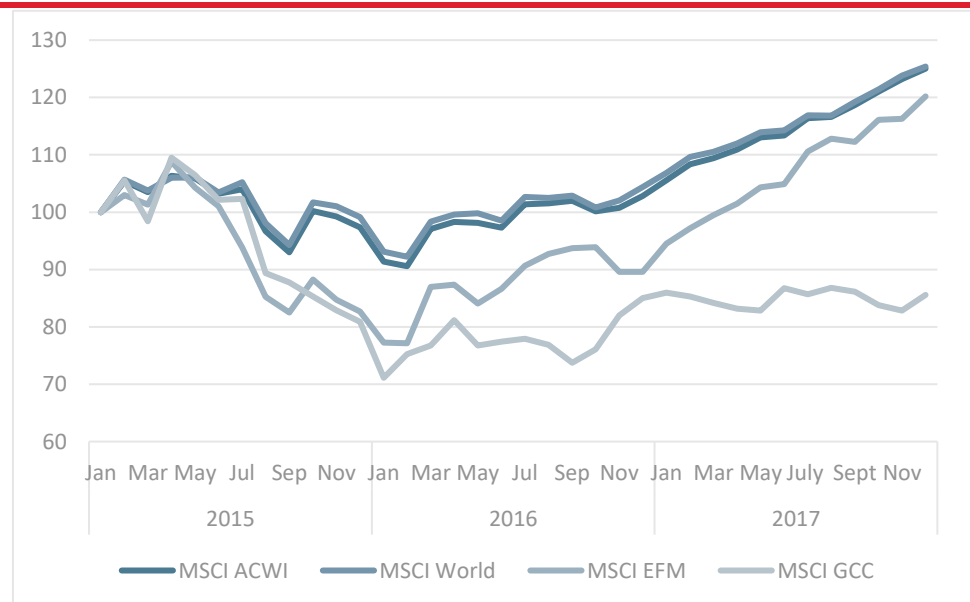
EMBARKING ON NORMALIZATION

The global economic conditions are generally continuing to improve as a cyclical recovery gathers steam

The year 2017 marked an important milestone for the global economy which, for the first time since the onset of the global financial crisis, showed signs of sustaining reasonable growth without increased reliance on policy stimulus. This suggests that some of the structural imbalances that have plagued the global economy for a decade have eased somewhat, while the fundamental growth drivers seem to be strengthening. Indicators of investment, trade, and manufacturing are all generally more positive

In spite of significant political risk factors, the global stock markets have repeatedly exceeded all-time highs in a further sign of confidence in the near-term prospects for the global economy. Under the circumstances, 2018 thus starts on a positive note with some prospect of the global economy turning over a new year leaf after a decade of relative underperformance. It is noteworthy, though, that essentially half the global growth increment in the medium-term is to be delivered by China and the US combined, which suggests continued potential vulnerabilities. After robust growth in 2017, the World Bank recently increased its 2018 global growth forecast to 3.1%. It expects the advanced economies to expand by 2.2% while the emerging markets are likely to expand by 4.5%. In spite of the positive momentum, the bank expects the upswing to be relatively short-lived with the longer-term growth potential depressed by structural challenges.

Global equity market performance (Jan 2015 = 100)



Source: MSCI

Stimulus withdrawal

The performance of the global economy has been critically linked to unusually permissive monetary and fiscal conditions since 2008. There are growing indications, however, that policy conditions are finally about to become less permissive, although the process is both very gradual

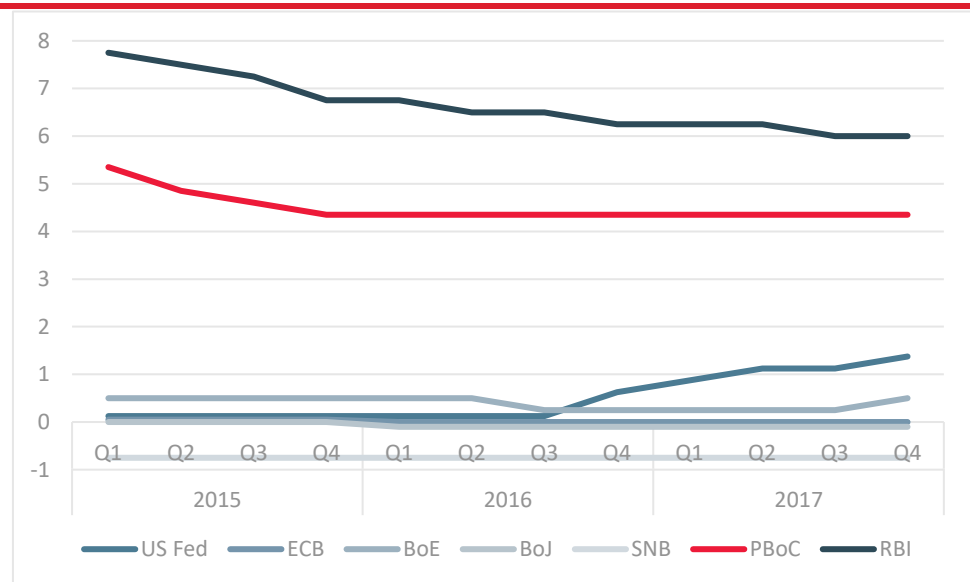
The US Federal Reserve has continued its gradual monetary tightening, although the process is expected to remain measured

and unlikely to mark a full reversal to the pre-crisis conditions. In particular, inflationary pressures still seem relatively subdued, which reduces the urgency of monetary tightening.

The US Federal Reserve has so far been leading the retreat from ultra-low interest rates and looks likely to continue this process, especially given the substantial fiscal stimulus delivered by the historic tax reform package which was passed at the end of 2017. It raised the federal funds rate to 1.25-1.5% in December and is expected to implement three 25-point increases in 2018.

However, so far the Bank of England is the only other major central bank to have increased policy rates. Most central banks around the world continue to set their policy rate at historic record lows. Apart from subdued inflation, continued high levels of leverage in many major economies will act as a brake on rapid rate increases. The main risk to this outlook comes from potential bond market instability which will potentially tighten market conditions relatively quickly.

Key central bank policy rates, %



Source: Central banks

Oil posts a strong close of the year

After a period of recurrent oil market volatility around a downward trend in the first half of 2017, the price dynamics reversed sharply in the second half. The monthly average of Brent rose from USD46.4 per barrel in June to USD64.4 in December, a 43.1% increase. The monthly averages remained on a consistent upward trajectory throughout the second half of the year. During the year as a whole, the Brent price averaged USD53.33 per barrel, up by nearly a quarter (22.2%) from USD43.64 in 2016. The WTI benchmark rebounded from USD43.29 to USD50.25.

The rebound in prices was the result of a number of factors, but above all due to brisk growth in global oil demand as well as the prospect of foreseeable oil market rebalancing after a protracted glut and historically high reserve levels. With the global economy now transitioning to what looks like the first synchronized recovery since the global financial crisis, and thanks in part to a period of lower prices, the demand for oil is growing at a brisk pace. For instance, OPEC in November

Oil prices have continued to rebound strongly in the closing months of 2017 against the backdrop of gradual market rebalancing

increased its 2018 demand growth forecast from 1.26 to 1.51 mbd. China is projected to contribute 28% of the total demand increment with the US and India responsible for 12% each.

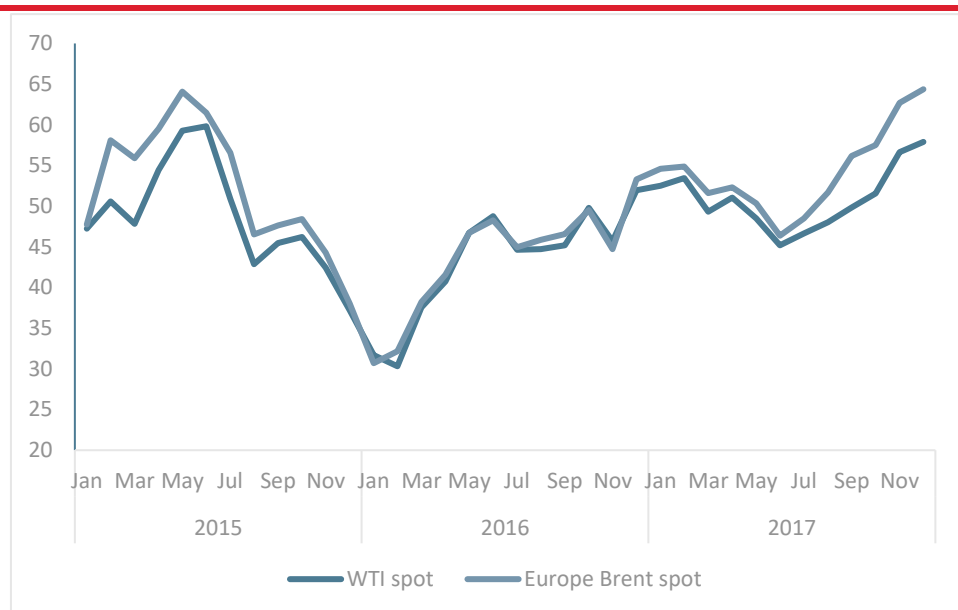
At the same time, the OPEC-led effort to drive a faster market rebalancing seems to be bearing fruit. The output cuts agreed with several non-OPEC producers have now been extended until the end of 2018, although they will be reviewed in June. Compliance with the policy has remained strong and efforts to contain production have proven somewhat easier because of recurrent production disruptions in countries such as Iraq, Libya, Nigeria, and Venezuela, as well as, potentially even Iran. For instance, Venezuelan production fell to 1.7 mbd in December from 2-2.2 mbd a year earlier. Some projections suggest that this could fall below 1 mbd this year.

As a result, oil stocks have been declining fairly consistently. Having been 278mn barrels above the five-year moving average in early 2017, the OECD (advanced economy) oil stocks had come down to 136mn by October. Periods of extreme winter weather in the parts of the northern hemisphere have further accelerated the market rebalancing since then. The tighter market balance is in turn leaving prices much more sensitive to production disruptions and geopolitical risks.

The prospect of market rebalancing is likely to increase pressures to exit from the current quota regime. However, some OPEC members have suggested that the output cuts could continue past the end of 2018. So far, OPEC and its partners have provided no clarity on their exit plans, although they have vowed to be “agile and flexible.”

One of the key questions for oil prices has to do with the behaviour of the US shale companies in a more comfortable pricing environment. Much more flexible than conventional fields, the shale sector has shown itself to be relatively quick to respond to price changes. The US rig count has been rising again since late September and, overall, rose by 42% in 2017 to reach 747. However, a new spirit of moderation appears to have taken place in the sector with many suggesting that this figure would now remain relatively stable. In general, a sustained increase in the WTI is seen as necessary for the rig count to increase much further. At the same time, the efficient gains they achieve in a low oil price environment are to a degree being undone by renewed cost increases in tighter market conditions. US production declined somewhat in later December to 9.75 mbd. Following an 11% jump in 2017, the EIA expects US oil production to increase by 5% in 2018 to a total of 10.1 mbd. Shale production is set to reach an all-time record of 6 mbd. Recent estimates suggest that output gains from the Permian Basin, currently the most important hub of the shale industry, could reach 1.5 mbd by the end of 2020 if prices were to sustainably rebound to USD65.

Monthly average crude oil prices (USD/barrel)



Source: US Energy Information Administration

Global oil demand and supply dynamics (mbd)

	IEA	OPEC	EIA*
2017 Global oil demand (mbd)	97.8	97.0	98.4
Advanced economies	47.3	47.4	47.1
Developing economies	50.6	31.9	51.3
China	12.4	12.3	13.2
2018 Global oil demand (mbd)	99.1	98.5	100.1
Advanced economies	47.3	47.6	47.6
Developing economies	51.9	32.6	52.5
China	12.8	12.7	13.6
2017 Global oil supply (mbd)	-	96.5	98.0
OPEC	-	32.4	39.3
Non-OPEC	58.0	64.1	58.7
2018 Global oil supply (mbd)	-	-	100.3
OPEC	-	-	39.6
Non-OPEC	59.6	58.9	60.7

*Petroleum and other liquids data

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

Implications for Bahrain

The global context for the Bahraini economy at the beginning of 2018 is more favourable than it has been in several years:

- ✦ The global growth prospects are strong and improving further
- ✦ Oil prices have continued to edge up and there is a good prospect of near-term market rebalancing even with increased US shale production
- ✦ Even as the cost of capital is increasing in the wake of continued US Federal Reserve rate hikes, the process is likely to prove fairly gradual. Moreover, with the economic fundamentals strengthening, overall monetary conditions remain historically favourable

THE GCC REGION

PRIORITISING GROWTH

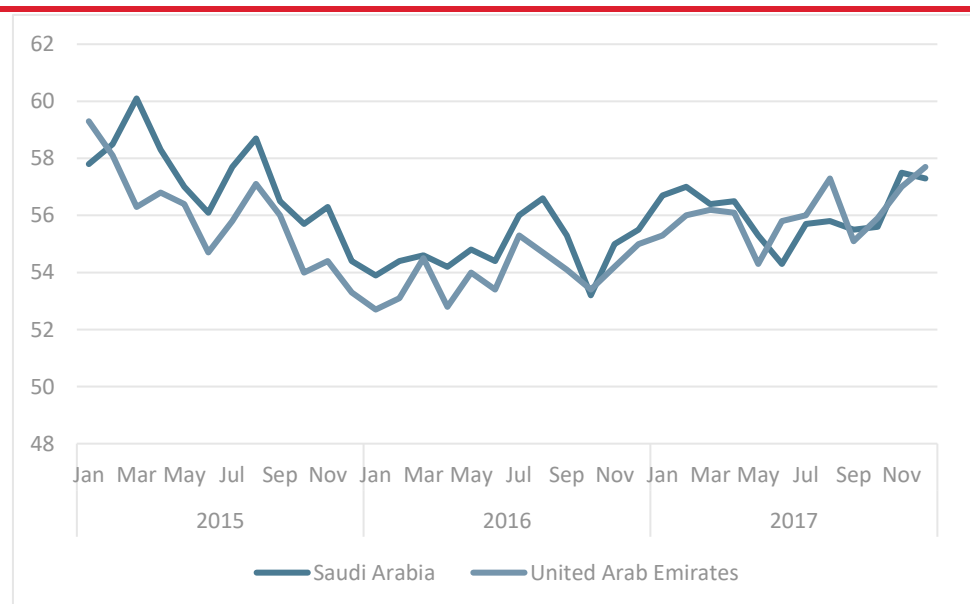
While oil production cuts will bring down regional headline growth this year, non-oil economic activity is showing signs to accelerating from last year's lows

The year 2017 is likely to have marked a cyclical low point for real growth in the GCC region. Non-oil growth, while generally resilient, was adversely affected by fiscal consolidation and historically subdued government spending. This in turn squeezed liquidity in the banking sector. Beyond this, compliance with the OPEC-led oil output cuts meant that the regional oil and gas sector contracted from the record output levels seen in 2016.

Looking forward to 2018 and beyond, the regional growth prospects are beginning to look significantly brighter. Not only have companies and individuals had time to adapt to the new fiscal realities, but the need for further belt-tightening is becoming somewhat less pressing in parts of the region following the adoption of landmark measures. As a result, the fiscal stance of the regional governments looks set to become somewhat more permissive this year. Moreover, growth is likely to receive a fillip from a more benign oil price outlook. Even with the OPEC cuts continuing, the effect on growth will no longer be negative as the oil sector output looks likely to be more or less flat.

Nonetheless, the broader fiscal overhaul will continue with many measures due to be implemented gradually over several years. This will likely leave regional growth rates somewhat below the recent historical norm. For much of the GCC, this will mean headline expansion in the range of 2.5-3.5%. Encouragingly, however, growth looks almost certain to be almost entirely driven by the non-oil sector where confidence has remained resilient. This in turn will entail a further boost to the region-wide economic diversification efforts.

Emirates NBD Purchasing Managers' Index



Source: Emirates NBD, Markit

Growth prospect brighten somewhat

The economic outlook for the GCC region looks brighter after a year dominated by fiscal consolidation and oil output cuts. In the region's largest economy, Saudi Arabia, economic growth in 2017 was estimated by the Government at just 0.5% at the time of the 2018 budget release. Provisional data by the General Authority of Statistics, in fact, suggested a small 0.7% contraction due to a 3% decline in the oil sector. Non-oil growth was estimated at 1%. In 2018, the Government expects economic growth to accelerate sharply to 2.7% in 2018 led by 3.7% non-oil growth. Growth in 2019 is expected to be comparable.

Although headline growth has been depressed by oil output cuts, the GCC non-oil sector is showing considerable resilience

In the UAE, non-oil growth has shown considerable continuity and appears to have been on something of an upswing throughout 2017. According to the UAE Central Bank's Non-Oil Economic Composite Index, non-oil growth reached an annual 3.1% in Q3 and an average of 3% YTD. However, due to a 4% drop in oil production, the overall index rose by only 0.7% in Q3 as compared to 2.3% in Q2. Headline growth in 2017 is projected at 1.6% in a decline from 3% the year before. However, the rate of non-oil growth is set to accelerate somewhat from 2.7% in 2016 to 3% in 2017. Growth is expected to rebound back toward the 3% mark in 2018. The Emirates NBD Dubai Economy Tracked in December recorded its lowest reaching (54.7) since October 2016. However, the average reading for 2017 was 56, up from 53.7 in 2016.

In Kuwait, some continued delays in project implementation have coincided with a marked improvement in consumer confidence and spending. The YoY pace of real growth dropped to -3.6% in 3Q17. The annual pace during the first three quarters of 2017 taken together was -3.2%. The real GDP contraction was entirely caused by oil output cuts in line with the current OPEC policy. The oil sector contracted by a real 9% YoY in Q3 and by a comparable 8.8% YoY during 1-3Q17. By contrast, the non-oil sector has continued to show good momentum with 4.4% YoY real growth in Q3. The pace during 1-3Q17 was 4.9% YoY. Going forward, project implementation is likely to constitute an important growth driver and non-oil growth should remain around the 4% mark in 2018-2019. Positive headline growth of around 2% is expected after the decline seen in 2017.

Omani growth in 2017 is projected at only 0.4%, largely as a result of oil output cuts in compliance with the OPEC-led coalition. Growth is expected to pick up to the neighbourhood of 2.5% in the near term, with the Government projecting over 3%. While the oil sector will likely remain a drag on growth, the initiation of BP's Khazzan tight gas project will impart an important economic stimulus.

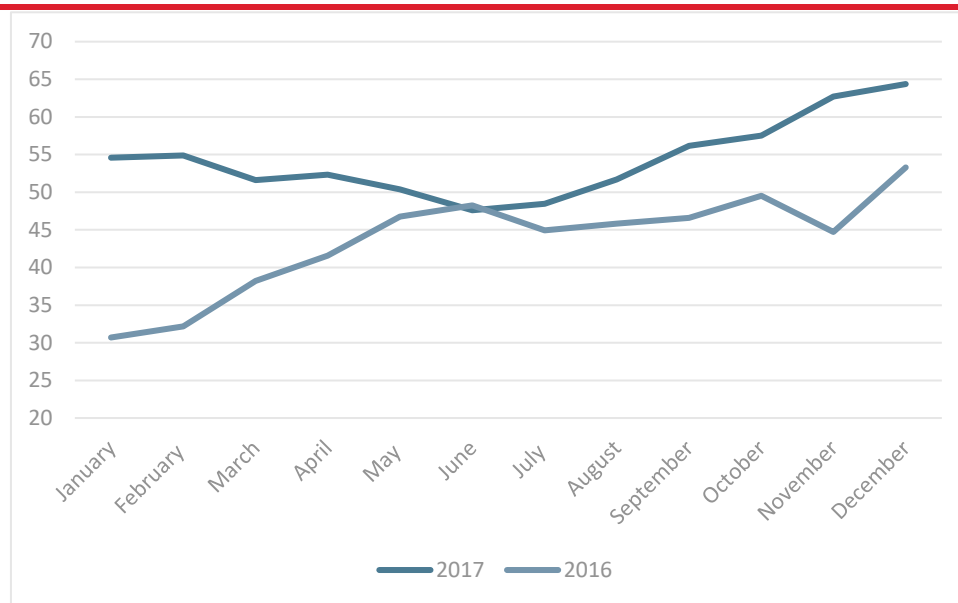
Growth in Qatar has been inevitably affected by the ongoing diplomatic stand-off with three of its GCC neighbours. The annual pace of real GDP growth accelerated to 1.9% in Q3 thanks to a rebound in the hydrocarbons sector. The non-oil sector grew by 3.7%.

A fiscal shift

The fiscal strategies of the regional economies are shifting from a primary emphasis on consolidation to a more balanced approach between driving long-term growth while continuing to work toward fiscal sustainability. This is partly because the main planks of the fiscal overhaul

have now been agreed, with for instance VAT now moving to the implementation stage. Similarly, some of the key institutional reforms are in place with, for instance, the new Bureau of Capital and Operational Spending Rationalization in Saudi Arabia delivering savings of SAR17bn during 2017. At the same time, the more benign oil price environment has allowed governments to revisit the timing of certain elements in their fiscal strategies. With the exception of the month of June, the Brent benchmark in 2017 remained firmly above the 2016 averages.

Brent oil price dynamics, 2016-2017 (USD/barrel)



Source: US Energy Information Administration

The 2018 Saudi budget presented in December marks a clear shift toward a more expansionist stance. The projected government expenditure of SAR978bn is the largest on record and compares with SAR890bn budgeted for 2017. However, recurrent spending is due to rise by only 4%, partly thanks to a freeze on the public sector wage bill since September 2016. The government projects revenues of SAR783bn along with a further reduction in its deficit to SAR195bn. Public debt is projected to increase from SAR483bn to SAR555bn, some 19% of GDP. In line with an established pattern, expenditure is set to prioritize social infrastructure and security. Capital expenditure is budgeted to reach SAR205bn in an increase from SAR180bn in 2017.

The budget attests to ongoing fiscal diversification with a 37% projected rise in non-oil revenues over the 2017 total. These are set to reach SAR291bn in 2018. The main new revenue sources will include the VAT, expatriate levies and dependent fees, and the white land tax, as well as additional investment income. Saudi Arabia expects to raise SAR23bn from VAT and over SAR9bn from the new excise tax. Also, the ongoing program of scaling back subsidies is continuing.

The total deficit at the end of 2017 reached SAR230bn, or some 8.9% of GDP. This was sharply down on the SAR416bn shortfall recorded in 2016. Non-oil revenues rose by 38%. This was above all thanks to increased tax receipts, some asset divestments, and better investment returns. At the same time, the challenges of cutting expenditure were underscored by the SAR926bn turnout for 2017 which was 1% lower than the 2016 actual figure.

With the ongoing implementation of the key planks of the GCC countries' fiscal consolidation agenda, policy focus is shifting somewhat toward strategically anchored efforts to stimulate growth

The budget documents this time included medium-term fiscal projections which foresee a reduction in the Government's dependence on oil revenues from 58% in 2018 to 42% in 2023. Expenditures are projected to continue to increase to a total of SAR1.34trn in 2023. Public debt as a percentage of GDP is to be capped at 25%.

The Saudi authorities are using a range of instruments to stimulate economic activity after a period of lacklustre growth. The budget was preceded by the announcement of a SAR72bn four-year package of projects. Roughly half this will be allocated to real estate-related spending. Other elements of the stimulus package include SAR5bn for an export-import bank, SAR5bn for an investment program, and SAR2.6bn for broadband and fibre optics. In addition, the Public Investment Fund and the National Development will spend a combined SAR133bn on projects in Saudi Arabia. A further SAR50bn stimulus package was announced at the beginning of the year. Additionally, some SAR30bn have been allocated to the Citizen's Accounts to compensate low- and middle-income households for the increased cost of living.

The Dubai budget, in anticipation of Expo 2020, projects a 19.5% increase in Government expenditure to AED56.65bn, the highest ever. This is led by a 46.5% jump in infrastructure investments. Government revenues are projected to increase by 12.5% to AED44.78bn, which would translate into an AED6.2bn deficit equivalent to some 1.55% of GDP. This compares to a projected shortfall of AED2.5bn in 2017. The oil sector is set to contribute only 7% of the Dubai Government income. The consolidated deficit in the UAE (including the federal government and the constituent emirates) is relatively small compared to the rest of the region and was projected to decline from 4% to 3.3% of GDP in 2017.

Oman's 2018 budget foresees an OMR3bn deficit which is roughly equal to 10% of GDP. 84% of this shortfall is expected to be financed through foreign and domestic borrowing. On the basis of a conservative oil price projection of USD50 per barrel for 2018, revenues are set to increase by 3% to OMR9.5bn. The Government is planning a 6.8% increase in spending to OMR12.5bn. Oman has officially announced its plan to defer VAT implementation until 2019. A selective tax on certain products, such as carbonated drinks, energy drinks, and cigarettes, will start mid-2018. Oman also announced plans to privatize six state-owned enterprises in 2018.

Structural growth drivers robust

The fiscal tilt toward a more growth-oriented strategy builds on strong growth drivers across the region. Above all, the regional project pipeline remains strong. According to MEED estimates, the aggregate value of current and planned infrastructure projects in the GCC rose by 11.6% in 2017 to reach just under USD3.1trn. The Saudi figure increased by 27.3% to 1.4trn. The UAE total rose 2.4% to USD869.3mn. Kuwait saw a 3.5% increase to 239.8mn. Oman experienced a 9.4% drop to 176.7mn and Qatar saw a 4.3% decline to 251mn.

Thematically, the focus of these investments is set to remain firmly around physical infrastructure and energy:

- ✦ The Middle East region as a whole is investing some USD90bn in airport expansion projects, a significant proportion of the estimated global total USD 560bn. Jeddah's King Abdulaziz

Project spending is continuing to increase as an important growth stimulus across the region

International and Muscat International airport due to open soon. Budget aviation has increased with the launch of Flydeal – a Saudia subsidiary – in Saudi Arabia and Salam Air in Oman.

- ✦ In 2017, the GCC region saw the award of seven power and water projects with an aggregate value of USD7.8bn. The largest ones were the USD3.4bn Dubai concentrated solar power plants and the USD1.2bn Abu Dhabi Sweihan photovoltaic solar plant. Several major deals are expected in 2018, led by the 5,400 MW PP15 station in Riyadh and the Jubail 3 cogeneration plants. Dubai has a 75% renewables target for 2050 while Saudi Arabia's Renewable Energy Project Development Office is planning to source 9.5 GW of renewable energy by 2023.

The regional economies are working to enhance private sector participation in the major infrastructure projects. Saudi Electricity Company and Saline Water Conversion Corporation have announced that future projects will be invariably undertaken on a PPP basis. Saudi Arabia in June created Saudi Company for Energy Purchase. The country is planning to sell some 15-20 GW of power generating assets in 2018. SWCC has been preparing the sale of its Ras al Khair water and power plants since last June. Also Kuwait is planning to sell off its existing power stations.

The oil sector focuses on downstream

Oil production levels in the GCC have remained historically low in compliance with the OPEC targets. Rigs employed in the Middle East/North Africa region totaled 422 as of 3Q17, 342 of them in the Gulf. This was one more than the 2016 average. However, as a percentage of the global, the region saw a drop from 26.4% to 20.9% over the same period. Saudi Arabia had 119 rigs, a figure that has risen by more than 80 since 2005.

At the same time, the regional oil companies have been reviewing their operating models to diversify their portfolios internationally and, above all, into downstream activities. The Middle East region is projected to add some 1.5 mbd (1.3 mbd in net terms) of refining capacity by 2021, led by new refinery developments in Saudi Arabia and Kuwait. The landmark projects in the region are a 600,000 b/d Al Zour refinery in Kuwait, a 400,000 /d Jazan refinery in Saudi Arabia, and a 100,000 increment to the capacity of Bapco in Bahrain.

The focus on downstream activities in part reflects increased local demand as transportation volumes continue to rise. They also create value added exports as well as new broader development opportunities through better integration with manufacturing activities. In recent years, the regional refining capacity has grown by 1.2 mbd, of which diesel represented more than 50%. A total of 350,000 b/d was added to petrol refining and 140,000 b/d to jet fuel. Among other things, the capacity additions have allowed Saudi Arabia to become a net exporter of diesel and petrol as of 2016. Overall, the GCC region is now a net exporter of all refined products. Diesel exports in 2016 reached 500,000 b/d of, up from 310,000 b/d in 2015.

Although lower oil prices have eroded the competitive advantage of GCC petrochemical companies, the region remains committed to its long-term objective of expanding capacity and gaining global market share. The total GCC output of petrochemicals was 158.8mn tn in 2016, which produced revenues of USD77bn. The region has a pipeline of ten major petrochemicals

Lower oil production has coincided with a stronger strategic focus on downstream activities

ventures with an aggregate value of USD42.3bn. For instance, Abu Dhabi's Borouge is planning to more than double its capacity by 2023 through a new petrochemical complex and an additional polypropylene plant.

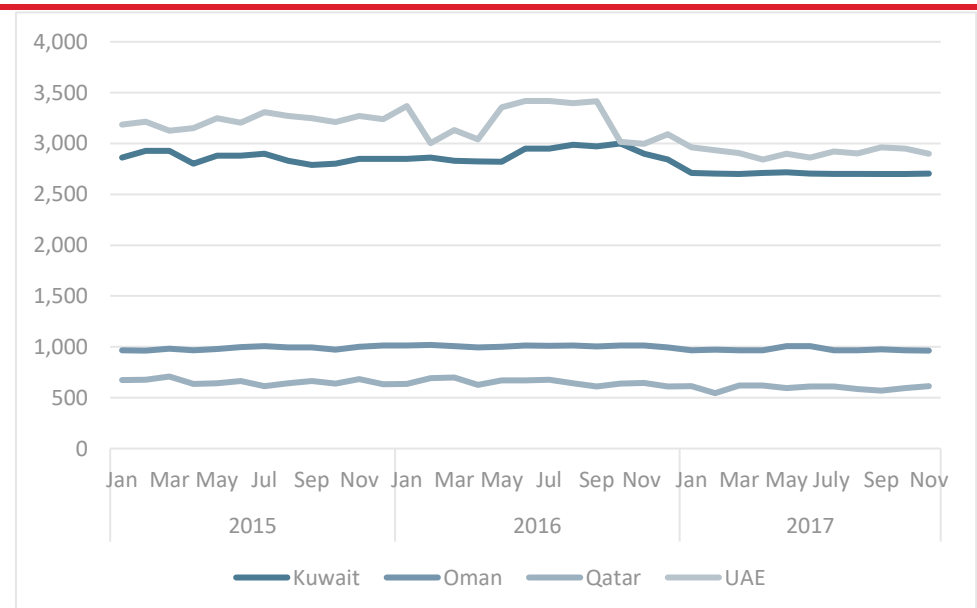
Also investments in innovation and R&D have reached an unprecedented level. Saudi Aramco and SABIC have been working on a pioneering oil-to-chemicals complex since 2015. Due to be completed in 2025, the venture is projected to have a capacity of 400,000 b/d of crude. The annual output 9mn tn a year. The projected budget of USD20bn would make it the largest petrochemical facility globally.

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



Source: Joint Organisations Data Initiative, OPEC

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



Source: Joint Organisations Data Initiative, OPEC, Bloomberg

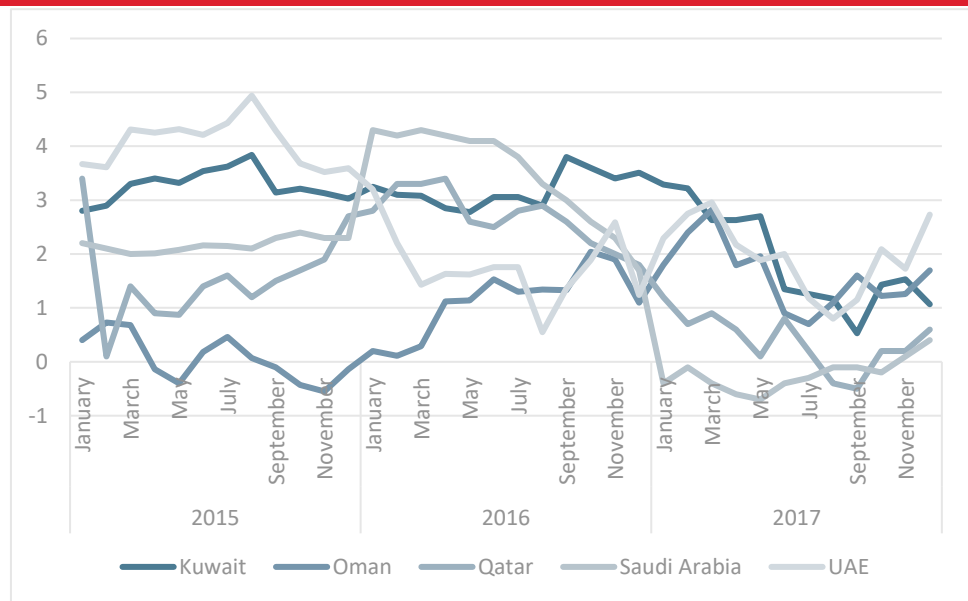
Renewed signs of inflation

Following a period of historically subdued inflation readings across the region, price pressures became somewhat more pronounced during the second half of 2017. By December, the CPI readings of individual GCC countries ranged from 0.4% (Saudi Arabia) to 2.7% (UAE).

The weakening of inflationary pressures earlier was primarily caused by the base effect of the previous round of subsidy cuts wearing off a year later. Similarly, the regional housing markets have struggled at a time of rapid build-up of new supply, which has resulted in continued downward pressure on prices and rents.

The recent pick-up in inflation is mainly due to new fiscal consolidation measures, whether renewed subsidy modifications or the introduction of excise duties. Saudi Arabia and the UAE are also pioneering the regional VAT from the beginning of 2018. A period of relative US Dollar weakness has contributed to imported inflation. While the regional housing markets are still adjusting to incremental supply, most of them are showing signs of stabilizing, and the disinflationary impact from housing costs has become weaker.

Consumer price inflation, %



Source: National statistical agencies

A capital market revival as liquidity tightens

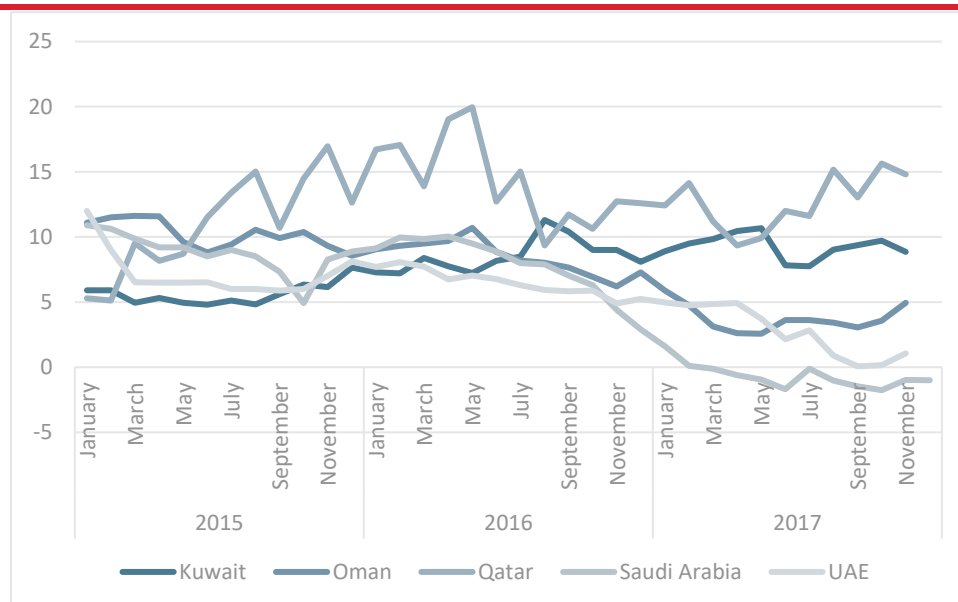
Following a sustained period of lower oil prices since late 2014, liquidity conditions in the GCC remain fairly tight. At the same time, borrowing costs are gradually edging up in response to the US monetary policy stance. Most regional central banks increased after the US Federal Reserve in December. For instance, the UAE repo rate now stands at 1.75%. Saudi Arabia kept its repo rate at 2% but increased its reverse repo rate by 25 bps to 1.5%.

There has been a region-wide acceleration in inflation during the closing months of the year

Even with a slight recent improvement, bank credit growth remains historically subdued

The YoY growth of bank lending has been slowing virtually across the region and now stands below 5% everywhere other than Qatar and Kuwait. In Saudi Arabia, the rate has been marginally negative almost throughout 2017.

Bank credit growth, %



Source: Regional central banks

Even as bank lending has slowed, capital market activity is showing signs of picking up quite significantly with historically low borrowing costs. The 2017 average of the J.P. Morgan Middle East Composite Index debt yield was 4.58% in 2017, which marked a two-year low. Even with the progress of fiscal consolidation and higher oil prices, sovereign borrowing needs remain historically high, and GCC governments are likely to continue to tap the international and domestic markets in the near term. For instance, Fitch Ratings expects GCC countries to raise debt or draw down their reserve funds for a total of USD160bn. Debt issuance is expected to total USD110bn. Moody's Investor Services expects regional sovereign borrowing needs of USD148bn. However, international sovereign debt issuance is projected to fall by 16.5%.

Regional bond and sukuk markets have become more active at a time of slower credit growth

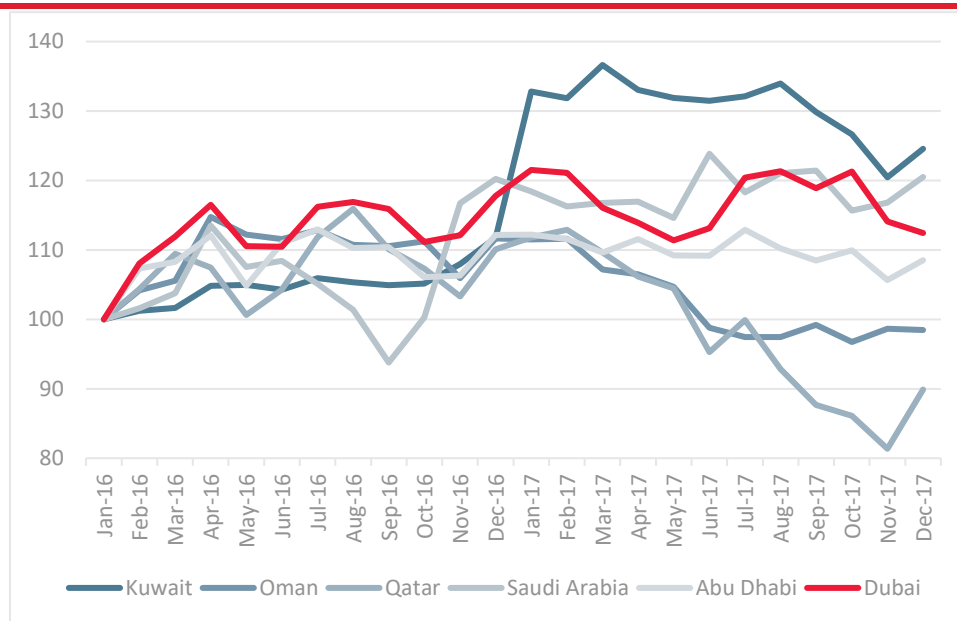
Saudi Arabia in December sold SAR4.77bn worth of domestic sukuk. This was composed of three maturities of five, seven, and ten years, respectively. Abu Dhabi is planning to launch a program of Treasury bill sales in 2018.

Also, corporate debt capital markets have seen a revival. For instance in Saudi Arabia, issuance had more than doubled to USD9.6bn by November. In the Islamic capital market space, corporate and infrastructure sukuk made up 8% of total GCC fixed income issuance during the first three quarters of 2017.

The regional oil companies have been active in the debt capital markets of late. Hydrocarbons producers raised a total of USD28.7bn through bonds and syndications in 2017. Landmark deals included a USD6.2bn bond by KNP in May, a USD3bn sukuk by Saudi Aramco in April, and a USD3bn October bond offering by Adnoc. Saudi Aramco has plans to invest USD414bn over the next decade

while Adnoc has plans to spend USD109bn over the coming five-year period. KNP has plans worth a total of USD112bn over the coming five years.

GCC equity market indices (January 2016=100)



Source: Regional stock exchanges

The regional stock market had a relatively lacklustre second half of 2017, although some pick-up became evident at the very end of the year. Only three markets in the end closed 2017 with a net gain. Kuwait advanced by 11.5%, Bahrain by 9.1%, and Saudi Arabia by 0.2%. The Abu Dhabi market declined by 3.3% and Dubai by 4.6%. Oman lost 12.7% and Qatar, in spite of a year-end rally, 18.3%. Most regional bourses lost ground during Q4 with Abu Dhabi flat and Bahrain and Qatar making small gains.

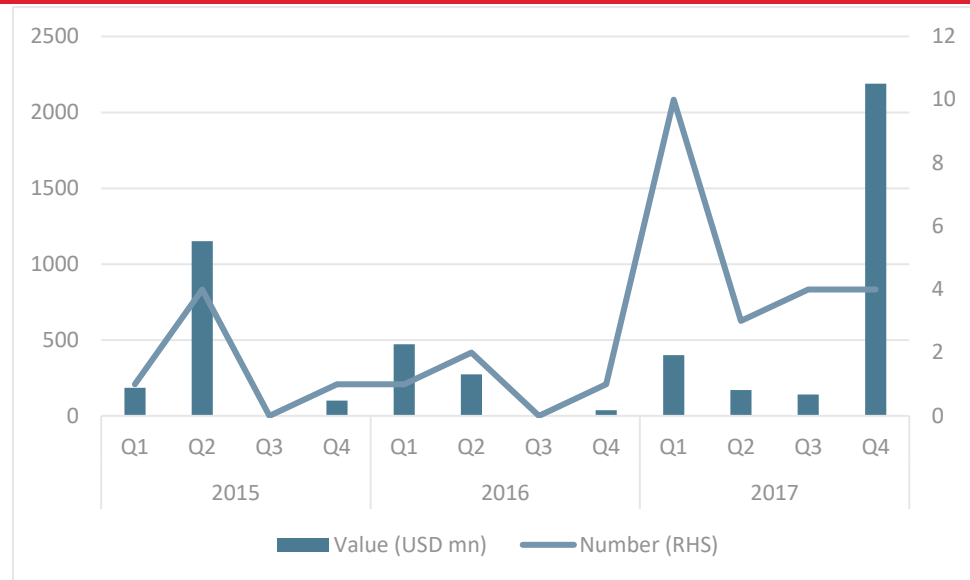
In spite of the relative lack of momentum on the regional exchanges, primary market activity saw a marked revival in the GCC in 2017. A total of 21 initial public offerings took place across the region, three times the 2016 tally of seven. The capital raised by these operations represented a more than three-fold increase from USD782mn in 2016 to USD2,188mn in 2017.

The year closed with two important landmark offerings. The Emaar Development IPO in Dubai raised USD1.31bn by floating a 20% stake in by far the largest single offering of the year. In Abu Dhabi, Adnoc Distribution raised USD851mn from the sale of a 10% stake. Even Muscat City Desalination Company's OMR6.5mn IPO in December attracted subscriptions of OMR122mn (USD317mn).

The increasing popularity of REITs has been another hallmark of the year. Some half a dozen Saudi REITs have listed since the passage of new legislation in late 2016. Derayah Financial is issuing a REIT for more than SAR1.1bn in early January.

While the performance of GCC stock markets has been fairly flat, IPO activity has picked up markedly in the course of 2017

GCC quarterly IPO activity



Source: PricewaterhouseCoopers, Regional exchanges

Implications for Bahrain

The regional environment in 2018 is likely to become more benign for Bahrain:

- ✦ Regional growth will benefit from base effects after a year of oil output cuts, as well as higher oil prices and a more permissive fiscal policy. This should translate into positive spill-overs through more regional tourism and property purchases
- ✦ While the financial market conditions are looking somewhat tighter, upward pressures on the cost of capital are likely to be very measured

BAHRAIN

TOWARD A HIGHER GROWTH TRAJECTORY

The performance of the Bahraini economy in 3Q17 continued exceed expectations with 3.6% YoY real expansion, which marked a slight improvement on the (revised) 3.5% pace seen in Q2. The economy was in real terms 1.6% larger in Q3 than in Q2. The annual pace of real growth during the first three quarters of 2017 taken together was a robust 3.6%, which was clearly ahead of the 3.2% pace recorded for 2016 as a whole.

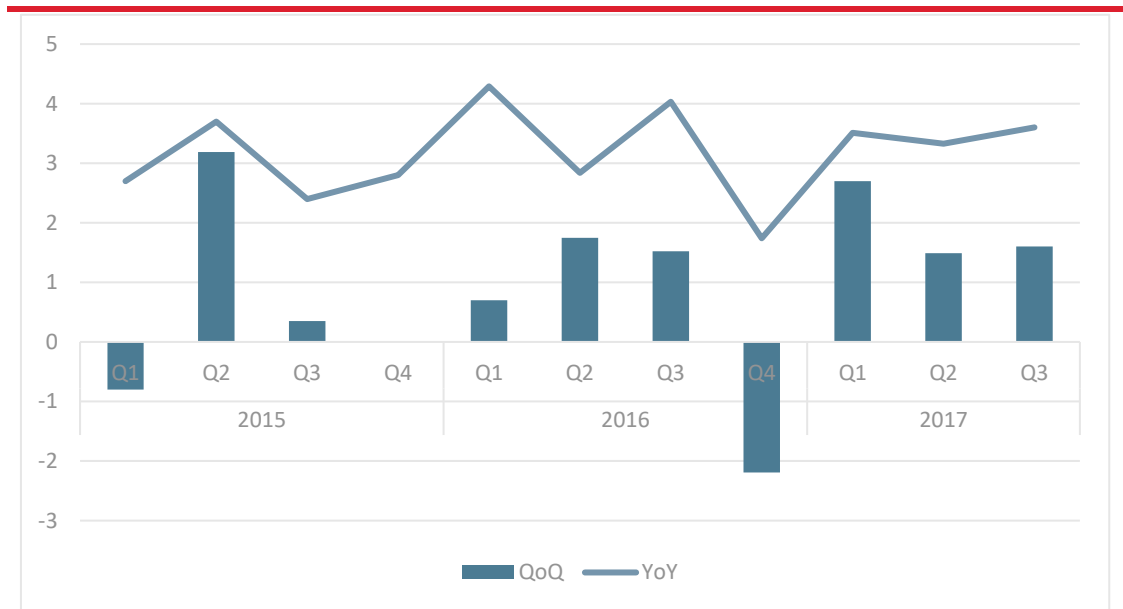
Growth in the Kingdom has continued to be firmly led by the non-oil sector which expanded by 4.6% in Q3. This marked a slight acceleration on the 4.3% pace recorded in Q2. Overall, the rate non-oil real growth during the first three quarters of 2017 was just over 4.8% in real terms. This was significantly above the 4.0% pace seen in 2016 and reflects above all the good progress in ramping up major infrastructure project activity.

The oil sector has remained more or less flat in line with recent trends. It contracted by an annual 0.3% YoY in Q3. Overall, the oil sector declined by 1.4% YoY during the first three quarters of 2017.

Bahrain's population in 2017 reached 1.5mn after a 77,000 increase during the year. Bahraini citizens make up 45% of the total.

The YoY rate of real growth in Bahrain accelerated to 3.6% during the first three quarters of 2017 taken together.

Real GDP growth



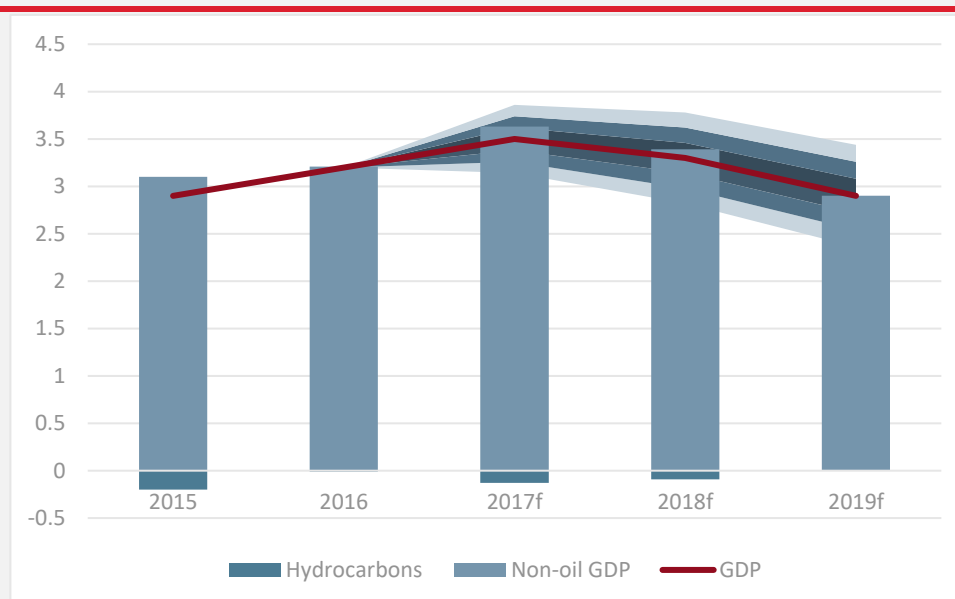
Source: Information & eGovernment Authority

Forecasts: Growth continuity in the face of conflicting pressures

	2016	2017f	2018f	2019f
Real GDP growth, %	3.2%	3.5%	3.3%	2.9%
Non-hydrocarbons sector	4.0%	4.5%	4.1%	3.5%
Hydrocarbons sector	-0.1%	-0.7%	-0.5%	0.0%
Nominal GDP growth, %	3.4%	7.7%	7.0%	6.5%
Inflation (CPI %)	2.8%	1.4%	3.0%	3.5%
Current account (% of GDP)	-4.6%	-3.8%	-3.5%	-3.2%
Fiscal balance (% of GDP)	-13.6%	-11.0%	-9.8%	-6.4%
Crude Oil Brent (USD)	44	53	60	61

Source: Central Bank of Bahrain, Ministry of Finance, Information & eGovernment Authority, Economic Development Board forecasts

Projected real GDP growth contribution



With the national accounts data continuing to surprise on the upside, the near-term growth trajectory of the economy looks likely to remain above a 3% YoY annual growth rate well into 2018 and possibly somewhat beyond. The growth dynamics will continue to be shaped above all by the conflicting forces of infrastructure project implementation and fiscal consolidation.

Real GDP growth in 2017 looks likely to come in at around 3.5%, in a slight acceleration from the 3.2% rate recorded in 2016. With the projected cash-flows of major projects as well as the ongoing multiplier effects from ongoing investments, growth in 2018 has the potential to match – indeed even exceed – the 2017 figure, although fiscal reforms will likely exert some downward pull.

With the full implementation of VAT as well as the base effect from a period of rapid project build-up, growth is likely to begin to moderate fairly clearly by 2019. At the same time, new growth drivers will begin to emerge, above all thanks to major manufacturing and logistics investments. Among other things, Alba Line 6 will begin operations. Growth will be entirely driven by the non-oil economy with oil and gas production expected to remain flat.

Multiplier effects fuel non-oil activity

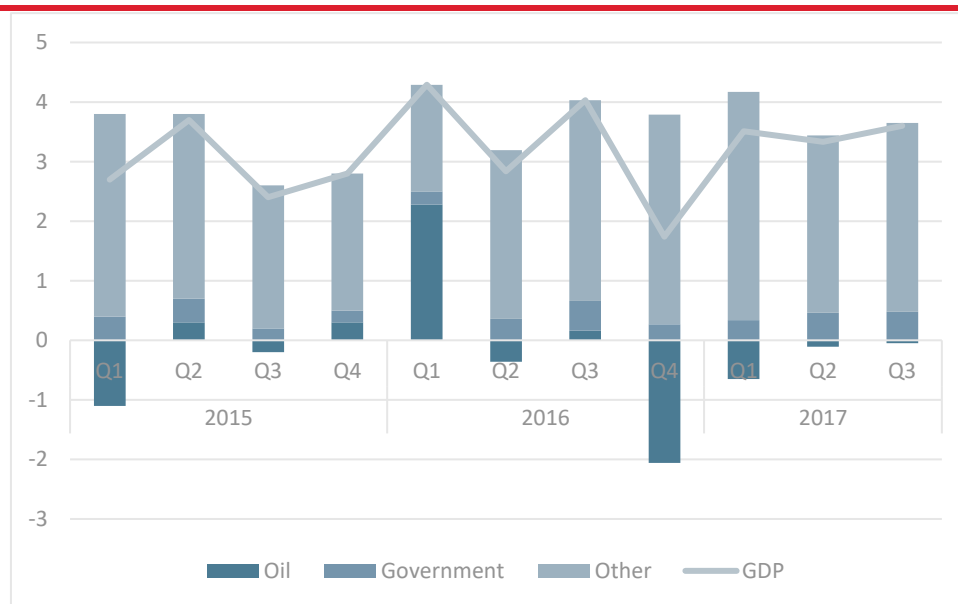
Non-oil growth during 1-3Q17 attained an annual pace of 4.7%. The momentum was led by the private sector which expanded by 5.0% YoY

Economic growth has continued to be driven by considerable non-oil sector dynamism even in the face of a historically challenging regional environment which has somewhat dampened positive spill-over effects from the rest of the region. The YoY pace of non-oil growth in Q3 reached just under 4.6%. This was very much in line with 4.5% pace recorded in Q2.

Growth was strongly led by the private sector, reflecting the weaker growth contribution of Government Services at a time of fiscal consolidation. The non-oil private sector grew by 4.7% YoY in Q3, following just over 4.6% in Q2. To an extent, growth will have benefited from the perception of policy continuity after the adoption of the final 2017/18 budget as well as a confidence boost delivered by higher oil prices.

During the first three quarters of 2017, the annual rate of non-oil growth reached just over 4.8%, which was clearly ahead of the 4.0% pace recorded in 2016. The non-oil private sector in fact expanded by more than 5.1% annually.

Real GDP growth composition



Source: Information & eGovernment Authority

Non-oil growth remained very broad-based, but appears to have been increasingly led by the secondary effects from the large infrastructure pipeline. Indeed, the construction sector, which drove growth in 2015-2016, clearly paused for a breather in Q3. While the Construction sector grew by just 0.8% YoY, having marginally contracted the quarter before, its strong linkages to other parts of the non-oil sector continue to deliver strong momentum. The slower construction growth likely suggest that contractors have built up more or less adequate capacity for their near-term projects. However, further additions still look likely to materialize in 2018 given the planned further scaling up of GCC-funded projects and the initiation of the Bapco expansion, among other things.

The fastest-growing sectors in Q3 were, once again, Social & Personal Services (mainly private education and health care) at 9.3% YoY, followed by Hotels & Restaurants at 8.6% and Trade at

Economic growth in 1-3Q17 continued to be led by the service sectors

7.7%. Transportation & Communications expanded by 5.8% YoY while the Real Estate & Business Activities sector was 4.6% larger than the year before. The Manufacturing sector saw the fastest turnaround in growth as the normalization of production at Alba, among other things, delivered 3.2% YoY gain after a 1.9% contraction in Q2. Alba experienced a three-hour power outage on its Line 5 on 13 April and this was estimated to reduce the company's annual production by 3-5%. By contrast, the Hotels & Restaurants sector, as well as Financial Services, grew markedly more slowly in Q3 than during the first half of the year.

The overall pace of YoY growth during the first three quarters of 2017 taken together broadly mirrored the Q3 figures. The fastest growing single sector was Hotels & Restaurants which expanded by 11.4%. It was followed by Social & Personal Services at 9.7% and Trade at 8.8%. Transportation & Communications grew by 6.6% and Financial Services by 6.4%. By contrast, Construction sector growth moderated to 1.7% and manufacturing barely expanded by 0.5%.

Sector-level real growth rates, YoY (%)

	2015	2016	2017			
YoY growth, %	Annual	Annual	Q1	Q2	Q3	1-3Q
Crude Pet. & Nat. Gas	-0.1	-0.1	-3.3	-0.5	-0.3	-1.4
Manufacturing	3.2	1.3	0.4	-1.9	3.2	0.5
Construction	5.9	5.7	4.6	-0.1	0.8	1.7
Trade	2.1	3.0	9.3	9.3	7.8	8.8
Hotels & Restaurants	3.0	2.0	12.3	13.4	8.6	11.4
Transp. & Comm's	6.8	3.2	8.2	5.9	5.8	6.6
Social & Pers. Serv.	3.5	9.1	10.1	9.8	9.3	9.7
Real Est. & Bus. Act.	1.7	2.8	4.5	5.3	4.6	4.8
Finance	4.5	5.2	8.3	7.6	3.5	6.4
Government	2.2	2.5	2.6	3.6	3.8	3.3

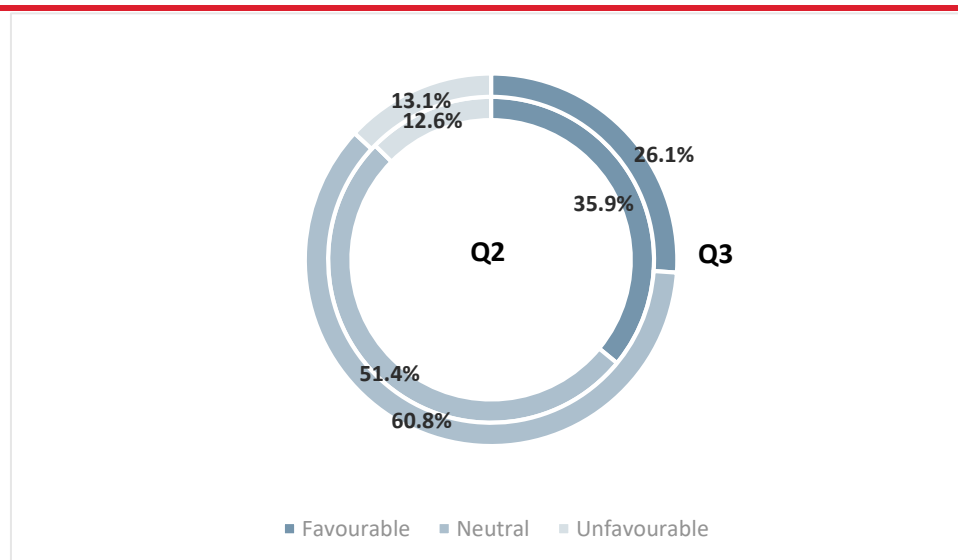
Other	7.9	3.6	6.6	5.6	8.2	6.8
GDP	2.9	3.2	3.5	3.3	3.4	3.6

Source: Information & eGovernment Authority

The continued strength of the Social & Personal Services sector among other things reflects the dynamism of the health care sector. In 2017, the National Health Regulatory Authority (NHRA) accredited six hospitals and four medical facilities. It issued 2,188 new licenses for medical professionals and renewed 6,480 existing ones. Over 2,000 training programs were conducted for doctors. The growth momentum looks set to remain strong. The NHRA issued 234 new licenses for medical facilities. 36 of them are preliminary approvals and 101 are at the final approval stage.

Survey data among local businesses concurs with the non-oil growth momentum reflected by the national accounts, although it also reflects differences in growth patterns among sectors. According to the Quarterly Business Perceptions Survey (QBPS) undertaken by the Information & eGovernment Authority (IGA), over a quarter of the respondents had a favourable impression of the performance of the economy in Q3. The 26.1% reading marked a decline from 35.9% in Q2. Most respondents were neutral. They accounted for 60.8% of the total as compared to 51.4% in Q2.

Bahrain QBPS opinions regarding current business performance, 2-3Q17

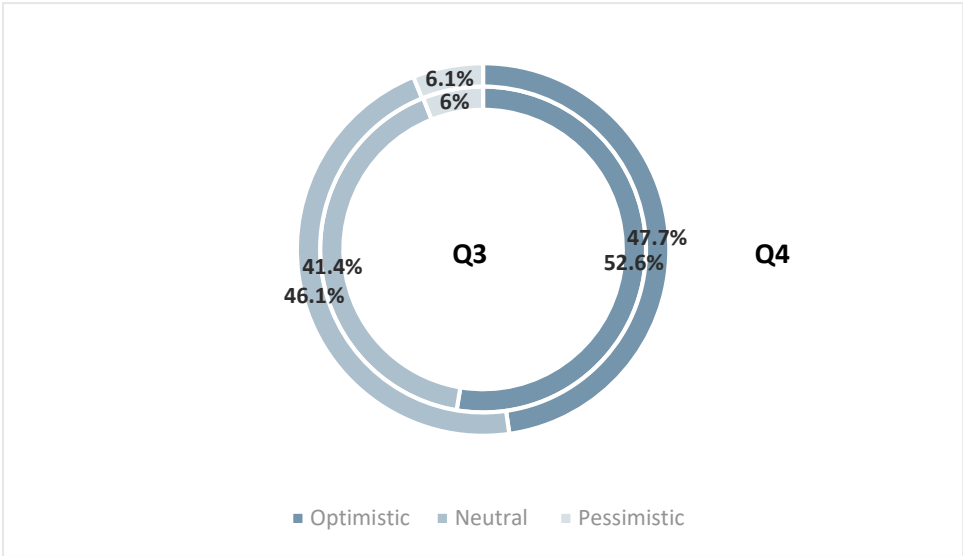


Source: Information & eGovernment Authority

In spite of some moderation in business confidence, virtually all companies are either optimistic or neutral about the near-term outlook

Forward-looking expectations have become marginally more cautious. Nonetheless, nearly half the respondents – 47.7% -- were optimistic regarding Q4. This compares to 52.6% reading a quarter earlier. The share of neutral respondents was almost comparable at 46.1%, which was up from 41.4% in Q3.

Bahrain Business Confidence Index, 3-4Q17



Source: Information & eGovernment Authority

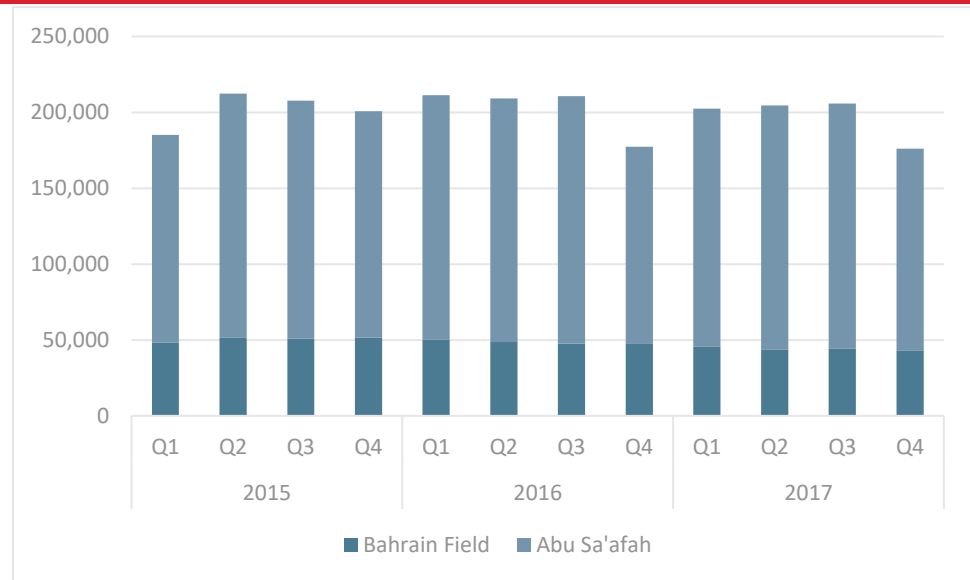
Oil production

Bahrain’s oil output contracted somewhat in 2017 as a result of seasonal maintenance on the offshore Abu Sa’afah field in December and ongoing gradual erosion in Bahrain field production. The average daily output during the year was 197,276 b/d, some 2.4% below the 2016 total of 202,063.

Oil production in 2017 declined somewhat from the historically high 2016 levels

Offshore production from Abu Sa’afah, even with the lower December total, was almost flat in YoY terms with a small 0.3% decline. The 2017 average came in at 153,038 b/d. By contrast, the onshore Bahrain field saw a 8.8% decline to 44,239 b/d.

Overall, Q4 was the weakest quarter of the year with Abu Sa’afah producing at 132,906 b/d and the Bahrain field at 43,203 b/d.

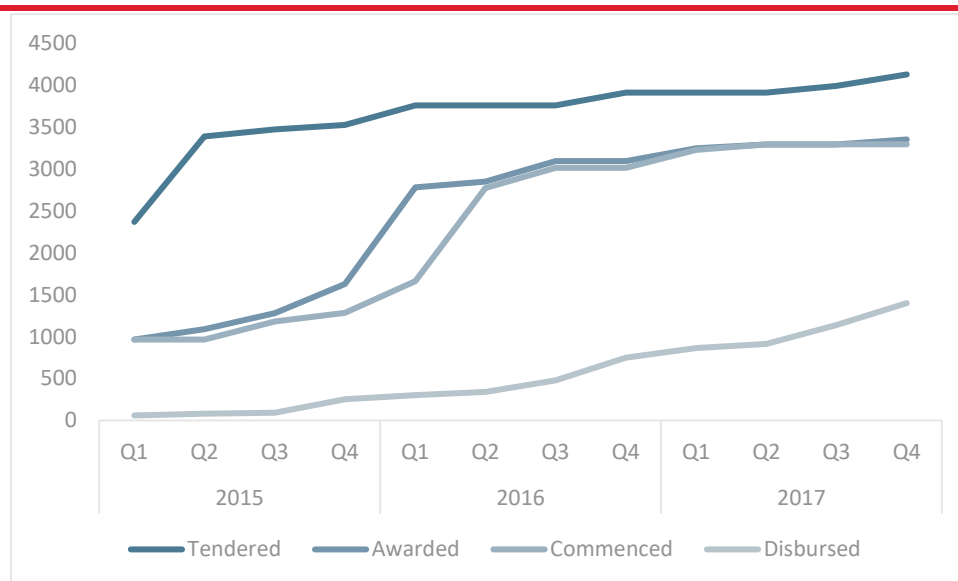
Crude oil production, b/d

Source: National Oil and Gas Authority

The infrastructure driver to set to strengthen further

Large-scale infrastructure investments continue to exert a powerful countercyclical effect on economic activity in Bahrain. Both government-related and private investment activities have continued to be steadily scaled up in 2017. While this positive momentum appears evident across most classes, of projects, it is particularly evident from the activities of the GCC Development Fund. During 2017 as a whole, the value of tendered projects rose from USD3.9bn to more than USD4.1bn. The cumulative value of projects that had commenced reached USD3.3bn, as compared to just over USD3bn a year earlier. The acceleration in project execution has been particularly pronounced in light of the cash flow dynamics. The cumulative amount of money disbursed almost doubled from USD751mn in 4Q16 to USD1.4bn a year later. A significantly larger increment is expected in 2018.

GCC Development Program project pipeline, USD mn (cumulative totals)



Source: Government sources

Other important infrastructure projects are also making good progress. Indeed, Bahrain saw a significant increase in its overall infrastructure project pipeline in 2017. According to MEED Projects, the aggregate value of projects rose by 19.2% to reach USD82.9bn at the end of December. A number of individual investments are making good headway:

- ✦ The Airport Modernization Program is on track for completion in Q2 of 2019. The USD1.1bn investment will expand the capacity of the airport to 14 mn passengers a year. Following completion, the airport will have a built up area of 207,000 sq m. The 4,600 sq m departure hall will have 104 check-in counters, 36 passport control booths, and 24 security screening points. The building will meet the LEED Gold Specification standard. A new transit hotel with some 40 rooms will cater to the needs of passengers with long layovers. A multi-storey car park will accommodate more than 3,500 vehicles. A planned Phase 2 of the project will include, among other things, a station of the planned Bahrain Light Rail Network
- ✦ Simultaneously with the airport upgrade, the national carrier, Gulf Air is modernizing its fleet. It has signed a lease agreement with DAE Capital of Dubai for five Boeing 787-9 Dreamliner aircraft. Gulf Air will take possession of the planes starting in 2018
- ✦ Alba's Line 6 is expected to start production in early 2019. It will increase Alba's production capacity by 540,000tn to 1.6mn tn a year
- ✦ Tender documents are due to be issued soon for the Al Dur 2 independent water power project which will have a power generation capacity of up to 1,500 MW and a water desalination capacity of 50mn imperial gallons a day. The power capacity is expected to become available by mid-2020 followed by water a year later. The Electricity and Water Authority will purchase the power under a 20-year power purchase agreement. Peak demand growth for power is projected to increase by up to 6.4% a year until 2020

Record infrastructure investments remain a potent countercyclical driver that is set to further strengthen in 2018

- ✦ The main USD4.2bn contract for the Bapco Modernization Program was awarded in early December. The capacity of the refinery will increase from 267,000 to 360,000 b/d
- ✦ Kuwait-based SSH has become the construction supervision consultancy for the CanalView mixed-used development. IT will cover an area of 13,068 sq m near the Dilmunia Mall

The Ministry of Works, Municipal Affairs, and Urban Planning awarded 22 tenders worth BHD6.3mn in Q3. A total of 74 projects worth BHD127.7mn are currently underway in the roads, sanitary, and construction sectors. Bahrain is also planning major health care investments during the next government period. Three new health centres are planned while two existing ones are due to be expanded. The Sitrah Maternity Hospital will be rebuilt.

According to Cluttons estimates, recent dynamics in the Bahraini real estate market have broadly mirrored regional trends. In the face of new supply, residential rents have weakened by roughly 11% during the past year. The market appears to have stabilized, however, and rents are expected to remain at current levels into 2018. The real estate stock is currently expanding at the rate of 5,000 units a year. Retail is seen as an important attraction for different residential areas. Bahrain was estimated to launch some 78,000 sq m of new retail space during 2017. This is projected to increase to 93,000 by 2018 and 455,000 by 2020. The pipeline of retail schemes includes 21 projects with an aggregate footprint of 1.05 sq m and a total value of BHD277mn. All are due to be completed by the beginning of 2020. In contrast to the residential sector, office rents remained stable in 2017. The regulation of the sector is taking a major step forward with the newly established Real Estate Regulatory Authority readying to implement Law 27 on organizing the real estate sector, which will become effective in March.

Beyond the growth impetus delivered by infrastructure investments, entrepreneurship has continued to strengthen as a strategic growth driver. The Ministry of Industry, Commerce, and Tourism issued 7,002 new registrations for commercial companies in 2017. A total of 9,411 new individual institutions were registered and a further 500 Sijili licenses issued. The combined capital of the new licenses was BHD116.2mn. The cumulative capital of all companies reached BHD20.56bn. Sixteen companies were licensed in 2017 under the auspices of the Ministry's Business Incubator and Accelerator.

The infrastructure projects provide a powerful underpinning to economic activity at a time when Bahrain, along with the rest of the region, is overhauling its fiscal model. The parliament approved the introduction of the GCC excise duty – or special tax – in November. Among other things, the tax will double the price of energy drinks and increase the price of soft drinks by 50%. A 40% customs duty of cigarettes was replaced with a 100% tax. The Ministry of Finance expects the tax to generate revenues of BHD58mn by the end of 2018 and BHD62mn by the end of 2020.

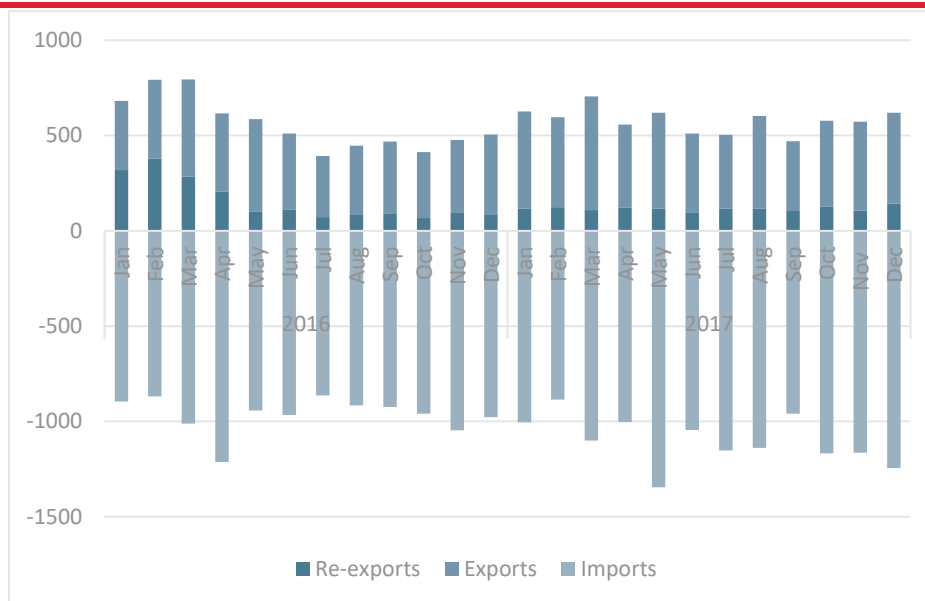
In line with the earlier decisions, the next round of increases to electricity and water tariffs is due to take place in March. The basic domestic electricity rate will increase from 13 to 21 fils per kWh. The water consumption unit will increase from 200 to 450 fils. The measures are expected to generate savings of BHD435.4mn by 2019.

Bahrain's non-oil export volumes have rebounded sharply since 2016

Trade volumes stable

Trade volumes have remained in line with last year's readings. The total value of non-exports during the first eight months of the year rose to USD4.72bn. This was comparable to USD4.82bn during the corresponding period of 2016. The value of exports of Bahraini origin increased quite sharply from USD3.26bn in I-VIII 2016 to USD3.81bn a year later – a 16.9% YoY increase. This was above all indicative of strong prices of metals and metal products which dominate among Bahrain's export bundle.

Non-oil trade, USD mn



Source: Information & eGovernment Authority, preliminary data from Customs Affairs

During the year 2017 as a whole, Bahraini imports attained an estimated total (with provisional data for Q4) of just over USD13.2bn. This marked a 14.1% increase over 2016. Exports of national origin totalled USD5.6bn, an increase of 16.5% over the 2016 total. By contrast, re-exports declined by 26.7% to USD1.4bn, leaving the total export value almost flat at just short of USD7bn, up 4.2% on 2016. The estimated non-oil trade deficit in 2017 reached USD6.2bn, a 27.6% increase over 2016.

Some pick-up in inflation

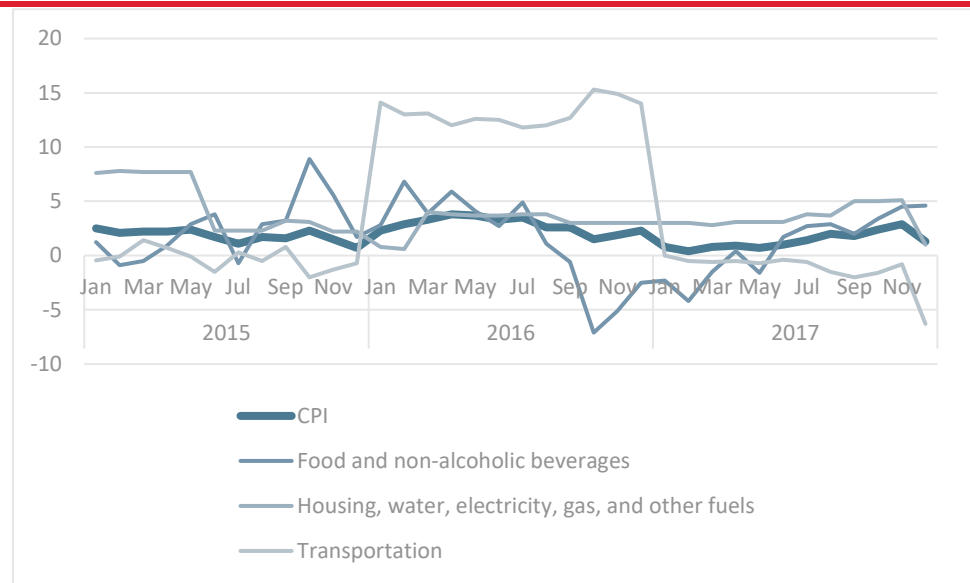
Headline inflation in Bahrain accelerated somewhat in the second half of 2017 after several months of minimal price pressures. The YoY rate of consumer price increased to an all-year peak of 2.9% in November but then dropped off again sharply to 1.3% in December. For the year as a whole, inflation reached 1.4% and was thus well below recent historical averages.

The renewed pick-up in inflationary pressures reflects the latest round of subsidy cuts in line with earlier agreements along with the introduction of the excise duty. At the same time, somewhat tighter housing markets are pushing up housing costs. Also, renewed US Dollar weakness has fed through in some import price inflation. Price pressures during the year were led by furnishings, household equipment, and routine maintenance rose by 5%. Food prices rose by 4.6%. Culture, as

Consumer price inflation accelerated somewhat in 2H17

well as alcoholic beverages and tobacco appreciated by 3.1%. Prices of clothing and footwear increased by 2.7%. By contrast, the rise in housing costs dropped to 1% by the end of the year. Transportation prices continued to decline – by 6.3%. Health care and communication prices saw small declines.

Consumer price inflation, % YoY



Source: Information & eGovernment Authority

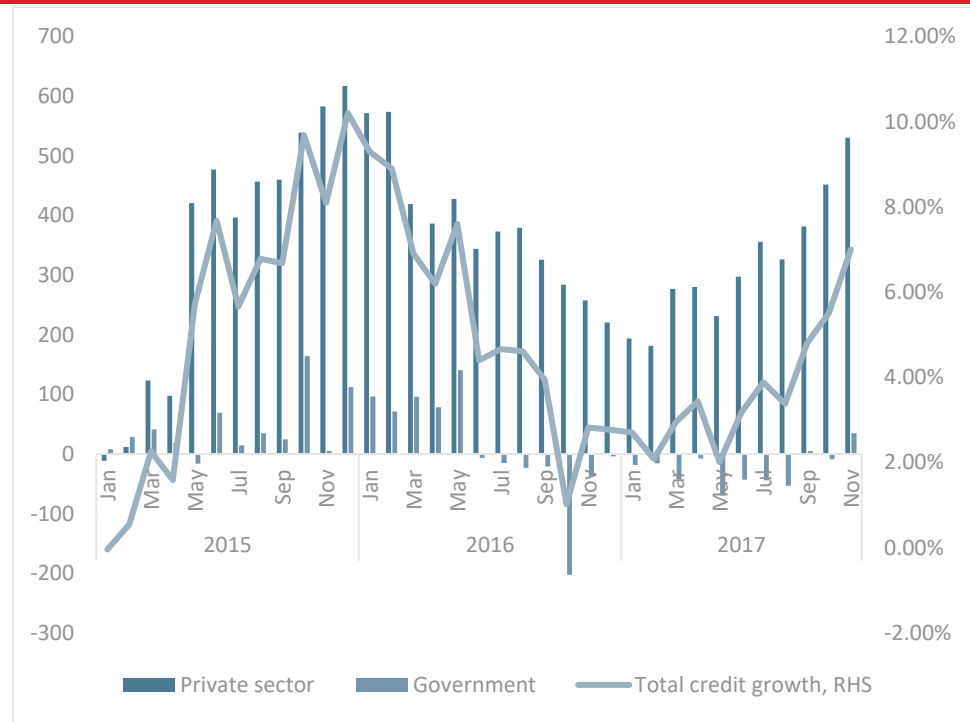
Credit growth accelerates

Following a gradual deceleration in the annual pace of bank lending since the beginning of 2016, recent months have seen renewed growth at an accelerating pace. The overall YoY rate of credit growth peaked at 7% in November. As recently as May, the rate had been just narrowly above 2%. Encouragingly, the lending growth has been almost entirely thanks to increased credit to the private sector. Throughout the year, the YoY change in credit to the Government has been fairly consistently negative.

As of November, business loans made up 53.3% of the total BHD8.6bn retail bank portfolio. Loans to the personal sector accounted for 43.2% while the share of the government sector was 3.5%.

Credit growth by retail banks has been accelerating fairly consistently in recent month

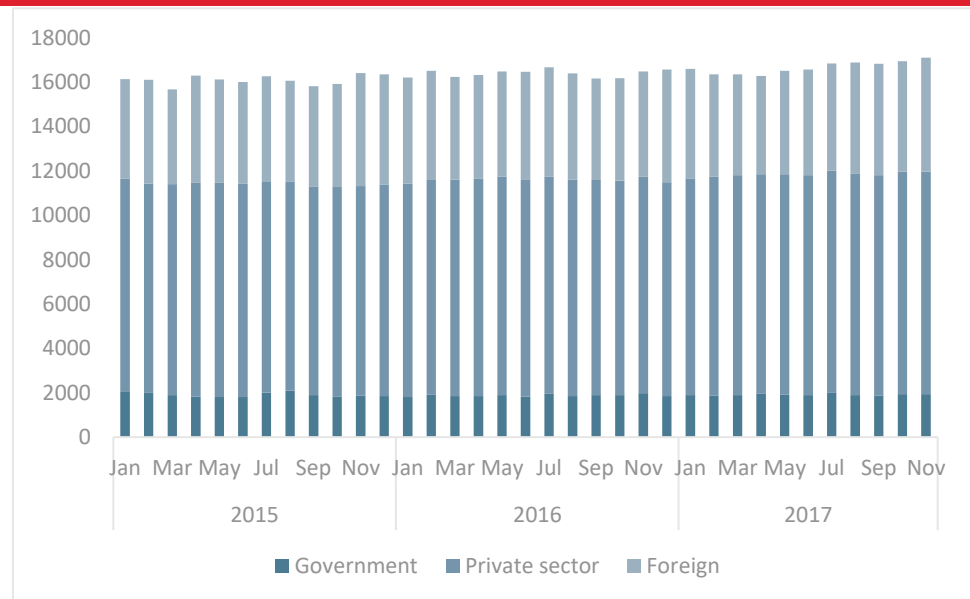
YoY growth in credit issued by retail banks, BHD mn



Source: Central Bank of Bahrain

In spite of a tighter liquidity situation across the GCC region, the deposit base of Bahraini retail banks has continued to grow. The total value of deposits in November stood at BHD17.1bn. This marked a 3.8% increase in YoY terms.

Deposit liabilities to non-banks, BHD mn



Source: Central Bank of Bahrain

The ongoing gradual policy tightening by the US Federal Reserve has been mirrored by higher policy rates in Bahrain. In December, the Central Bank raised the rate on its one-week deposit

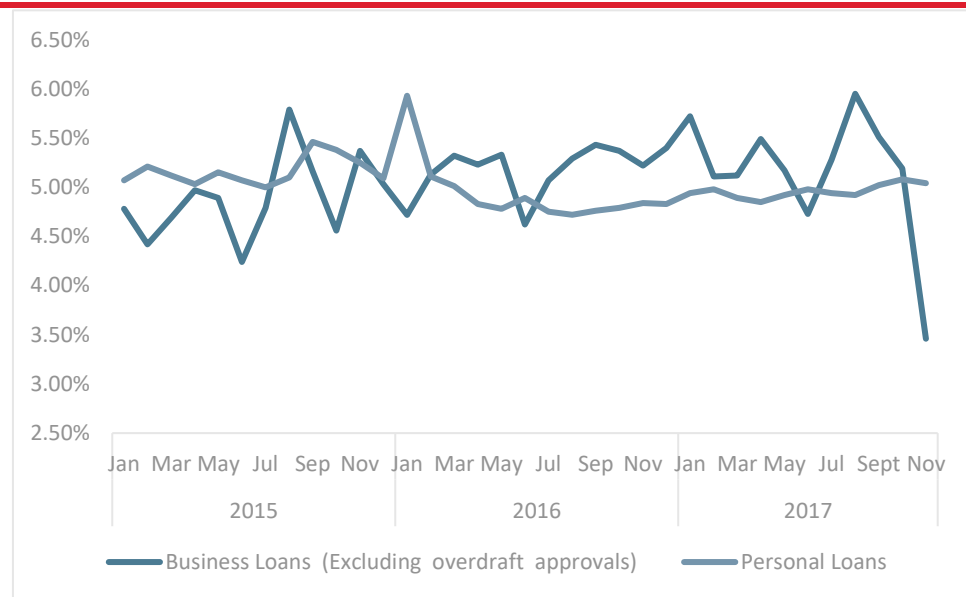
Deposit growth has accelerated to almost 4% YoY

The cost of credit has remained largely flat in spite of the US rate increases

facility from 1.5% to 1.75%. The overnight deposit rate rose from 1.25 to 1.5%, the one-month deposit rate from 2.15% to 2.4%, and the lending rate from 3.25% to 3.5%.

In spite of this, the cost of capital in Bahrain has remained more or less flat. The average interest rate charged by conventional retail banks for business loans dropped exceptionally under 3.5% in November. It averaged 5.2% during the first 11 months of the year. Whereas business loans have manifested a degree on month-to-month volatility, the cost of personal loans has been virtually flat. It reached just over 5% in November, which left the YTD average at just under 5%.

Average rate of interest on credit facilities (conventional retail banks)



Source: Central Bank of Bahrain

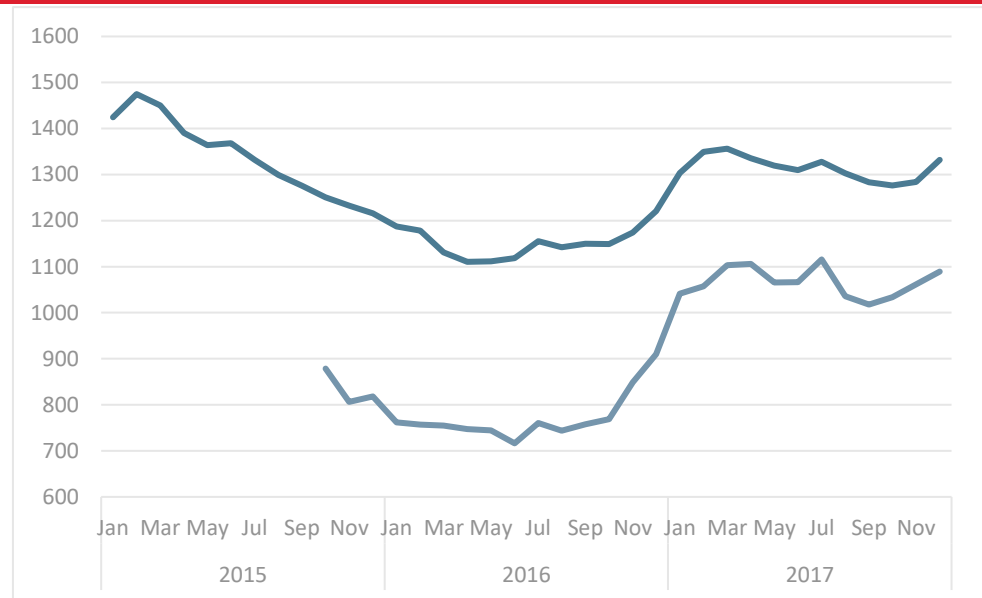
Capital markets regain lost ground

Bahrain Bourse closed the year 2017 with a 9.1% net gain

The performance of Bahraini Bourse improved somewhat during the closing weeks of the year after a relatively lacklustre second half. This end-year rally left the BAX general index up by 9.1% for the year, the second largest gain in the region. The Bahrain Islamic Index mirrored similar dynamics but ultimately closed the year with a 19.7% gain.

The value of shares traded during the year reached BHD211.3mn, which marked a 69.8% increase on 2016. The trading volume increased by 53.9% to 1.13bn shares. Bahraini investors accounted for 68.2% of the total value of trading.

Bahrain All Share Index and Bahrain Islamic Index

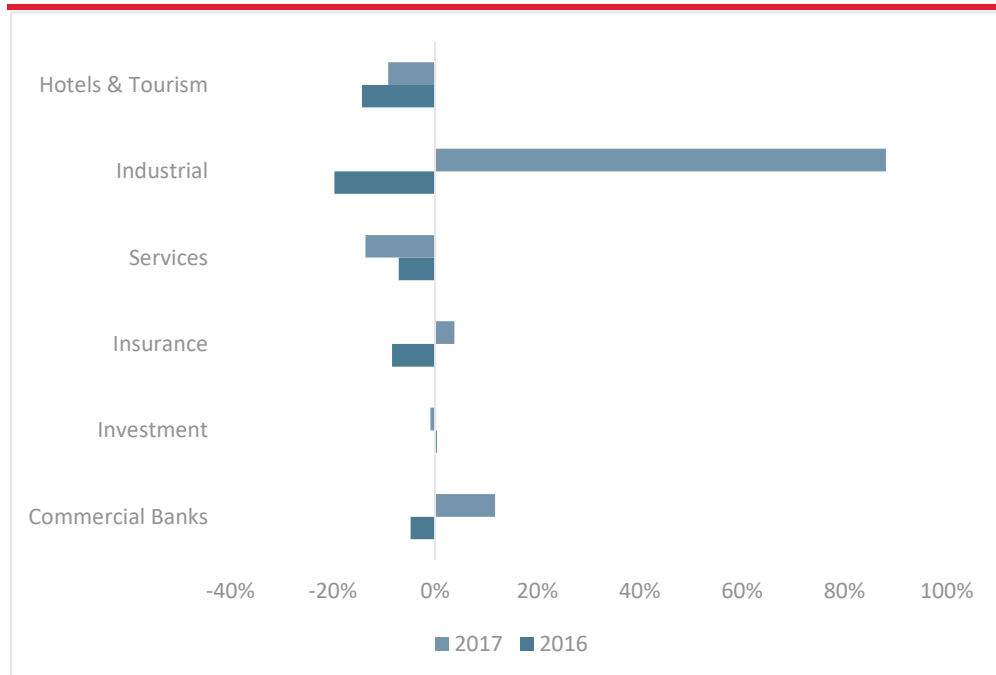


Source: Bahrain Bourse

The Industrial sector posted an exceptional year with 88.2% growth

The performance of individual sectors during 2017 was highly variable. The sharpest improvement was seen in the industrial sector, which was up a remarkable 88.2%. This marked an impressive turnaround from a 19.7% correction during 2016 as a whole. Commercial banks were the second the strongest sector with a 11.7% YoY advance. The insurance sub-sector posted a 3.8% gain. The other three indices were negative: investment -0.9%, hotels & tourism -9.2%, and services -13.6%.

Sectoral stock market indices, 2016-2017

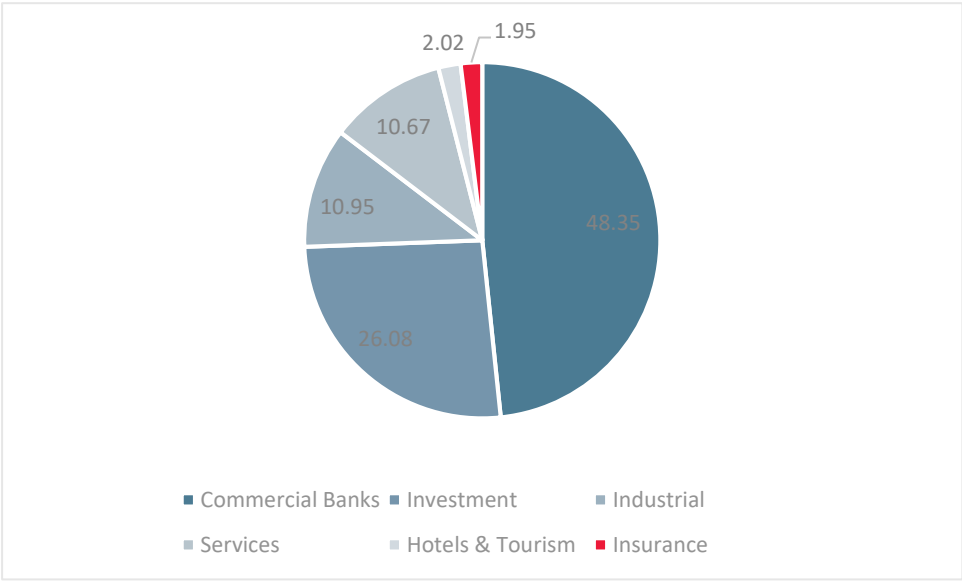


Source: Bahrain Bourse

The market capitalization of Bahrain Bourse reached BHD8.2bn at the end of the year. This marked a 12.4% increase over BHD7.3bn in 2016. Commercial banks remained the dominant sector

accounting for 48.4% of total capitalization. The share of investment houses was 26.1%. The industrial sector made up 11% of the total.

Sector breakdown of Bahrain Bourse capitalization, December 2017 (%)



Source: Bahrain Bourse

Among listed companies, Ithmaar Holding in December received approval from the UAE’s Securities and Commodities Authority to dual list of the Dubai Financial Market. The company is currently listed in Bahrain and Kuwait.

In the fixed income space, the Central Bank of Bahrain in late December arranged issue no 15 of Government Development Bonds. The BHD200mn offering has a 5.5-year tenor and was fully subscribed. The bonds will have an expected interest rate of 5.5%.

Otherwise, regular short-term issuance of Treasury bills and sukuk continues with a slight increase in interest rates evident. In the corporate space, Nogaholding has reportedly hired banks to prepare for the issuance of a 10-year bond.

Securities issued by the Central Bank have seen a slight increase in rates

Issue date	Issue	Value, BHD mn	Maturity, days	Average interest/ profit rate, %	Average price, %	Over- subscript ion, %
1 Oct 2017	Treasury bill No. 1671	35	182	3.01	98.502	120
4 Oct 2017	Treasury bill No. 1672	70	91	2.61	99.344	111
11 Oct 2017	Treasury bill No. 1673	70	91	2.66	99.332	111
12 Oct 2017	Sukuk al ijarah No. 146	26	182	2.75		100
18 Oct 2017	Sukuk al salam No. 198	43	91	2.60		100
25 Oct 2017	Treasury bill No. 1674	70	91	2.73	99.315	100
26 Oct 2017	12-month Treasury bill No. 38	100	365	3.41	96.665	118
1 Nov 2017	Treasury bill No. 1675	70	91	2.67	99.328	144
8 Nov 2017	Treasury bill No. 1676	70	91	2.70	99.321	107
9 Nov 2017	Sukuk al ijarah No. 147	26	182	3.00		121
12 Nov 2017	Treasury bill No. 1677	35	182	2.98	98.513	100
15 Nov 2017	Treasury bill No. 1678	70	91	2.72	99.317	128
22 Nov 2017	Sukuk al salam No. 199	43	91	2.72		100
29 Nov 2017	Treasury bill No. 1681	70	91	2.79	99.299	117
30 Nov 2017	12-month Treasury bill No. 39	100	365	3.49	96.590	145
3 Dec 2017	Treasury bill No. 1680	35	182	3.02	98.494	256
6 Dec 2017	Treasury bill No. 1681	70	91	2.84	99.286	100
13 Dec 2017	Treasury bill No. 1682	70	91	2.95	99.261	117
14 Dec 2017	Sukuk al ijarah No. 148	26	182	3.05		100
20 Dec 2017	Sukuk al salam No. 200	43	91	2.98		100
28 Dec 2017	12-month Treasury bill No. 40	100	365	3.68	96.414	117
31 Dec 2017	Treasury bill No. 1684	35	182	3.09	98.463	117
3 Jan 2018	Treasury bill No. 1685	70	91	3.09	99.225	100

Source: Central Bank of Bahrain

Job creation slows down in Q3

Private sector job creation decelerated markedly in Q3, albeit primarily to one-off factors

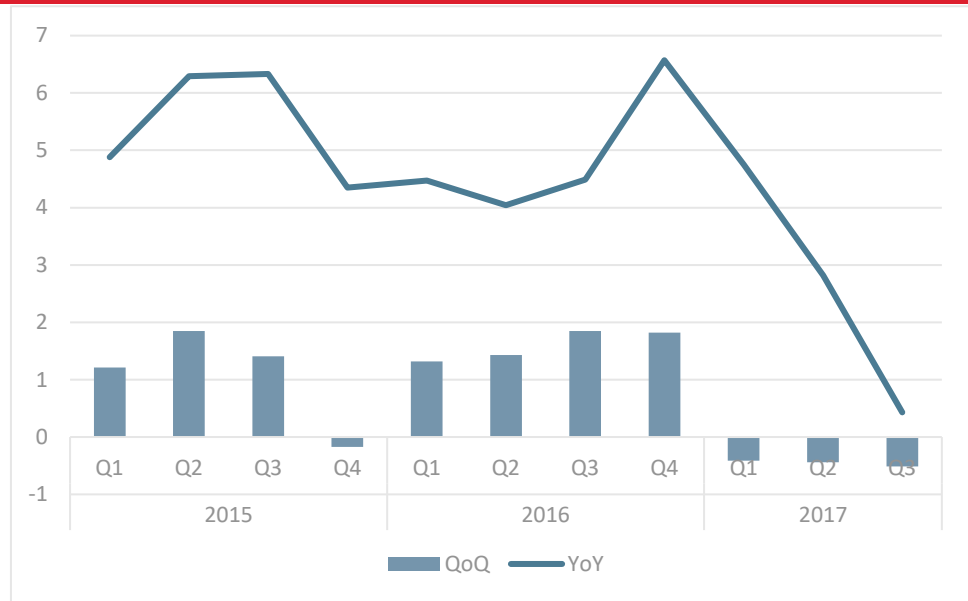
The pace of new job creation in Bahrain slowed down markedly in 3Q17. The YoY rate of growth in employees registered with the Social Insurance Organisation dropped to 0.4% as compared to a pace of 4.5% a year earlier. Indeed, the rate of growth had peaked at 6.6% in 4Q16. The quarter-on-quarter change in jobs has been negative for three consecutive quarters after brisk growth in 2016.

This dynamic is partly reflective of a period of stabilization after rapid growth as companies built up their employee base for the large infrastructure projects. Some of its caused by the cancelation of visas linked corporate registrations that were not renewed. Increases in new project spending in 2018 mean that this slowdown in new job creation is likely to be temporary.

As of 3Q17, the Social Insurance Organisation membership included a total of 649,630 contributors broken down as follows:

- ✦ 595,354 individuals working in the private sector and 54,276 public sector employees. Of this total 504,023 were non-nationals
- ✦ A Bahraini national labour force of 145,607 composed of 91,331 individuals working in the private sector and 54,276 employed in the public sector

Change in the number of members of the Social Insurance Organisation (%)



Source: Social Insurance Organisation

External assessments

Index/report	Description	Global rank	MENA rank	Key strengths highlighted
Doing Business by the World Bank	<p>Measures and track changes in key areas of regulation affecting businesses:</p> <ul style="list-style-type: none"> ✦ starting a business ✦ dealing with construction permits ✦ getting electricity ✦ protecting minority investors ✦ registering property ✦ getting credit ✦ resolving insolvency ✦ trading across borders ✦ enforcing contracts ✦ paying taxes <p>Based on a review of regulations, business responses, and World Bank assessments of governments</p>	66 (out of 190)	2	<p>The main strengths for Bahrain are:</p> <ul style="list-style-type: none"> ✦ paying taxes – ranked fifth globally ✦ registering property – ranked 25th globally ✦ economy ✦ politics <p>The most significant improvements was recorded in the area of trading across borders where Bahrain's position improved four places</p>
Gender Gap Report by World Economic Forum	<p>Quantifies gender disparities and tracks their progress over time. Focuses on the relative gaps between men and women in four key areas:</p> <ul style="list-style-type: none"> ✦ health ✦ education ✦ economy ✦ politics 	126 (out of 144)	1	<p>Bahrain was named one of the regional best performer having closed 63-65% of its overall gender gap. Bahrain leads in the GCC because of:</p> <ul style="list-style-type: none"> ✦ Wage equality for comparable work ✦ Estimated earned income ✦ Legislators, senior officials, and managers

Index/report	Description	Global rank	MENA rank	Key strengths highlighted
ICT Development Index by the UN International Telecommunications Union	<p>Measures ICT development based on:</p> <ul style="list-style-type: none"> ✦ skills ✦ access ✦ usage <p>Draws primarily on quantitative data from UNESCO and ITU</p>	31 (out of 188)	1	<p>Bahrain outperforms the rest of the region in terms of ICT access and usage. Key strengths:</p> <ul style="list-style-type: none"> ✦ 98% of the population are internet users ✦ 217% of the population have mobile subscriptions ✦ 162% of the population have mobile broadband subscriptions
Islamic Finance Development Report by Thomson Reuters	<p>Assesses the Islamic finance industry across all its component segments. Measures the overall health and development of the industry based on: on:</p> <ul style="list-style-type: none"> ✦ quantitative development ✦ knowledge ✦ governance ✦ corporate social responsibility ✦ awareness <p>Based on quantitative sources compiled by Thomson Reuters and ICD (Islamic Corporation for the Development of the Private Sector)</p>	2	1	<p>Recognizes Bahrain as:</p> <ul style="list-style-type: none"> ✦ the global leader in Islamic financial regulation ✦ the global leader in Shariah governance ✦ the regional leader in Islamic financial awareness ✦ the regional leader in Islamic finance knowledge ✦ home of several internationally significant Islamic financial organizations

KEY SECTORS

SHAPING A DIGITAL ECONOMY

Building a FinTech hub

Bahrain is set to launch the Middle East-North Africa region's first dedicated FinTech hub

Following transformative progress in 2017 in adopting key planks of the regulatory framework for FinTech, Bahrain is set to launch the first dedicated FinTech hub and corporate incubator in the Middle East and Africa region. Bahrain FinTech Bay will be operated by the Singapore-based FinTech incubator, Fintech Consortium. The 10,000 sq ft facility will include shared infrastructure such as co-working spaces.

The facility is designed to leverage the latest available technology along with a global network to create a collaborative ecosystem to drive the growth of FinTech in Bahrain and the broader region. It will bring together tech entrepreneurs with established corporates as well as regulators and investors. The hub will collaborate closely with the Central Bank of Bahrain, notably its new, dedicated FinTech and Innovation Unit, and the Bahrain Economic Development Board. Six companies have joined the FinTech sandbox to date.

Creating awareness of the potential of FinTech is a key mission of the hub. To this end, it will organize and host educational courses, events, and conferences. The development of the sector follows a number of recent initiatives including the FinTech regulatory framework introduced by the Central Bank, as well as crowdfunding regulations and investments in cloud computing. Key priorities of further regulatory reform going forward are a new bankruptcy law, open data law, and enhanced cybersecurity regulations.

FinTech investments are driving transformative innovation in financial services. Considerable progress has already materialized in areas such as digital payments, e-wallets, and robo-advisory services. By boosting security and transparency, RegTech can help financial institutions meet their increased reporting and compliance requirements more efficiently and at less cost.

The Central Bank has also introduced new regulations in the area of asset management:

- ✦ In November, new directives related to Bahrain-dominated real estate investment trusts (REITs) were issued as part of exchange traded funds. ETFs are recognised as a type of collective investment undertaking (CIU) under Volume 7 of the CBB Rulebook. The new regulations will enable retail investors to invest in local REITs
- ✦ In December, the CBB issued new rules to recognize offshore and locally domiciled exchange traded funds. ETFs are recognised as a type of CIU under Volume 7 of the CBB Rulebook.

New licenses in Q4 included a wholesale branch license for UAE-domiciled Mashreqbank. Mashreq has operated in Bahrain since 1980, and has held a full commercial bank (retail branch) license since 2005.

Developing the ICT infrastructure

Bahrain is currently making substantial investments in its ICT infrastructure and ecosystem in a bid to make digitization and creative tech-based entrepreneurship key drivers of economic activity. For instance, the second half of 2017 saw a number of events designed to create publicity and drive this agenda forward. These included the Amazon Web Services (AWS) Summit, the Technology Week Tent, and the MIT Innovation Conference. Bahrain in November also hosted the 10th Global Entrepreneurship Week, which is intended as an annual celebration of innovators and job creators. The Week involved more than 30 events under the auspices of Tamkeen.

Bahrain is a regional leader in most key aspects of ICT development and the growth of the sector remains robust

Statistical indicators points to a continued rapid development of the ICT sector in Bahrain. It is currently estimated to be growing at more than 10% a year and projected to reach USD2.7bn by 2020. According to the Telecommunications Regulatory Authority (TRA), the percentage of Bahraini residents using the Internet has risen to 98% from 89% in 2015. All respondents to the TRA survey had access to mobile phones with 31% of the respondents having multiple SIMs – a decline from 41% in 2015. 29% of the respondents said they used e-commerce with the remainder tending to refer to potential security risks as a concern. The TRA survey had 1,621 respondents aged 15 or above. 90% of the respondents expressed satisfaction with their mobile service and 84% with their Internet service.

Data usage in Bahrain increased by 53% to more than 296.5 mn GB on broadband packages during 2016. 48% of fixed broadband connections were able to receive access speeds of 10Mbit/s or more in 2016, up from 36% the year before. Mobile penetration in Bahrain was 184% in the middle of 2017. Nearly 71% of mobile customers have data subscriptions, up from 64% the year before. Average monthly data use per broadband connection rose by an annual 30% to 70.2 GB in 4Q17. Mobile broadband connections saw a 37% increase to 7.8 GB.

According to iGA, the number of electronic transactions in Bahrain increased by an annual 51% to 28,000 during Q3. The aggregate value of financial payments rose by 69% to more than BHD24mn over the same period. iGA is pursuing an eTransformation agenda designed to make electronic service provision the default choice. The national bahrain.bh portal saw 244,000 transactions worth BHD22mn during the first three quarters of the year, a 44% YoY increase. The website is used for utilities bills, driving licenses, University of Bahrain services, and company registration.

Bahrain is working to connect 95% of residences and 100% of business districts to the national broadband fibre optic network by 2019. The project is currently 60% complete. The network will be operated by Netco, which will in turn provide standardized services to all telecommunications providers in the Kingdom.

Bahrain's international rankings reflect its ICT competitiveness. Having been the first regional economy to liberalize its telecommunications sector in 2004, Bahrain was ranked first in the Middle East-North Africa region for e-government development by the United Nations in 2016. The World Economic Forum had its top the region for ICT use, while the International Telecommunications Union ranked first regionally for ICT development.

Manufacturing momentum

Large-scale manufacturing projects will be an important element in Bahrain's growth narrative in the near- to medium term:

- ✦ Alba's Line 6 is expected to start production in early 2019. It will add some 540,000tn to Alba's overall production capacity, which will then reach a total of 1.6 tn a year, making Alba the world's largest single-site smelter. The project will be supported by a new power station 5, which is critical for further boosting Alba's efficiency. The generation capacity will be some 1,800 MW. The Line 6 engineering, procurement, and construction management is handled by Bechtel, while GE and Gama are constructing PS5
- ✦ The main USD4.2bn contract for the Bapco Modernization Program was awarded in early December to a consortium made up of TechnipFMC, Samsung Engineering, and Technical Reunidas. The engineering, procurement, construction, and commissioning project is designed to expand the capacity of the region's oldest refinery from 267,000 to 360,000 b/d while enhancing the product mix, improving energy efficiency, and meeting environment standards. Completion is expected by 2022. Technip was responsible for the FEED project. Three other consortiums submitted bids for the program. To secure the feedstock, a new 350,000 b/d oil pipeline between Saudi Arabia and Bahrain is due to be completed next year
- ✦ Bapco is also expected to issue a request for proposal for EPC contracts to develop its planned USD1.5bn Aromatics Complex
- ✦ Nogaholding and Schmidt Heilbronn of Germany have opened a logistics centre in the Bahrain Logistics Zone. The venture will be known as Schmidt Logistics Bahrain. Involving investments of USD20mn, the facility is expected to create 100 direct and indirect jobs

Also lighter manufacturing has wind in its sails. The Ministry of Industry, Commerce, and Tourism (MoICT) in 2017 allocated 36 industrial plots in specially zoned areas, an increase from 23 in 2016. At the moment, 89% of government land earmarked for industry is in use. New spaces are set to become available by early 2019 when the East Sitrah industrial area begins operations. The new Northern Town development is expected to have areas allocated for light industry.

Apart from infrastructure development, the Government is working to improve the regulatory framework governing the manufacturing as well as the broader corporate sector:

- ✦ The Companies Law will be amended to better protect the rights of minority shareholders
- ✦ A new bankruptcy law is set to be introduced along with an amendment to the auditors' law, a new Competition Encouragement and Protection Law, a Corporate Governance Charter, rules on professional offices, and various other regulations
- ✦ MoICT is leading the drafting of a new small and medium enterprise strategy. The Cabinet has agreed to allocate 20% of government procurement and tenders to SMEs. A new competition authority will be set up under the competition law to permit a more competitive market place.

Bahrain's manufacturing sector will be reshaped by transformative investments over the coming years

Tourist infrastructure investments

Bahrain is going through a period of unprecedented investments in its tourism infrastructure. Some 14 strategic projects with an aggregate value of over USD13bn are currently reshaping the tourism landscape in the Kingdom. This expansion is going hand in hand with sharp increases in tourist visits which expanded by an annual 12.8% to an aggregate of 8.7mn during the first nine months of the year, according to the Tourism Survey of iGA and the Bahrain Tourism & Exhibitions Authority.

Some USD13bn worth of strategic investments are currently underway in Bahrain's tourism sector

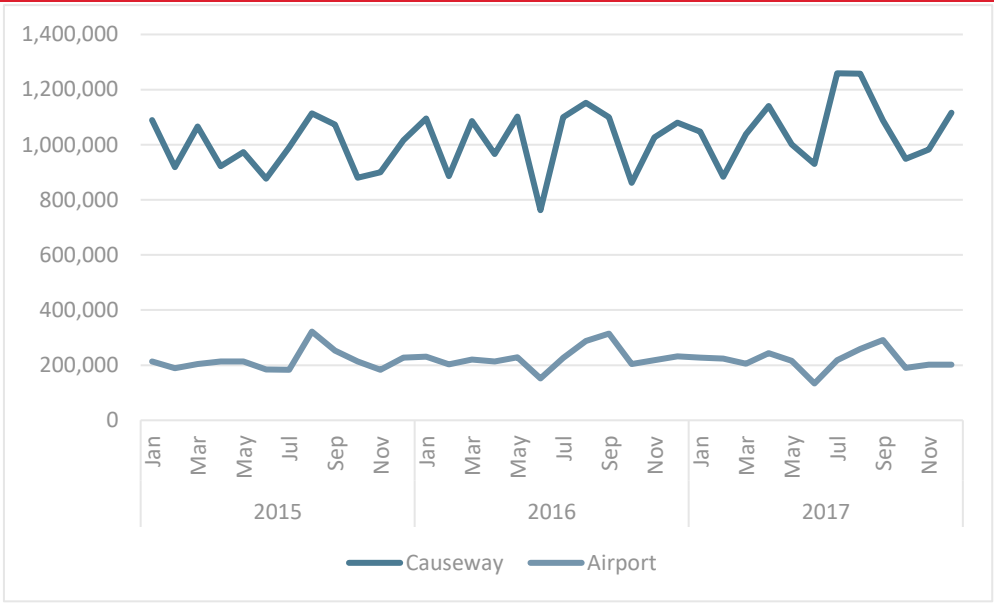
Key developments in the sector include:

- ✦ The USD1.1bn airport modernization program, which is set to expand capacity from nine to 14mn passengers a year by 2020
- ✦ Significant increases in hotel capacity through new five and four-star facilities, including the Address Hotel and Vida in Marassi al Bahrain, which is part of the large Diyar al Muharraq development
- ✦ Several shopping malls led by the recently opened USD159mn Avenues Mall in Bahrain Bay. Projects under development include the Dilmunia Mall and the Marassi Galleria in the north of Bahrain
- ✦ Investments in medical tourism are led by the large King Abdullah Medical City project in the south of the main island
- ✦ A number of mixed-use real estate projects, including Bahrain Bay, Bahrain Marina, Diyar al Muharraq, Water Garden City, and Dilmunia

The Ministry of Industry, Commerce, and Tourism is introducing or preparing a number of initiatives in order to boost the development of the sector. These include regulations for food trucks and sea tourism. 2018 is expected to see a greater focus of water sports and more effective utilization of opportunity created by Bahrain's coastlines. The Ministry is also planning to undertake electronic surveys of the hospitality sector.

Visitor numbers in Bahrain have continued to grow throughout the year, although the pace of increase has moderated somewhat. The total number of inbound visitors during the year was just over 15.3mn, up just under 2.4% from the 2016 total. Growth continued to be firmly led by traffic on the King Fahad Causeway where the cumulative number of inbound arrivals rose to nearly 12.7mn, up by almost 3.9% over 12.2mn a year earlier. Airport arrivals declined very marginally and totalled just over 2.6mn.

Visitor arrivals by port of entry



Source: Ministry of the Interior – Nationality, Passports & Residence Affairs

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