

Bahrain Economic Quarterly

June 2014



SUMMARY

POSITIVE MOMENTUM CONTINUES

The global economy is continuing its gradual recovery with increasingly positive employment data from the US and looser monetary policy in the EU. While the historically high valuations at which global equity markets are trading is a source of concern, major discontinuities are generally viewed as unlikely in the near term. This should translate into a generally positive backdrop for the regional and local economy.

- ▶ **Bahrain's GDP growth is led by the non-oil sector.** Reflecting regional trends, economic growth this year is likely to be almost entirely reliant on the non-oil sector. The initiation of a significant number of infrastructure projects, many of them funded by the GCC Development Fund, will drive activity through numerous linkages and positive confidence effects.
- ▶ **Bahrain's oil output looks likely to remain flat this year but several significant oil and gas sector projects are getting underway.** The main oil fields are likely to continue production at capacity in line with last year levels. Important new projects in the sector include the LNG import terminal, exploratory drilling for deep gas, and the Saudi pipeline upgrade.
- ▶ **The regional economy looks likely to reach trend growth fueled by the non-oil sector.** The dynamics of the global oil sector, most notably continued increases in non-OPEC output, may limit the opportunities for output gains in an environment of relative price stability. However, the non-oil growth drivers appear increasingly robust across the region.
- ▶ **The global economy is experiencing a degree of rebalancing.** The ongoing recovery in the West is showing signs of growing consolidation, above all in the US. The relative underperformance of emerging markets is continuing, although there are some indications of a greater willingness to engage in structural reforms to boost growth.

Bahrain economic outlook

	2013	2014f	2015f	2016f
Real GDP growth, %	5.3%	3.5%	4.3%	4.5%
Non-hydrocarbons sector	3.0%	4.4%	5.1%	4.5%
Hydrocarbons sector	15.3%	0.1%	1.0%	4.4%
Nominal GDP growth, %	8.0%	4.5%	6.5%	6.9%
Inflation (CPI %)	3.3%	3.0%	3.0%	3.0%
Current account (% of GDP)	7.8%	6.1%	6.1%	7.3%
Fiscal balance (% of GDP)	-3.3%	-3.0%	-3.0%	-3.0%
Crude Oil Arabian Medium (USD)	106.4	105.0	105.0	105.0

Source: Bahrain Economic Development Board

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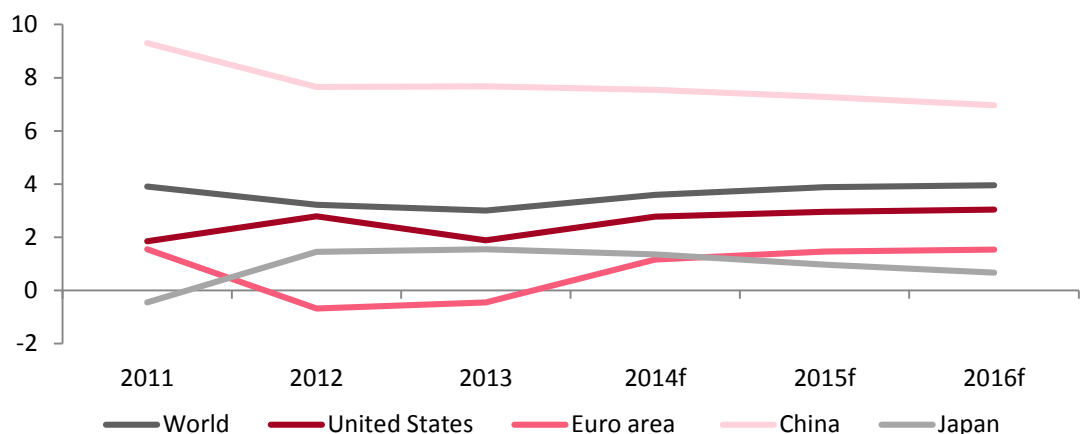
GLOBAL ECONOMY

THE RECOVERY STRENGTHENS

The positive momentum of the global recovery has continued but with significant differences among countries.

The global economy has continued its gradual recovery from the longest period of sub-par growth since World War II. This momentum looks likely to continue, although the dynamics remain uneven. The track record of the emerging markets as the driving force of global growth has given way to a much more mixed picture, partly as a result of policy tightening in many of these countries in response to last year's market volatility. In the West, the US rebound is fairly advanced whereas the Euro-zone continues to struggle with slow growth against the backdrop of historically low levels of capacity utilization. Japan saw a robust acceleration to 6.7% YoY growth in Q1, albeit likely partly due to an increase in investment spending ahead of a consumption tax increase in April. In spite of the generally positive dynamics of the global economy, the outlook continues to be characterized by unusual risks ranging from the geopolitical situation to the possibility of deflation in some advanced economies.

Real GDP growth, select countries (%)



Source: International Monetary Fund, World Economic Outlook, April 2014

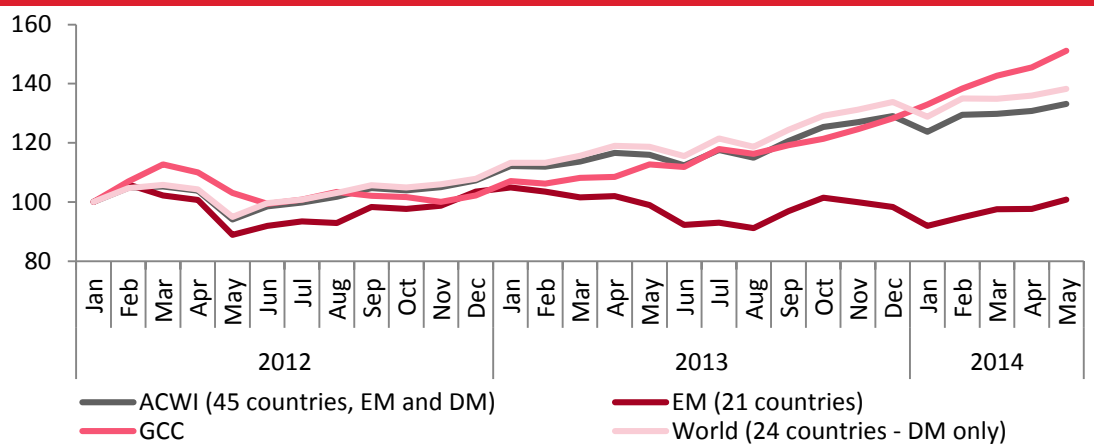
With global GDP growth set to accelerate, the growth differential between the advanced and emerging markets looks likely to diminish.

The International Monetary Fund (IMF) currently expects global growth to pick up somewhat from last year's 3% pace to 3.6% this year and 3.9% in 2015. Growth in the advanced economies is projected to average some 2.3% a year over this period, led by a roughly 2.8% pace of expansion in the US. The increasingly positive momentum in the West is supported by diminished fiscal drag and generally permissive monetary policy conditions. The emerging economies are expected to see a slight improvement in their performance from 4.7% real growth in 2013 to approximately 5% this year and 5.3% next year, partly thanks to strong demand by the West for their exports.

The environment of low – and in many cases declining – borrowing costs along with strengthening optimism is pushing equity markets around the world to new highs in spite of the fact that the global recovery remains relatively uneven and potentially fragile. The recent gains are partly reflective of increased optimism after a period of elevated risk perceptions in the spring has subsided. Significant near-term policy tightening is seen as unlikely and many of the geopolitical risk factors that had rattled markets in recent months are seen as more manageable.

There is growing market concern that the performance of asset markets may be diverging unsustainably from the still fragile economic fundamentals and trigger a correction. The permissive monetary policy environment around the world has reduced price volatility across a wide range of asset classes to a historically low level. Among other things, this poses risks of leverage-driven speculative activities. At the same time, market valuations are close to their historic peaks.

MSCI regional indices (Base Jan 2012=100)



Source: MSCI

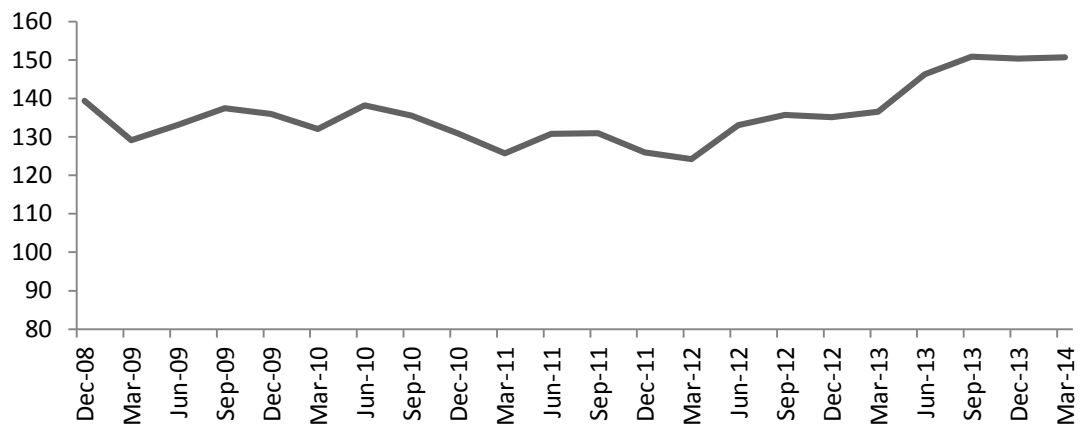
US job creation returns to pre-crisis levels

In spite of a sharp deceleration in growth in Q1, the US economy is showing signs of an increasingly sustainable recovery with jobs rebounding to pre-crisis levels.

According to revised growth estimates, the US real GDP contracted by 2.9% in Q1, which compared to an original estimate of 0.1% growth. This was the worst quarterly performance in three years and compares to 2.6% YoY expansion in 4Q13. The unexpectedly sharp drop was primarily attributed to an unusually cold winter, which affected retail sales and business investment. About two-thirds of the decline was due to the health care sector following regulatory changes introduced by the administration. Growth is generally expected to have rebounded sharply in Q2.

In an economy that is 70% of dependent on consumption, the recent performance of the asset markets has created a significant positive wealth effect which should sustain spending growth after a lengthy period of deleveraging. The wealth of US households is expected to have grown by 1.9% to USD81.8trn in Q1. This represents an 11% gain over a year ago and a 43% rebound since the trough seen during the 2008 recession. In spite of the asset price inflation, the national stock of mortgage debt is continuing the downward trend that began in 2010. However, rising consumer credit has begun to push up overall indebtedness. Corporate borrowing is also continuing, fueled by low interest rates. In gross terms, outstanding corporate debt reached USD9.6trn – 34% higher than 2007.

S&P/Case-Shiller US National Home Price Index



Source: Standard & Poor's

In an important reflection of the positive dynamics in the economy, US employment has continued its steady recovery in recent months and in May exceeded its pre-recession levels in absolute numbers. The US economy created 217,000 new jobs in May, marking four straight months of job creation in excess of 200,000. However, as a legacy of an unusually lengthy downturn, the labour market participation rate of 62.8% is at its lowest level since the late 1970s. Wage inflation is still modest with average hourly earnings up 2.1% on a year ago.

The improving performance of the economy has allowed the Federal Reserve to continue with the gradual phasing out of its quantitative easing policies. The Federal Open Market Committee in April announced that the bank would cut its monthly asset purchases by a further USD10bn to USD45bn, down from a peak of USD85bn. However, the Fed also pledged to keep rates low as long as unemployment was above 6.5% and the outlook for inflation did not exceed 2.5%. The partial withdrawal of monetary stimulus in the spring appeared to have some effect on stalling the housing market recovery where the increased cost of mortgages has slowed down refinancing. However, renewed declines in bond yields may counter this effect.

Monetary easing and voter unease in Europe

The fears of a Euro-zone break-up have largely abated but growth remains anemic.

The Euro-zone has increasingly emerged as the relative laggard in the ongoing global recovery, although this now appears to be over. The risk of a Euro-zone break-up now seems minimal as bond yields in the critically important Spanish and Italian markets have fallen below 3%. The troubled peripheral economies have seen significant economic rebalancing and been able to return to the bond market.

But while the worst now appears to be over, growth in general remains anemic and new job creation has been minimal. The main perceived risks in Europe seem to have shifted to a possible risk of deflation as well as the political fall-out from a longstanding crisis. The European Parliament elections in May involved a strong protest vote with anti-establishment parties triumphing in countries such as France and the UK. The annual pace of consumer price inflation in the Euro-zone in May was a very low 0.5%, the lowest reading in more than four years and far below the 2% target of the European Central Bank (ECB). The core inflation rate has nearly

halved from the 1.3% rate observed over the past six years, which suggests that the structural inflation drivers have become muted at best. Falling into deflation would create the prospect of a growing debt burden in real terms, as well as delayed consumption, at a time when the regional economy is barely emerging from a protracted recession. New inflationary pressures are likely to remain minimal with unemployment in April standing at 11.7% in a marginal improvement from 12% a year earlier. Overall, the ECB expects growth of 1% this year.

The European Central Bank has embarked on another round of policy easing in a bid to counter deflationary tendencies in the economy.

The ECB Governing Council in June committed to using “all unconventional instruments” within the bank’s mandate to counteract any deflationary risk. The bank further reduced its refinancing rate from 0.25% to 0.15%. In an unprecedented step, the rate of deposits by commercial banks was reduced below zero to -0.1%. A new mechanism of targeted long-term refinancing operations was introduced to boost liquidity. Financial institutions will be allowed to borrow up to three times their net lending to private sector entities outside of financial services and mortgages. The program is due to run for four years and has an initial budget of EUR400bn. The bank also announced its intention to work on ways to purchase asset-backed securities along the lines of the quantitative easing policies pursued in the US and elsewhere. The monetary easing should put some downward pressures on the Euro in relation to other key currencies and should enhance the competitiveness of European exporters.

The performance of the European economies outside the Euro-zone has generally remained significantly stronger than that of the European core. In spite of a stronger rebound in the UK economy, which saw annual real GDP growth of 3.1% in Q1, the Bank of England has continued to maintain a cautious approach to retreating from its ultra-loose policy stance. The Monetary Policy Council this month agreed to keep rates at 0.5% while maintaining the stock of bond purchases at GBP375bn. The policy continuity was justified by slack in the labor market and the absence of inflationary pressures. However, asset price inflation has rebounded in response to policy initiatives to stimulate the housing market. A housing bubble driven by growing leverage levels was cited by the IMF as a main risk to the ongoing recovery.

A mixed picture for emerging markets

After a period of relative underperformance, the outlook for the emerging economies appears to have improved somewhat. In particular, fears of a sharp slowdown in China have abated significantly. The Chinese economy grew at an annual pace of 7.4% in Q1 in a slight deceleration from the 7.7% pace seen in 4Q13. In an encouraging sign, China’s trade surplus expanded sharply in May to USD36bn, as compared to USD20.4bn a year earlier. Reflecting a stronger global economy, exports rose by an annual 7%. By contrast, imports contracted by 1.6% YoY. Also the purchasing manager’s index reading for May was at 50.8 the highest so far this year and an indication of possible recovery in the industrial sector. This positive indicator comes at a crucial time to counter signs of a slowdown in the Chinese real estate market which is considered one of the strongest drivers of the Chinese economy.

There is mounting concern about the sustainability of the Chinese property market which has grown at an unprecedented pace to account for about 23% of China’s GDP in 2013 according to Moody’s Analytics estimates. Indeed, the IMF has warned that growth next year could fall below 7% due to property market pressures and higher leverage. However, May’s reading of the China

Emerging market growth is likely to benefit from renewed stimulus in China. Similarly, a new government in India is expected to introduce structural reforms needed to accelerate growth.

Real Estate Index shows that average prices for new homes witnessed the first month-on-month contraction since 2012. The Chinese government has indicated its willingness to resume efforts to stimulate economic activity. China in June announced a 50 basis point reduction in reserve requirements for a number of banks in a bid to stimulate bank credit.

India has been among the emerging markets seeing the sharpest loss of momentum in recent years and its external deficit has been a source of concern in the face of US monetary policy tightening. Potentially heralding new policy initiatives, the general elections in May produced the rare outcome of a clear majority for the opposition coalition headed by the Bharatiya Janata Party (BJP) of new Prime Minister Narendra Modi. The Indian economy expanded by 4.7% in the 2013-14 fiscal year and most estimates put this year's growth at less than 6%. Growth has been hampered by slower investments and inflationary pressures. The new government is expected to introduce reforms designed to tackle some of the supply-side bottlenecks that have been holding back growth.

Political risks mount in the oil market

Global oil prices have demonstrated exceptional stability in the face of significant demand and supply side pressures.

The global oil markets have continued to be characterized by significant disruptions on the supply side. Already before the latest escalation of violence in Iraq, market estimates suggested that the global output had been reduced by some 3.5 mbd from where it otherwise could have been. In spite of this, prices remained relatively stable throughout the spring, largely in reflection of the continued changes on the supply side that have shifted much of the incremental production globally from the OPEC economies to the unconventional oil fields of North America. As a result of these dynamics, global oil prices have experienced a remarkably long period of relative stability since 2011. Volatility last year declined to a ten-year low.

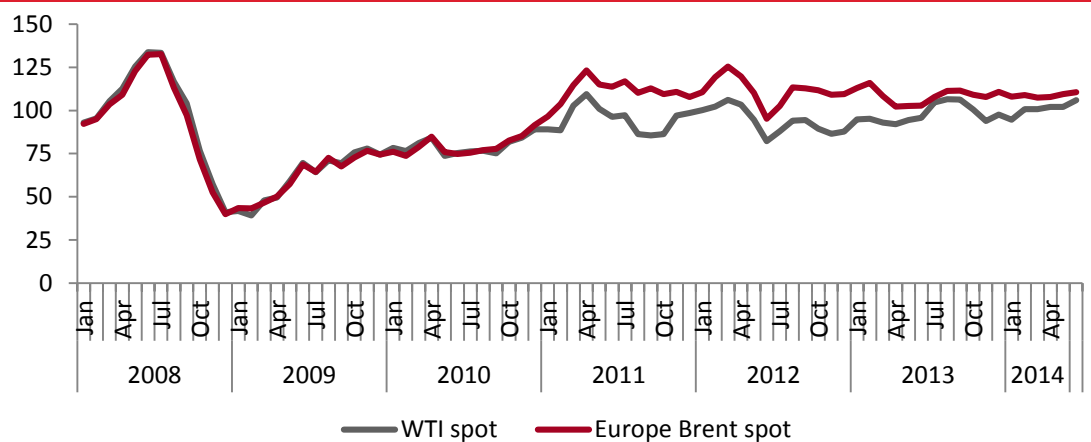
In spite of expectations of normalization of production in a number of key producers hit by instability in recent years, the global supply of oil has been constrained by political factors. Libya, where the militia seized some of the leading ports last summer, has seen output losses by as much as 80% in recent months. Political instability and sabotage in Nigeria have, similarly, reduced the country's daily output by some 300,000 b/d. Also, Iran's exports, contrary to some earlier expectations of growth, remained relatively steady at 1.5 mbd. In leading Latin American producers, most notably Venezuela and to an extent even Mexico, underinvestment and regulatory constraints have contained output gains. Risks perceptions have been further fueled by the ongoing tensions between Russia and Ukraine which, due the possibility of increasing sanctions, have raised concern about the availability of Russian oil in the market. These considerations are of particularly importance for Europe which sources close to a third of its oil from its eastern neighbor.

The recent escalation in internal strife in Iraq has potentially significantly complicated the situation further. While the southern oil fields and the area controlled by the Kurdistan Regional Government have been unaffected to date, oil production in the center of the country has been hit by the insurgency. Oil from Kirkuk cannot be easily exported following damage to the Iraq-Turkey pipeline earlier in the year. The 310,000 b/d Baiji refinery – the largest in the country – has suspended operations. Iraqi exports totaled 2.6 mbd in May and have so far been

unaffected. However, most new oil sector developments are on hold, which has raised doubt over Iraq's ability to boost its output.

In spite of the significant supply side disruptions, any potential shortfall in oil has in recent months been fully compensated for by increased output from the US and Canada. During the three-year period of relatively flat prices, the US oil output rose from some 3 mbd and now exceeds 8 mbd, a level that puts the country in close proximity of Saudi Arabia's output levels. Also Canadian oil output has risen by more than 1 mbd. These transformative changes have reduced US dependence on imports from 60% in 2005 to less than 30% now.

Crude oil prices (USD/barrel)



Source: US Energy Information Administration

Positive supply side dynamics remain vulnerable to political risk factors in many cases.

The positive dynamics in non-OPEC production are likely to continue in the near future with the latest projections by the International Energy Agency putting the total output gain at 1.7 mbd this year. This would be clearly ahead of the 1.4 mbd projected increase in global oil consumption. The gap is attributed to projections of slowing demand in China which has seen a drop in its oil demand for the past two quarters. However, expectations of a tighter demand-supply balance following the recent disruptions in Iraq have the potential to push up prices to a higher range.

Moreover, the positive supply side dynamics notwithstanding, oil is becoming significantly more expensive to extract. Especially the unconventional sources have limited lifetimes and short peak production time. In response to their inability to achieve returns on their investments in the face of high and mounting exploration costs, many global oil majors are considering reductions in development spending.

Global oil demand and supply dynamics (mbd)

	IEA	OPEC	EIA
2013 Global oil demand	91.4	90.0	90.4
Advanced economies	46.1	45.9	46.0
Emerging economies	35.1	28.9	33.6
<i>China</i>	10.1	10.1	10.7
2014 Global oil demand (mbd)	92.7	91.2	91.6
Advanced economies	46.0	45.8	46.0
Emerging economies	36.1	29.8	34.6
<i>China</i>	10.4	10.4	11.1
2013 Global oil supply (mbd)	91.6	90.1	90.4
OPEC	36.9	36.2	36.4
Non-OPEC	54.7	54.2	54.1
2014 Global oil supply (mbd)		91.2	91.6
OPEC		35.9	36.0
Non-OPEC	56.2	55.6	55.6

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

Implications for Bahrain

The global economic environment continues to solidify and the recent performance in the financial markets is likely to create a generally benign backdrop for the economy in the near term.

- ▶ The global cost of capital looks likely to remain low for an extended period in spite of the gradual moves toward tapering in the US. The strong commitment to a permissive monetary policy by the leading global central banks should allay fears of interest rate increases in the near- to medium-term.
- ▶ The slightly improving prospects of the Asian emerging markets should benefit trade and investment flows.
- ▶ A long period of price stability in the global oil markets is being tested by elevated political risk. Prices at or above current levels will boost Bahraini government revenues beyond the assumptions made in the budget.

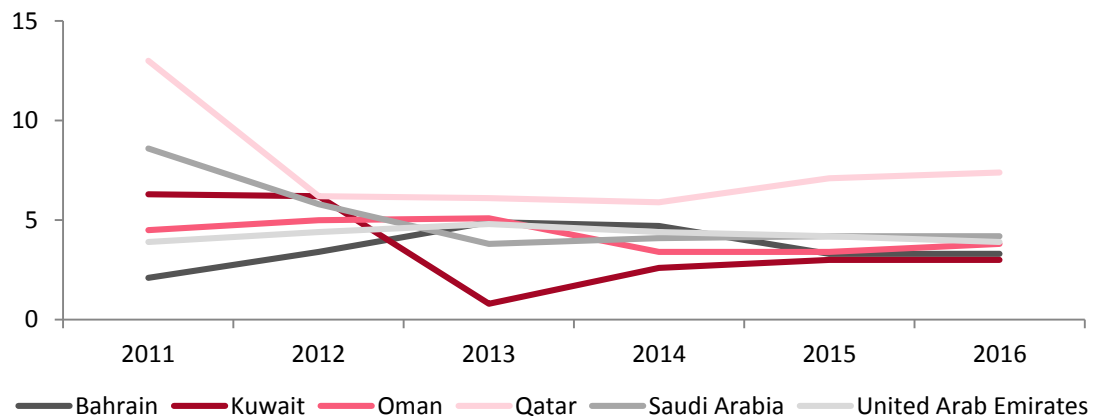
THE GCC REGION

ENDURING OPTIMISM

Regional growth has generally exceeded expectations in spite a weaker contribution from oil and government spending.

The regional economic dynamics remains favorable with strong growth drivers continuing to support non-oil growth. This is a welcome development at a time when the regional oil sector is likely to see minimal growth and the regional governments are generally working to contain spending growth from the rates seen during recent years of significant countercyclical interventions. In spite of the clear shift in the onus of growth toward the non-oil private sector, the performance of the regional economies has proven resilient. For instance, the IMF revised its 2013 regional growth estimate from 3.8% in October 2013 to 4.3% in April 2014. Reflecting the rebalancing of growth drivers, this nonetheless represented something of a slowdown from the 5.2% pace of expansion seen in 2012. However, the pace of non-hydrocarbons growth held up well at 5.4% in 2013, according to estimates by the Institute of International Finance (IIF). Growth prospects for this year are comparable to last year with the main exception of Kuwait which is expected to rebound from an estimated 0.8% growth in 2013 to 2.6% in 2014.

Projected GCC real growth (%)

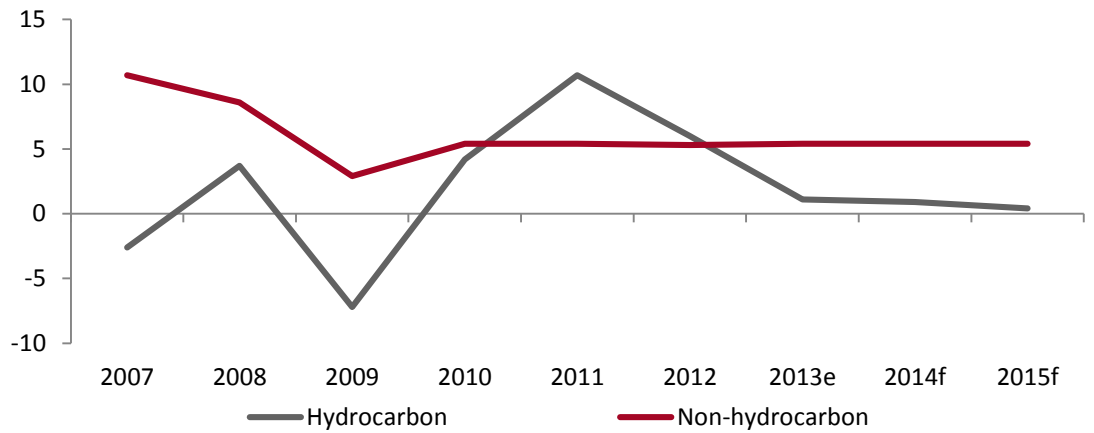


Source: International Monetary Fund, World Economic Outlook Database, April 2014

The private sector drives growth

The national data on the performance of GCC economies underscores the strength of the positive growth momentum. According to the official figures released by the Ministry of Development Planning and Statistics, the Qatari economy expanded by 6.5% in real terms in 2013. The non-hydrocarbon sector played a major role due to large infrastructure projects and higher population growth which is expected to remain at around 10% a year in the near term. Real estate and construction are now among the fastest growing sectors at annual rates of 15% or more. Qatari growth is likely to remain broadly comparable this year with the government projecting 6.0% real growth. The opening of Hamad International Airport in May signaled the full operational transition from Doha International Airport to the new facility which has a capacity of about 30mn passengers per year.

Composition of GCC growth

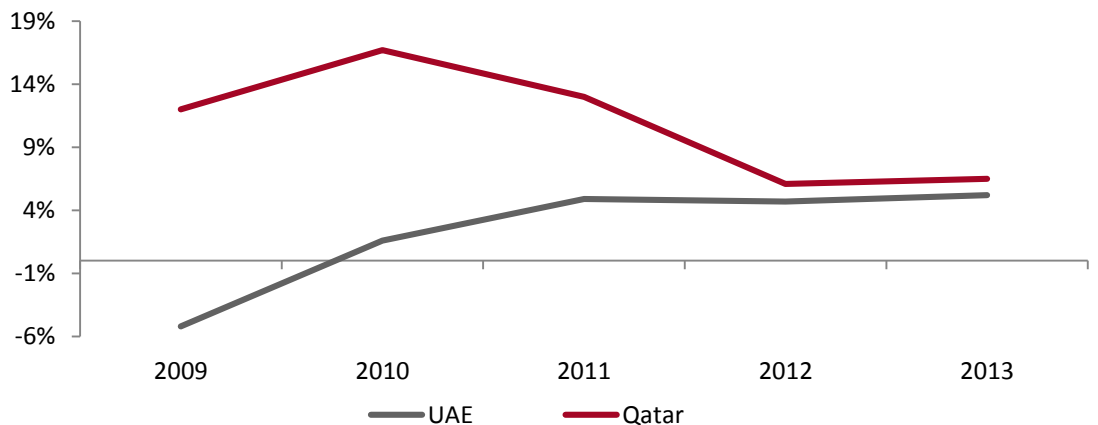


Source: Institute of International Finance, International Monetary Fund

Preliminary estimates by the UAE National Bureau of Statistics indicate that the economy of the federation expanded by 5.2% last year in an acceleration from 4.7% in 2012. The 2012 figure itself was revised up from 4.4%. The hydrocarbons sector experienced 4.8% growth in a marked deceleration from a 7.6% pace of growth in 2012. By contrast, non-oil sector growth accelerated from 3.3% in 2012 to 5.4% last year. According to the latest data, the oil and gas sector still accounts for 33% of the UAE economy. The largest sectors of the non-oil economy are real estate and trade, both at 12%, and transportation & communications, construction & manufacturing, each at 9%.

According to the Statistics Centre of Abu Dhabi, the emirate's economy grew by a real 5.2% in a slight acceleration from a 4.8% rate seen a year earlier. The government revised down the 2012 growth figure from a previous estimate of 5.6%. The oil sector grew by 3.2% in a deceleration from 3.8% the year before. The sector accounted for 51.4% of Abu Dhabi's total GDP. By contrast, non-oil growth accelerated markedly from 5.9% in 2012 to 7.4% last year. The Dubai economy expanded by an annual 4.4% in 3Q13 in a marked deceleration from 5.2% in Q2. The decline appears to have been largely seasonal in nature. The annual pace of growth during the first three quarters taken together was 4.5%.

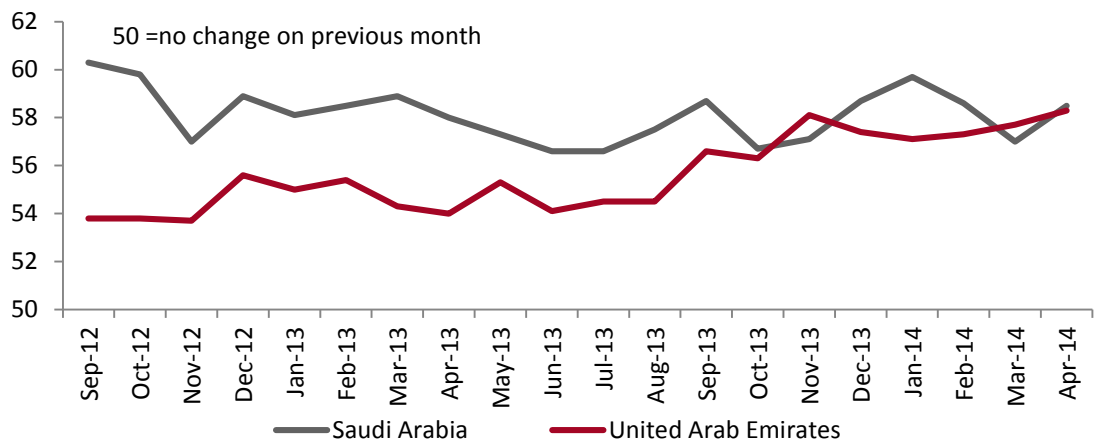
Real GDP growth in the UAE and Qatar (%)



Source: UAE National Bureau of Statistics, Qatar Ministry of Development Planning and Statistics

The two regional Purchasing Managers' Indices point to continued solid growth in spite of some loss of momentum in the late spring. The Saudi PMI stood at 57.0 in May in a slight decline from 58.6 in April. The decline was caused by a drop in new orders and export orders. Also the momentum of employment growth has moderated. The UAE PMI fell from 58.3 in April to 57.3 in April. Employment growth is continuing with some 10% of the survey respondents taking on new staff. At the same time, salaries are continuing to edge up due to higher costs of living.

HSBC/Markit Purchasing Manager's Index

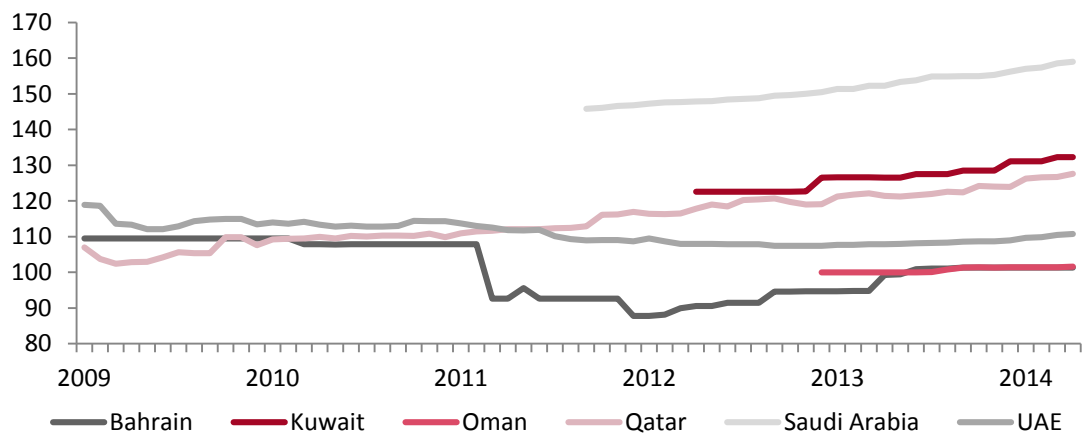


Source: HSBC, SABB

Regional real estate rallies

The real estate sector has been among the key drivers of growth in the GCC and its role remains central during a period of intense infrastructure build-up and rapid population growth. Following significant market corrections across the regions, but above all in the UAE, the momentum of the markets has once again been obviously reversed to a positive direction. While this is a generally positive process in light of the economic fundamentals, there is mounting concern that the momentum in some markets may be accelerating beyond sustainable rates.

Housing costs under the CPI indices of GCC countries



Source: National statistical offices

A number of factors account for the reversal:

- ▶ The economic fundamentals have improved with an upturn in the economic cycle but also due to the strengthening of some structural growth drivers, such as efforts to foster economic diversification and regional connectivity
- ▶ Some regional economies, most notably Saudi Arabia, have actively encouraged the sustainable development of the market through regulatory reform. Saudi Arabia adopted a new mortgage law in 2012
- ▶ Some regional markets attracted risk-averse capital during instability in nearby regions
- ▶ Landmark events such as the Dubai World Export 2020 and the Qatar FIFA World Cup 2022 have created the perception of strong medium- to long-term growth drivers for some of the regional markets
- ▶ The introduction of new and more comprehensive market regulations has assuaged earlier concerns and limited the scope for speculative behavior. In some instances, new regulations have increased market access by opening up new market segments to foreign investors

Growing concern about regional housing bubbles seems somewhat premature but has prompted the UAE Central Bank to highlight risks.

Especially the main UAE markets have been rallying fairly consistently since the end of 2012. Average residential sales prices in Dubai and Abu Dhabi are appreciating at an annual pace of close to 40%. Estimates by Knight Frank suggest that Dubai rentals rose by an annual 27.7% in Q1. In response, the UAE Central Bank in June warned that residential rental increases in Abu Dhabi and Dubai were indicative of market imbalances and overheating. However, the growth is less driven by leverage than in 2008 with banks allocating less than 23% of their overall loans to the sector. The Central Bank of the UAE has introduced new regulations to cap mortgages and limit speculation. The Dubai Land Department also doubled property registration fees to 4%.

The positive price dynamics in many markets are likely to be contained by a robust supply response. Dubai, for instance, expected to see a more than 10% increase in housing over the existing number of 365,000 housing units. Also other regional economies have seen a marked pick-up in construction activity. For example, Jeddah Economic Company is raising funds for the USD3.7bn first phase of the Kingdom City Project. A key part of the first phase, which is being financed by investors as well as local banks, is the Kingdom Tower which is expected to be completed by 2018 and projected to cost USD1.6bn.

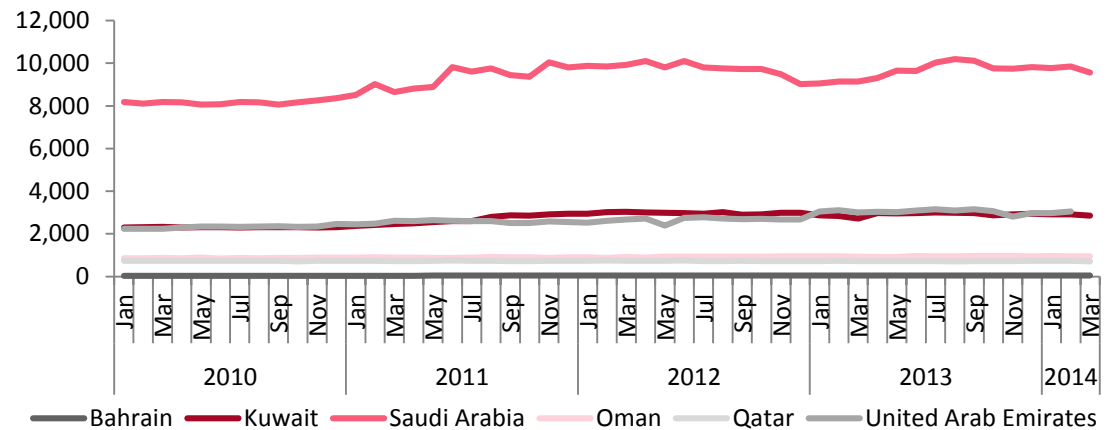
The oil sector positioned for relative stability

Crude oil production in the GCC has remained broadly stable in recent months, and significant changes in this regard are seen as unlikely during the remainder of the year. However, temporary disruptions to OPEC production would probably cause Saudi Arabia to compensate through its established role as a swing producer. The Kingdom is in the process of boosting the output capacity of some of its established fields. For instance, it is estimated that the Shaybah oil field will be able to pump 750,000 bpd for 70 years ahead thanks to technological advances, including three-dimensional seismic imaging and horizontal drilling. The Shaybah field, which pumped 1bn

barrels of oil and added 2bn barrels of reserves in 2013, plays a major role in Saudi Arabian oil production.

Monthly oil production by the leading GCC producers ('000 b/d)

Regional oil output level have remained largely flat.



Source: Joint Organisations Data Initiative

In Kuwait, Kuwait Petroleum Company (KPC) is looking to increase its involvement in the Liquefied Natural Gas (LNG) market with a USD12bn supply deal with Royal Dutch Shell. This deal comes as part of a larger strategy as the country seeks to meet growing energy demands. Another part of this strategy is a plan to sign a USD3bn LNG supply with BP. The overall aim in Kuwait, which started importing LNG in 2009, is to use more LNG and less diesel or crude oil which both have higher harmful emissions.

Continued moves toward fiscal consolidation

Steps toward moderations in the pace of increase of government spending have continued in the region. The FY2014/15 Qatar budget, which covers the fiscal year starting in April, reflects the broader regional trend toward a tighter fiscal stance in spite of a continued strong emphasis on infrastructure projects. It foresees a 17% YoY increase in spending to a total of QAR218.4bn. Government expenditure on priority projects is up by nearly 17% YoY to a total of QAR87.5bn. Among other things, the government will begin work on seven new stadiums for the 2022 FIFA World Cup. Non-development spending by the state is expected to decline to QAR130.9bn.

Qatar and Kuwait have joined the regional trend toward more moderate government spending growth.

The budget is premised on a conservative oil price assumption of USD65/barrel. Revenues are projected to reach QAR225.7bn, which would be translated into a fairly modest QAR7.3bn surplus, roughly equal to 1% of GDP. In practice, revenues are likely to be significantly higher and should yield a surplus of roughly 5% of GDP.

The FY2014/15 draft budget approved by the Kuwaiti cabinet foresees revenues of KWD20.1bn and expenditures of KWD21.7bn in a 3.2% increase over last year. Current spending is due to account for 86.6% of the total. An estimated 94% of government income is due to be derived from oil on the assumption of a market price of USD75/barrel. Although this represents a USD5 increase from the assumption in the previous budget, it still appears conservative in view of the market situation and should allow the government to once again post a substantial surplus. Kuwait's oil output is, again somewhat cautiously, projected at 2.7 mbd. The budget has a

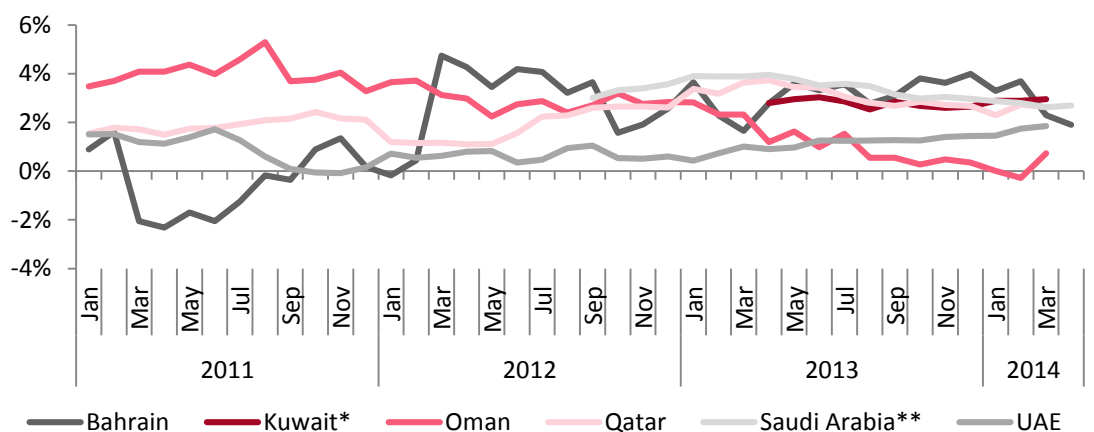
projected a KWD1.6bn deficit in spite of an increase in the oil price assumption used for revenue calculations. Kuwait posted a KWD12.7bn surplus in the 2013/14 fiscal year.

Regional price pressures remain moderate

Price pressures look likely to remain close to the current situation.

Inflationary pressures in the region have remained contained at a low level in spite of the signs of revival in some regional real estate markets. For instance, Saudi Arabia's inflation reading reached 2.6% YoY in March 2014, the slowest pace since September 2013. In the UAE, inflation has been steadily accelerating from 0.4% YoY in January 2014 to 1.8% YoY in March. This increase has mainly been driven by rising housing costs which contribute the most to inflation with a 39% weight in the UAE inflation index. Qatari inflation reached 2.6% YoY in March 2014 driven mainly by rising rent prices. Overall, Qatar experienced 3.1% inflation in 2013, also largely due to increased housing costs.

Consumer price inflation in GCC countries (% YoY)



* Starting April 2013 Kuwaiti CPI rebased to 2007

** Starting Sept 2012 Saudi CPI rebased to 2007

Source: National statistical offices

Bank credit cycle showing renewed signs of a pick-up

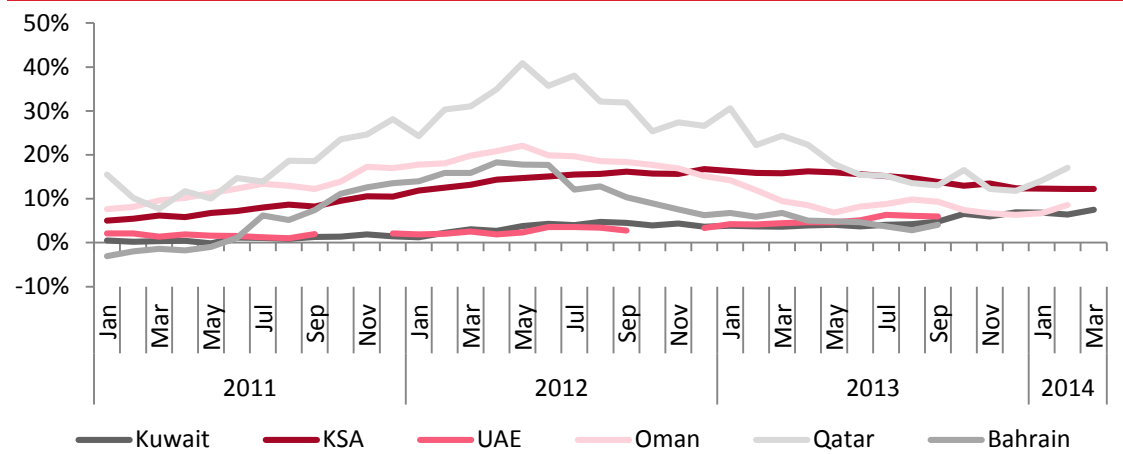
Following a lengthy period of a general deceleration in bank lending growth, some regional markets are beginning to see renewed acceleration. Loan growth in Saudi Arabia has become increasingly driven by the public sector. The annual pace of government borrowing growth accelerated markedly from 21.2% in March to 35.9% in April. By contrast, the pace of private sector credit expansion moderated somewhat, from 12.8% in March to 11.8% YoY in April.

In the UAE, data from the central bank shows that private sector credit growth slowed to 4.2% YoY in December 2013 from 6.4% in September. Public sector borrowing, however, increased substantially from a mere 0.2% YoY in September 2013 to 32.8% in December. UAE broad money supply (M2) growth increased by 22.8% YoY in March, marking the highest annual growth since November 2008.

Banking assets in Qatar grew at a rate of 11.4% in 2013, with banking assets to GDP reaching 123% in 2013, an increase from 118% in 2012. A combination of a government surplus, strong

population growth, and increased deposit growth resulted in this pronounced growth in the banking sector. Domestic credit in Qatar grew at a rate of 17% YoY in February 2014 with the services sector fueling a large portion of that growth.

YoY growth of domestic bank credit (%)



Source: National central banks

Equity markets continue their strong run

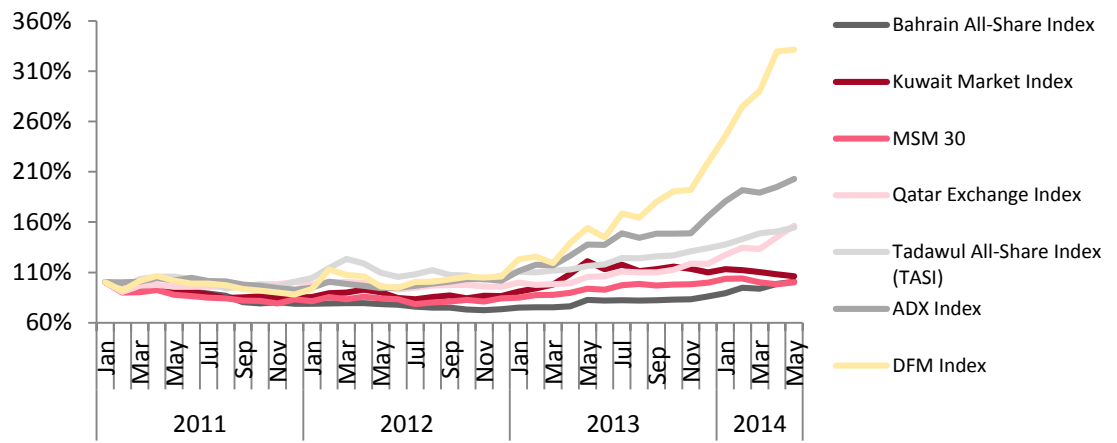
The GCC equity markets started 2014 strong, continuing the impressive rally of the previous year. Compared to developed and emerging market indices, the S&P GCC index performed strongly with an increase of 13.6% between January and May 2014. In this same period, GCC markets added USD207bn in capitalization to reach a total of USD1.14trn. Corporate sector profitability as well as GCC fiscal positions supported by favorable oil prices were the two main factors behind this upward trend. Among the the individual bourses, Dubai, Abu Dhabi, and Qatar were the best performers in the region as of the end of May. They had posted year-to-date gains of 51.0%, 31.9%, and 22.4%, respectively. Saudi Arabia's Tadawul had advanced by 15.1%. Oman's gains stood at 0.3% while the Kuwait Stock Exchange had actually declined by 3.5%.

The UAE and Qatari exchanges have played a major role in boosting regional markets after the MSCI decision to upgrade both markets to emerging market status starting May 2014. This decision could lead to a considerably strong inflow of institutional funds into the Emirati and Qatari markets. The Dubai financial market continued to show signs of improving economic fundamentals as the DFMGI is currently the best year-to-date performing equity index in the world. Kuwait is reportedly working to ease rules for listing joint-stock companies.

The generally robust performance of the regional stock markets has come under some downward pressure in June, seemingly in response to the increased instability in Iraq as well as concerns over the prospects for property prices in part of the region. The Dubai Financial Market shed some 20% in June, including a 6.7% one-day stop on 24 June. Also Abu Dhabi and Qatar saw losses of around 10% or more.

Regional stock markets have generally continued their strong performance this year led by the UAE and Qatar exchanges, but some of the positive momentum was reversed in June.

GCC equity market indices (Jan 2011=100)

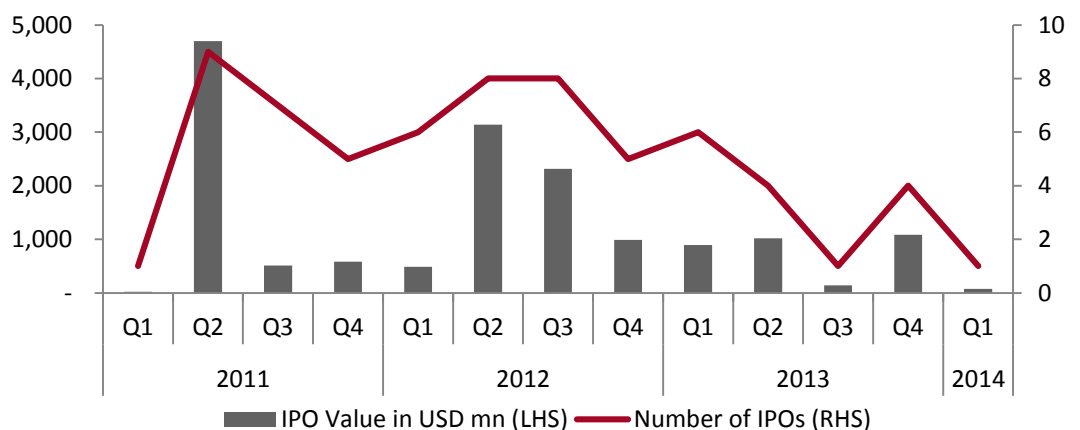


Source: Bahrain Bourse, Kuwait Stock Exchange, Muscat Securities Market, Qatar Exchange, Tadawul, Abu Dhabi Securities Exchange, Dubai Financial Market

The continued strong performance of the regional equity markets looks increasingly likely to belatedly trigger growing interest in primary issues as well. The region went through an extended period of minimal new IPO activity after the onset of the global crisis. The pipeline of IPOs has grown and now includes significant names such as the National Commercial Bank of Saudi Arabia and ACWA Power International. In spite of this, new IPOs in Q1 were modest with only one new offering. The Saudi Marketing Company placed 30% of its capital in January in a SAR270mn offering. However, the Abu Dhabi-based Gulf Maritime Services listed on the London Stock Exchange in March offering GBP165.7mn worth of shares, 35.1% of its capital. June has seen two offerings on the Muscat Securities Market by the Omani power companies, Al Suwadi Power Company (OMR38.3mn) and Al Batinah Power Company (OMR36.6mn).

After a subdued 2013, primary issuance by regional companies looks likely to accelerate this year.

GCC IPO activity (regional exchanges)



Source: Zawya

The GCC fixed income activity remains vibrant

The regional fixed income markets continue their strong performance. During the year to date, the region has seen some 40 conventional bond issues with an aggregate value of USD2.6bn.

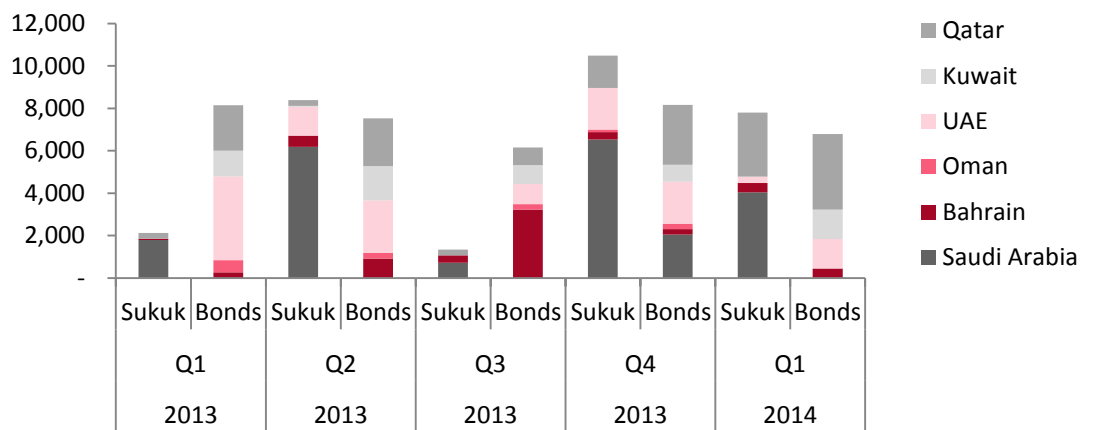
UAE issuers this year have been primarily corporates led by Abu Dhabi Commercial Bank (USD750mn), Abu Dhabi National Energy Company TAQA (USD750mn), Mubadala Development Company (USD750mn), Majid al Futtaim Properties (USD500mn), and Emirates NBD (a total of USD535.6mn). The issuance in Qatar and Kuwait has been sovereign, largely for liquidity management purposes.

The GCC fixed income markets continue to perform strongly with a steady stream of landmark issues.

Regional sukuk issuance this year has been limited to four regional jurisdictions with the UAE accounting just under one-half of the total value and Saudi Arabia for just under a third. The main UAE issues have been a USD700mn Investment Corporation of Dubai sukuk along with a USD750mn issue by the Dubai Department of Finance. Also, Dama issued a USD650mn sukuk in April.

The main Saudi issues have been three SAR2bn offerings by Banque Saudi Fransi, Saudi Telecom, and Saudi Investment Bank in June. Saudi Electricity Company has remained active in the market. Following a SAR4.5bn offering in February, it placed a total of USD2.5bn in April. The Islamic Development Bank made a USD1.5bn offering in March.

GCC bond and sukuk issuance (USD mn)



Source: Zawya

Implications for Bahrain

The regional economy continues to perform well, which provides a benign backdrop for Bahrain.

- ▶ The regional tourism flows are likely to remain strong, which should support activity in the hotels and restaurants sector along with retail.
- ▶ The positive dynamics of the GCC real estate markets are likely to be supportive of new developments also in the Kingdom.

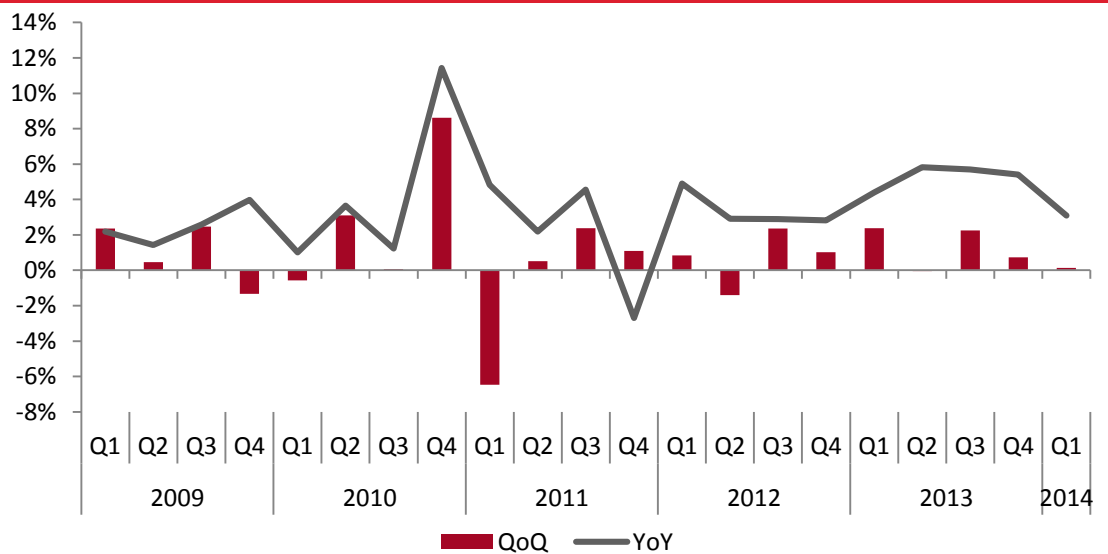
BAHRAIN

PROJECT SPENDING SHIFTS GEARS

While Bahrain’s headline growth this year is likely to moderate from last year’s rebound rates, the non-oil economy is expected to record a significant acceleration due to new project activity.

The Bahraini economy experienced a significant acceleration in its headline growth in 2013 when the Kingdom’s real GDP expanded by 5.3% as compared to 3.4% in 2012. The strong momentum was above all due to normalization in the hydrocarbons sectors where maintenance in the offshore Abu Sa’afah field had depressed growth in 2012. In contrast to the 15.3% pace of expansion in the hydrocarbons sector, Bahrain’s non-oil economy expanded by a fairly modest 3.0%. This growth pattern is likely to be significantly changed this year. While the hydrocarbons sector will likely continue to produce at last year’s levels, the non-oil sector looks well positioned for a significant pick-up in growth thanks to a number of infrastructure projects getting underway. We currently expect growth during the year as a whole to reach 3.5% this year with the rate of the growth of the non-oil economy set to accelerate to 4.4% while the oil sector while likely experience minimal growth at 0.1%. Headline growth in Q1 reached 3.1% with the oil sector expanding by 4.1% and the non-oil economy by 2.9%.

Real GDP quarterly growth



Source: Central Informatics Organisation

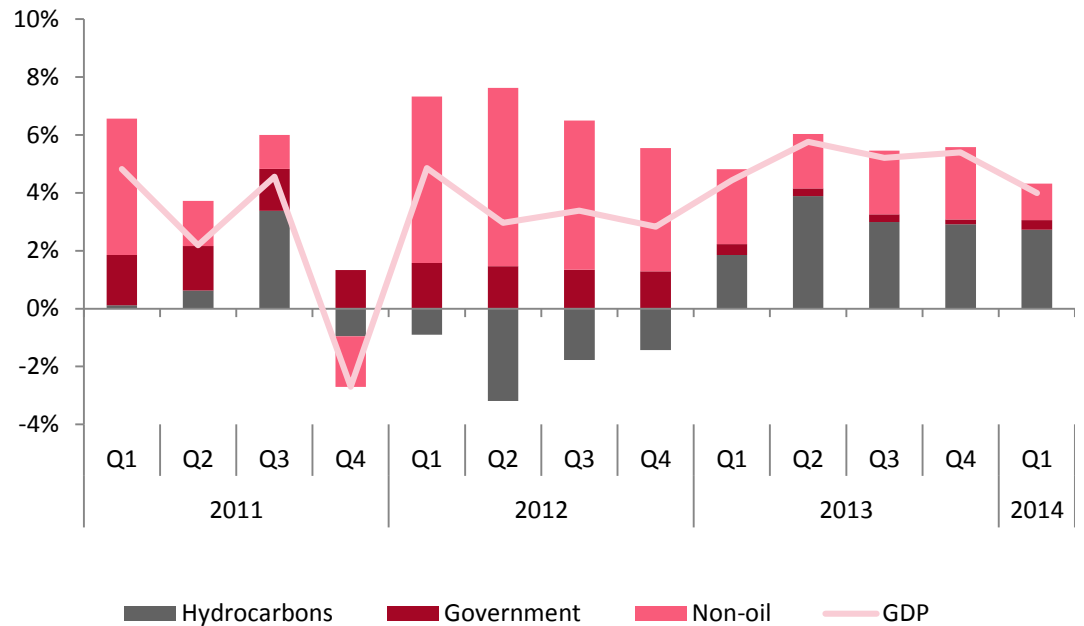
Oil sector normalization drove growth in 2013

The performance of the non-oil economy last year fell short of expectations due to delays in approving the 2013-2014 state budget, as well as slower than expected initiation of a number of the infrastructure projects funded by the GCC Development Fund. By contrast, the oil and gas sector experienced a sharp rebound peaking at an annual pace of 22.2% in Q2 of the year. Encouragingly, however, the growth of the economy was also far less dependent on the government services sector than had been the case in the preceding years. During the four quarters of the year, the contribution of the government to headline growth fluctuated between

The composition of GDP growth is likely to change significantly this year as the oil sector stabilizes and projects drive non-oil growth.

0.2 and 0.4 percentage points. By contrast, the contribution of the non-oil private sector varied between 1.9 and 2.6 percentage points.

Breakdown of quarterly growth (in real terms, YoY)



Source: Central Informatics Organisation

The strong sectors of the non-oil economy last year were hotels & restaurants, social & personal services, and manufacturing.

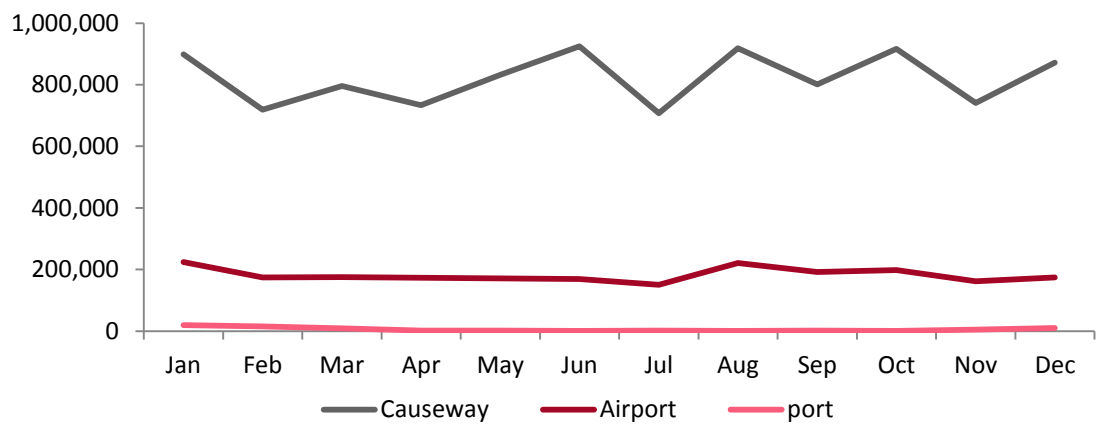
Almost all sectors of the non-oil economy recorded slower growth last year than in 2012. The best performer was the hotels & restaurants sector which expanded by an annual 9.5% in a slight deceleration from the pace of 11.2% recorded in 2012. The social & personal services sector, dominated by private health care and education, continues its strong performance of recent years posting 6.5% YoY growth following expansion of 12.7% a year earlier. The third strongest sector was manufacturing which grew by 3.2%, stabilizing after the 4.7% pace seen in 2012.

YoY real growth of key sectors, 2010-2013

YoY growth	2012					2013					2014
	Annual	Q1	Q2	Q3	Q4	Annual	Q1	Q2	Q3	Q4	Q1
Crude pet. & Gas	-8.5%	-4.3%	-15.1%	-8.1%	-6.5%	15.3%	9.8%	22.2%	15.4%	14.6%	4.1%
Manufacturing	4.7%	8.7%	8.8%	2.4%	-1.1%	3.2%	2.0%	-1.9%	5.6%	7.4%	0.8%
Construction	4.1%	1.4%	5.8%	2.8%	6.6%	2.7%	2.8%	5.6%	0.6%	1.5%	1.5%
Retail	6.2%	5.8%	8.1%	7.9%	3.2%	2.0%	1.6%	1.8%	0.3%	4.5%	3.3%
Hotel & rest.	11.2%	13.5%	20.7%	3.1%	9.0%	9.5%	13.5%	8.9%	16.2%	0.7%	5.9%
Trans. & Comm.	4.5%	6.1%	3.2%	5.4%	3.2%	2.5%	4.8%	2.3%	2.0%	1.0%	4.4%
Social & pers. Serv.	12.7%	13.3%	12.3%	15.6%	10.0%	6.5%	6.4%	7.1%	7.7%	4.9%	6.5%
Real est. and busi. Act.	3.6%	1.2%	3.4%	3.8%	6.2%	2.4%	1.7%	1.8%	3.0%	3.2%	4.4%
Finance	4.0%	4.3%	3.7%	4.2%	3.9%	2.3%	3.0%	2.8%	1.7%	1.5%	1.9%
Government	12.1%	13.5%	12.5%	11.5%	10.8%	2.1%	3.0%	2.1%	2.0%	1.3%	2.4%
Other	11.2%	10.0%	11.7%	7.5%	16.2%	2.8%	-0.1%	2.9%	3.7%	4.6%	6.0%
GDP	3.4%	4.9%	2.9%	2.9%	2.8%	5.3%	4.4%	5.8%	5.7%	5.4%	3.1%

Source: Central Informatics Organisation

Monthly tourist arrivals in Bahrain by port of entry

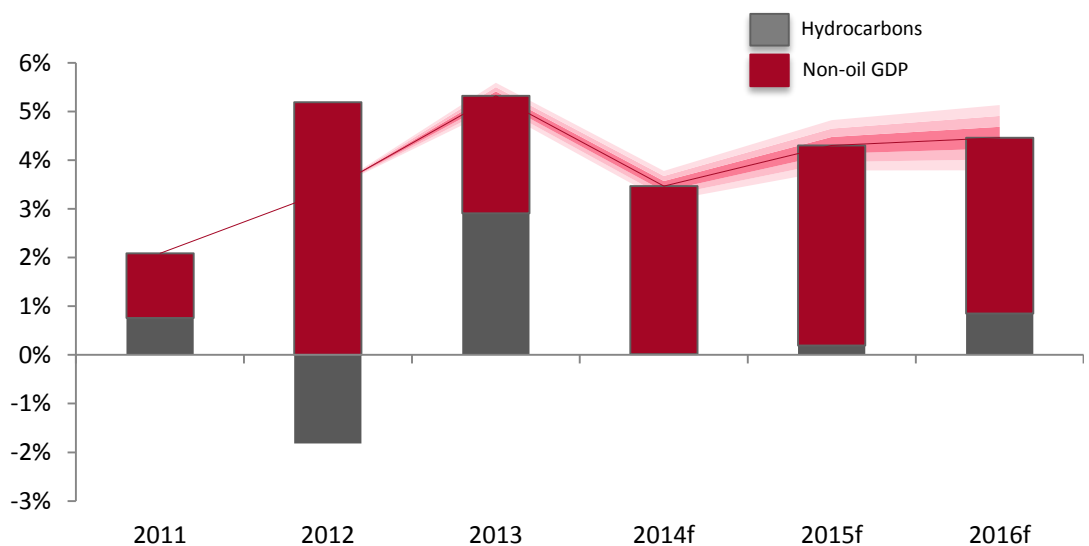


Source: Ministry of Culture

The pattern of growth changing this year

The pattern of growth this year is likely to prove significantly different from last year’s oil-led rebound, even though oil sector growth in Q1 outpaced non-oil growth. In spite of a brisk 4.1% YoY pace of expansion in Q1, indications are that the oil sector will post minimal growth this year. bu Sa’afah is expected to produce at capacity apart from scheduled maintenance. The output of the onshore Bahrain field should also remain broadly flat as various new production techniques are being reviewed and evaluated. The main new activity in the sector will involve drilling for deep gas in the Khuff reservoir as well as a number of downstream capital investment projects described in the March quarterly.

Past and projected growth (in real terms, YoY)



Source: Central Informatics Organisation, Economic Development Board estimates

By contrast, in spite of a fairly slow start to the year with a 2.9% YoY gain in Q1, the non-oil sector is expected to post a much stronger year than was the case in 2013 with activity likely to

pick up especially in the second half of the year. There are a number of indications of increased activity, for instance in the commercial real estate space which is seeing new developers and higher occupancy. However, the main growth impetus is likely to come from a number of infrastructure projects covering a range of areas from housing to transportation. Several projects will be financed by the GCC Development Fund which will provide the financing for USD10bn worth of projects over a ten-year period. The initial focus looks likely to be primarily on housing projects which represent one of the main priorities of the GCC funding. To date, an estimated USD3.4bn worth of projects in housing, utilities, and education are scheduled for completion by 2013. Thus far, USD 1.2bn has been dedicated from the fund to housing projects which have an aggregate target of 5,282 new housing units. These projects are part of a larger ambition by the Ministry of Housing to build over 15,000 housing units between 2014 and 2017, and a total of 40,000 housing units over the next ten years.

Housing projects are likely to dominate project activity in the near term with approximately 15,000 units planned for the coming four-year period.

Key developments in the housing area include East Hidd and the Northern City. The first stage of the Northern City development, composed of 530 housing units worth USD10mn, is nearing completion. Work on the second stage of the Northern Town is due to start following the signing of a BHD10mn deal for 316 units in June. Agreements have been signed with the private sector to provide another 1,618 units. An agreement for the first stage of East Hidd, for 483 units worth BHD18mn, has been signed. The Northern Town is eventually projected to have 15,161 while the Eastern Hidd Town will accommodate 4,526 families. Other key planned housing developments include the Eastern Sitra Town, the Southern Town, and the Salmabad Town, with a combined projected capacity of 14,000 units.

The second main priority is energy and water as power demand in the Kingdom has almost doubled over the decade to 2012, from 1,540 MW in 2003 to 2,967 MW in 2012. Current capacity stands at 4,000 MW and two 400-kW transmission stations are expected to be tendered soon.

Efforts are also underway to further improve Bahrain's connectivity with the rest of the region. The project of modernizing and expanding the Bahrain International Airport, which should increase the airport's capacity from 9mn to 13.5mn passengers, is expected to start towards the end of this year. The King Fahad Causeway Authority (KFCA) is reportedly planning to complete the Saudi-Bahrain rail study by September 2014. The project, which is expected to be completed within 7-10 years, is part of a larger GCC rail network anticipated to cost USD15.4bn.

Economic activity should further benefit from recently adopted reforms of the Commercial Company Law. Among other things, the amendments approved by the Shura Council on 16 June will:

- ▶ abolish the minimum capital requirements for different company types, including limited liability companies
- ▶ allow 100% foreign ownership of simple commandite companies
- ▶ permit the establishment of a joint stock company by a minimum of two persons
- ▶ strengthen minority shareholder rights, including representation on the company board

Amendments to the Commercial Companies Law should reduce hurdles on investment and enhance the protection of minority shareholders.

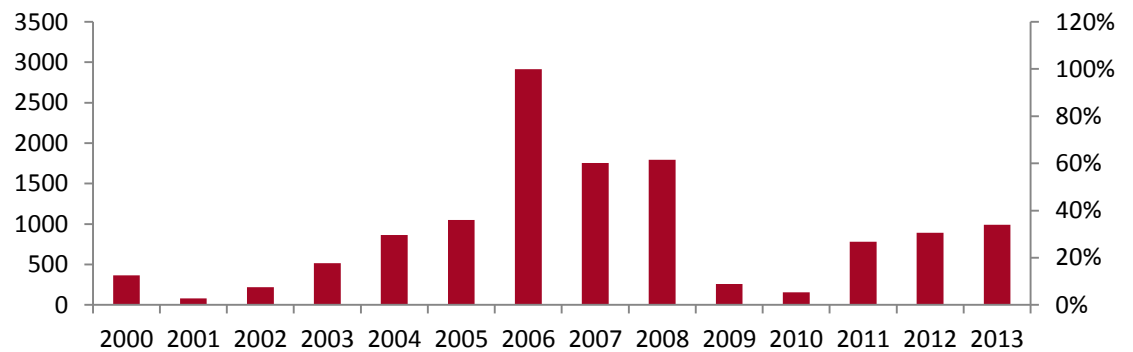
Positive FDI trends continue

Bahrain has continued to see strong growth in inward foreign direct investment (FDI) flows even though the West Asia region more generally has seen some erosion from USD48bn in 2012 to USD44bn last year. In total, Bahrain attracted USD989mn in FDI in 2013, which represented a 11% increase on 2012. This was entirely due to greenfield investment. The FDI inflows accounts for 15.7% of fixed capital formation in the Kingdom in a slight increase on 15.1% the year before.

The recent trends highlight the critical importance of foreign direct investment for Bahrain. The overall stock of inward FDI in Bahrain rose to USD17.8bn last year – a figure that was 17.6% higher than the USD15.2bn total recorded in 2010. The value of Bahrain's inward FDI stock is equivalent to 55.3% of the Kingdom's GDP.

Bahrain has continued to see robust growth in inward FDI. Following an 11% increase in inflows last year, the total stock of inward FDI stands at 55.3% of GDP.

Foreign direct investment inflows into Bahrain (USD mn)



Source: United Nations Conference on Trade and Development

Progress in commercial diplomacy

Several visits took place during 2014 to strengthen ties between Bahrain and significant Eurasian economies which offer considerable potential for expanded commercial and investment relations. These included:

- ▶ **Russia:** A delegation headed by His Royal Highness the Crown Prince visited the Russian Federation in April and discussed a range of bilateral development opportunities. Mumtalakat signed an agreement with the Russia Direct Investment Fund. Gulf Air is studying the option of opening a route to Moscow.
- ▶ **Kazakhstan:** Talks included plans to create a joint committee between Bahrain and Kazakhstan focusing on pushing ahead trade and economic cooperation with an emphasis on investment, agriculture, and banking. An agreement on aviation transportation between the two countries was signed. Bahrain also announced a plan to exempt Kazakhstan citizens from pre-arranged entry visas.
- ▶ **Pakistan:** His Majesty King Hamad's visit to Pakistan resulted in various economic cooperation agreements between the two countries. The focus of several of these agreements was in the field of food production.
- ▶ **India:** 12 business deals and 27 MoUs were signed during His Majesty King Hamad's visit to

Important state visits in recent months have driven the development of commercial ties with Eurasian economies.

India which included more than 130 businessmen and women. The deals included were in the fields of information technology, banking, construction and petroleum. Some of the agreements include:

- An MoU between Bahrain's Ministry of Industry and Commerce and JBF Industries, which specialises in manufacturing polyester, to set up an industrial project at Salman Industrial City in Bahrain worth USD200mn
 - An MoU between the EDB and Export-Import Bank of India to promote business opportunities and grow trade between the two sides with a particular emphasis on exports by SMEs
 - An MoU between University of Bahrain and Pandit Deendayal Petroleum University focusing on higher education and research in the fields of energy
- **Tajikistan:** The Tajik president Emomalii Rahmon visited Bahrain in May. A business forum brought together 350 representatives from the two countries. Potential areas for cooperation include food production and processing, Islamic finance, education, transport and communication, mining, and tourism.

Steps toward fiscal consolidation

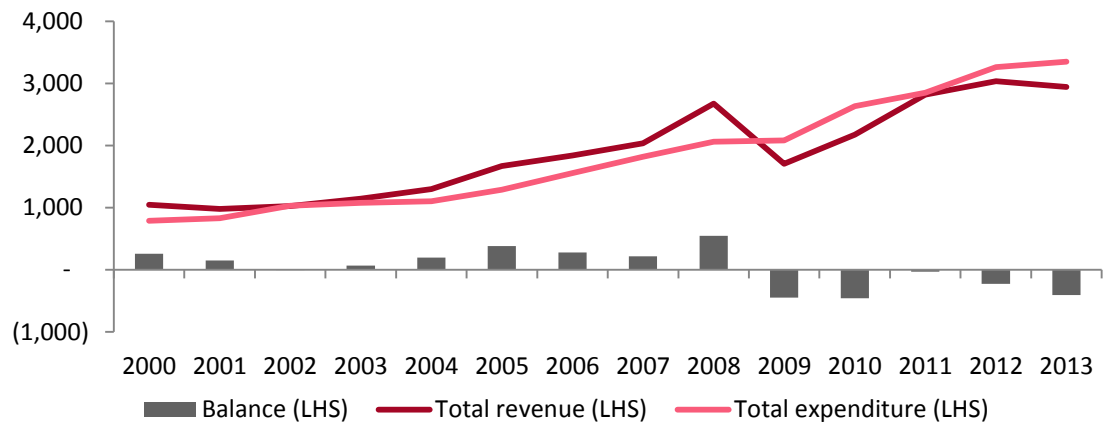
Bahrain has seen a significant build-up in its public debt since the onset of the global economic crisis due to strong countercyclical policies which have involved deficit spending since 2009. In practice, however, the actual deficit of the government budget has typically been less than expected owing partly to conservative forecasts for expected revenue. The 2013 final accounts showed a total deficit of BHD410mn, or 3.3% of GDP. This represented a doubling on the 2012 deficit of BHD226.6mn, which was equivalent to 2.0% of GDP.

Government spending in 2013 reached BHD3.4bn. This represented a YoY increase of 2.8% -- the slowest pace of expenditure increases since 2009. This was primarily due to a 35% decline in project spending to BHD477mn. Government revenues contracted by a modest 3.0% to a total of BHD2.9bn. Oil and gas revenues accounted for 88% of the total.

Fiscal consolidation is widely viewed as a priority, due in large part to the increase in the fiscal break-even price to around USD120/barrel. In recognition of Bahrain's commitments under the GCC monetary union, there is an effort underway to inscribe a 60% debt-to-GDP ceiling in law and to limit annual deficits to 3% of GDP, as mandated by the Maastricht-style convergence criteria. The Shura Council approved a draft debt law to the effect on 15 May 2014. The public debt-to-GDP ratio stood at 43.6% according to the 2013 final accounts.

Steps are underway to enshrine the convergence criteria of the GCC Monetary Union in law, which should contribute to ongoing efforts to stabilize the fiscal situation after several years of countercyclical spending increases.

Bahraini government revenues and expenditure (BHD mn)



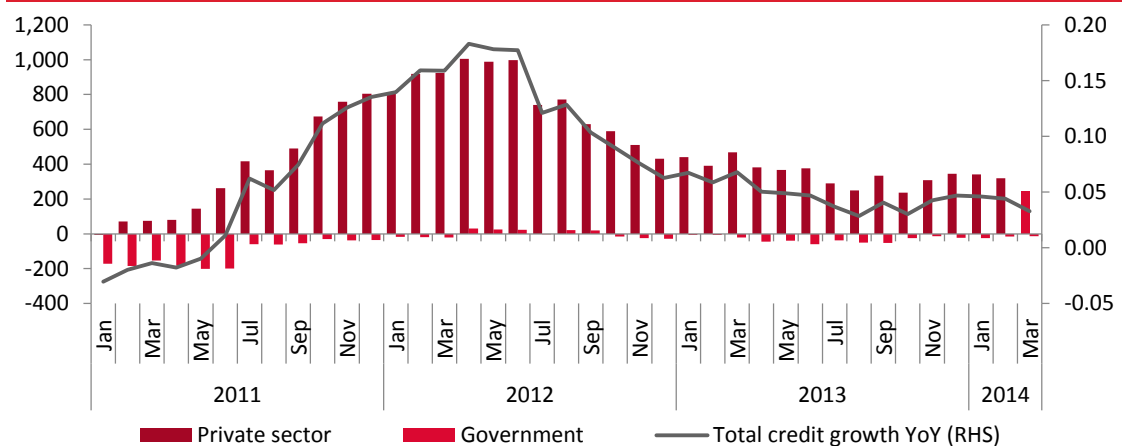
Source: Ministry of Finance

Bank lending still subdued

The growth of bank lending has remained measured in recent months, but the situation looks likely to improve during the rest of the year.

The growth of bank credit has remained measured in recent months with the YoY rate of increase for overall retail bank lending standing at 3.3% in March 2014. This marked a deceleration from the 4.3% YoY increase seen in February. Total bank loans stood at BHD7.3bn. Loan growth has been entirely due to private sector credit, with government loans either flat or declining in recent months. Business loans accounted for 60% of the total, personal loans for 37.6%, and lending to the government for 2.4%. Mortgage lending has emerged one of the most dynamic market segments over the past year. Personal loans secured by a property mortgage rose by an annual 22.7% to BHD890.1mn in March 2014, increasing their share of total bank credit from 10.3% to 12.2% over the past year.

Year-on-year credit growth to the private sector and government (BHD mn)



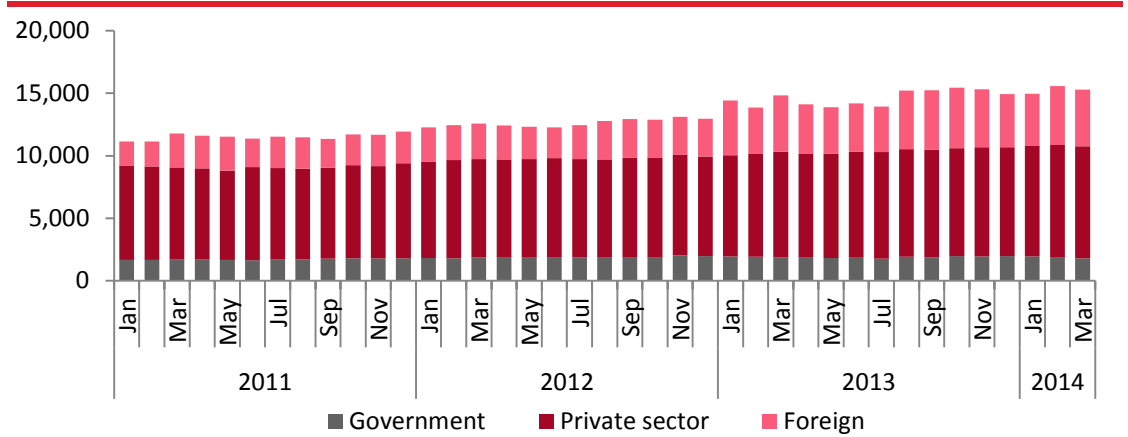
Source: Central Bank of Bahrain

In spite of the moderate pace of lending growth, the liquidity situation in the banking sector remains benign and Bahraini financial institutions have continued to post strong and improving results, as reflected in the credit rating agency Moody's upgrading Bahrain's retail banking system from negative to stable. Deposit growth has continued on a positive trend, some month-

to-month volatility notwithstanding. Overall bank deposits as of March 2014 stood at BHD15.3bn, up on BHD14.8bn a year earlier. The strong deposits base and low loan-to-deposit ratios should create a benign backdrop for credit growth once the implementation of the project pipeline begins to accelerate.

Efforts to stimulate lending to SMEs remain a particular focus of policy. The Bahrain Development Bank (BDB), the Kingdom’s leading SME lender, plans to increase its financing volume to more than USD159mn during 2014. The plan to diversify beneficiaries of the financial support is being rolled out as BDB increases financing to projects in the educational, medical, and food production sectors. Projects financed by the bank helped create roughly 18,000 jobs between 2009 and 2013.

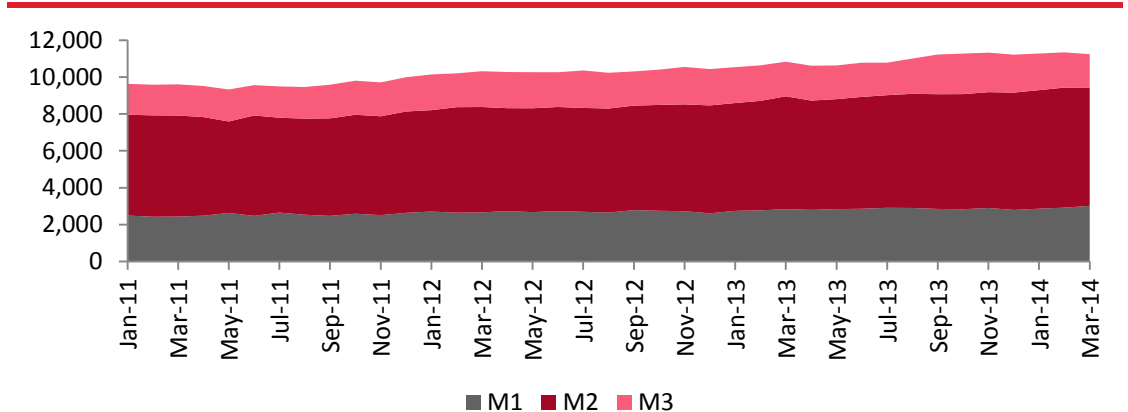
Deposit liabilities to non-banks, 2011-2013 (BHD mn)



Source: Central Bank of Bahrain

Indicators of money supply have continued their gradual upward trend in recent months. The broadest measure of money supply, M3, which includes currency in circulation and other less liquid assets, increased by 7.5% between December 2012 and December 2013 to a total of BHD11.2bn. During 4Q13, M3 remained relatively stable between BHD11.2bn and BHD 11.3bn. M1, which includes currency in circulation and some types of deposits, increased by 7%.

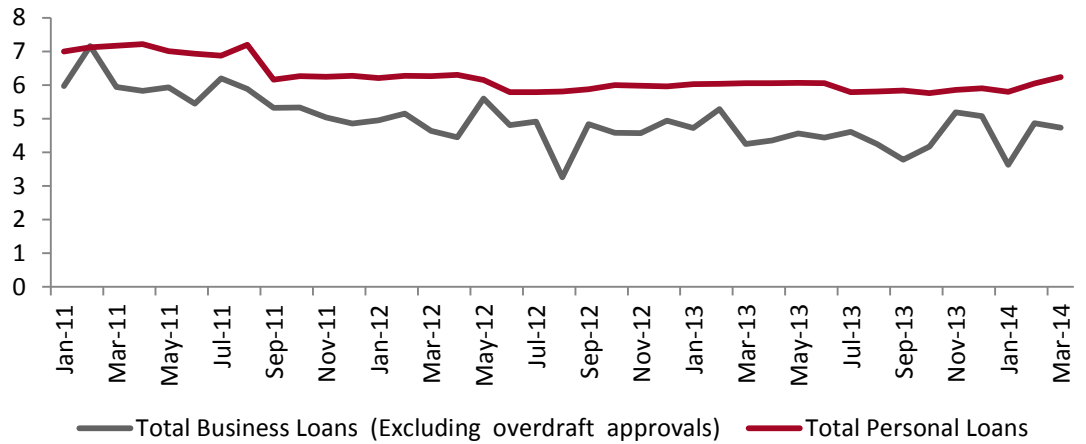
Money supply growth (BHD mn)



Source: Central Bank of Bahrain

The cost of capital in the Kingdom, following a lengthy downtrend, has remained generally stable in recent months, albeit with a degree of volatility. Whereas interest rates for personal loans remain stable, rates for business loans have witnessed slight upward movement.

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



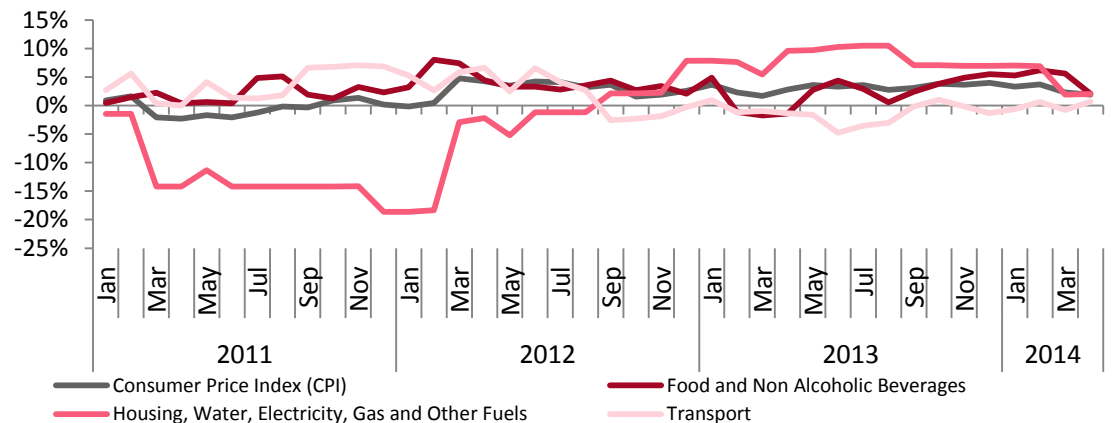
Source: Central Bank of Bahrain

Relative stability in consumer price pressures

Consumer price pressures looks largely absent with the pace of price increases decelerating also in the housing costs areas.

The rate of consumer price inflation in recent months has remained relatively flat, with some components of the CPI index even seeing a slight decline. The annual pace of consumer price inflation decelerated slightly to 2.0% during March 2014, compared to a 4.0% reading of December 2013. While housing remained the main driver of price pressures, it experienced the sharpest slowdown of any sub-index over the past quarter from an annual pace of 7% in December 2013 to 2% in March. Transport costs, in fact, dipped to the negative territory with a -1% YoY pace in March.

Sector-specific consumer price inflation indicators (YoY, %)



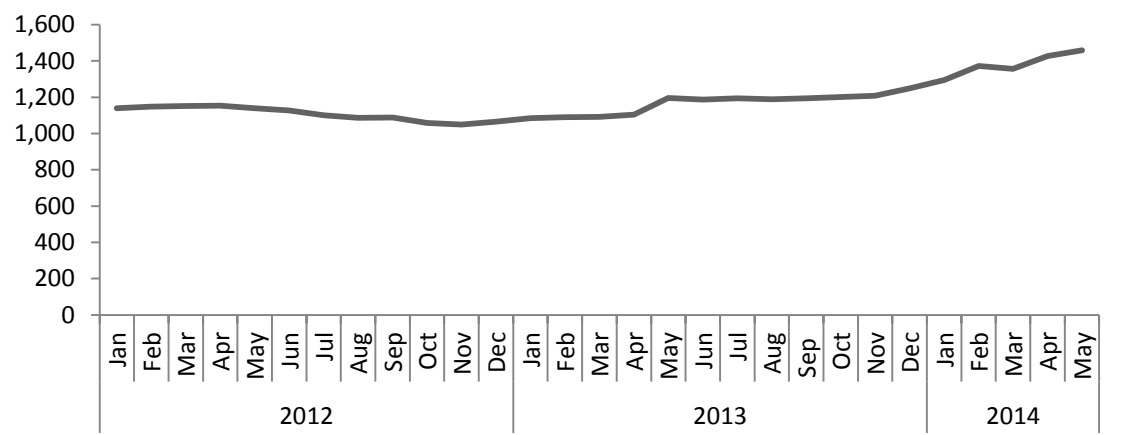
Source: Central Informatics Organisation

Increased capital market activity

The performance of Bahrain Bourse has continued to improve in recent months with the All-Share index up 16.9% YTD as of the end of May. This made it the strongest performer in the region after the UAE and Qatar stock exchanges which have benefited from their inclusion in the MSCI Emerging Markets index.

Bahrain All-Share Index

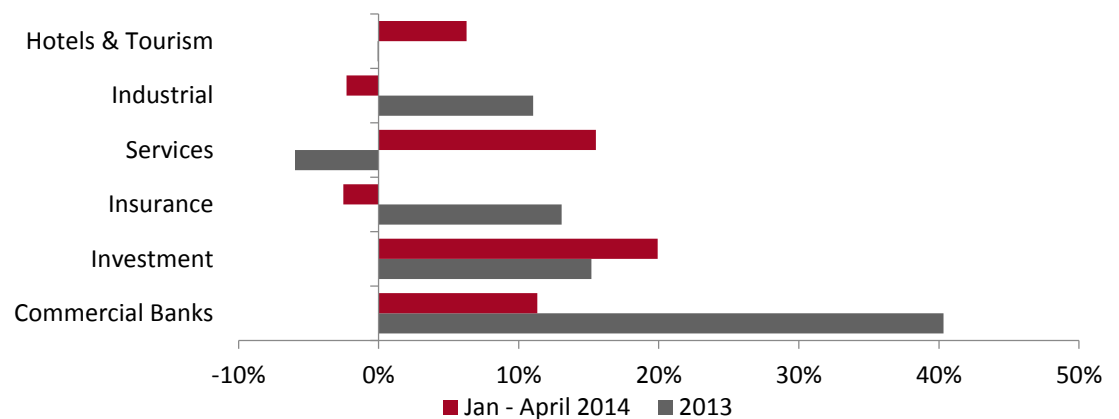
The performance of the national stock markets has continued to improve with particularly strong gains in financial services and manufacturing.



Source: Bahrain Bourse

The best performers of Bahrain Bourse since the beginning of 2014 were financial service companies, led by the Commercial Banks sector index and followed by Investment and Insurance. While the Industrial sector reached double-digit growth, the Services sector posted a small decline and the Hotels & Tourism sub-index was flat.

Sectoral stock market indices, January 2013-January 2014



Source: Bloomberg

Bahrain Bourse is continuing its development under its strategic plan. The bourse has introduced new market rules allowing non-Bahraini brokers to trade in the bourse directly without having a representative office in the Kingdom, provided that a clearing member has been appointed to settle transactions executed at the bourse. The new rules further allow for margin trading in a bid to boost liquidity and outline a framework for market makers. The Bourse is taking steps to introduce the Murabaha program, reflecting the growing popularity of this Shariah-compliant financial instrument. The new rules allow a range of other products such as options, exchange-

traded funds, and REITS. An arbitration committee will adjudicate on disputes pertaining to bourse transactions.

After a lengthy lull, a number of initiatives are underway to stimulate IPO activity. The company operating Khalifa bin Salman Port is understood to be considering an offering. The port, which has the capacity to handle 1mn 20ft equivalent units (TEUs), is planning the IPO as part of implementing the contractual agreement made when it was opened in 2009. Also in the Kingdom, Zain Bahrain is moving closer to its announced IPO which could help boost the Bahrain stock market.

Bahrain sovereign short-term bond and sukuk issuance

Date	Issue	Amount, BHD mn	Maturity, days	Average interest/profit rate, %	Average price, %	Over-subscription, %
25 June 2013	Sukuk al salam No 158	36	91	0.70		333
19 June 2014	Sukuk al ijarah No 106	20	182	0.85		410
18 June 2014	Treasury bill No 1500	45	91	0.67	99.830	279
11 June 2014	Treasury bill No 1499	45	91	0.69	99.827	274
8 June 2014	Treasury bill No 1498	30	182	0.79	99.601	273
5 June 2014	Treasury bill No 21	150	12 months	1.14	98.863	300
28 May 2014	Sukuk al salam No 157	36	91	0.73		282
18 May 2014	Treasury bill No 1495	30	182	0.80	99.597	471
15 May 2014	Sukuk al ijarah No 105	20	182	0.90		378
14 May 2014	Treasury bill No 1494	45	91	0.70	99.824	111
7 May 2014	Treasury bill No 1493	45	91	0.69	99.826	241
30 April 2014	Treasury bill No 1492	45	91	0.70	99.823	242
23 April 2014	Sukuk al salam No 156	36	91	0.75		260
17 April 2014	Sukuk al ijara No 104	20	182	0.90		325
16 April 2014	Treasury bill No 1491	45	91	0.72	99.817	203
9 April 2014	Treasury bill No 1490	45	91	0.75	99.812	246
6 April 2014	Treasury bill No 1489	30	182	0.87	99.564	212
2 April 2014	Treasury bill No 1488	45	91	0.75	99.812	218
26 March 2014	Sukuk al salam No 155	36	91	0.78		311
20 March 2014	Sukuk al ijara No 103	20	182	1.00		425
19 March 2014	Treasury bill No 1487	45	91	0.75	99.812	145

Source: Central Bank of Bahrain

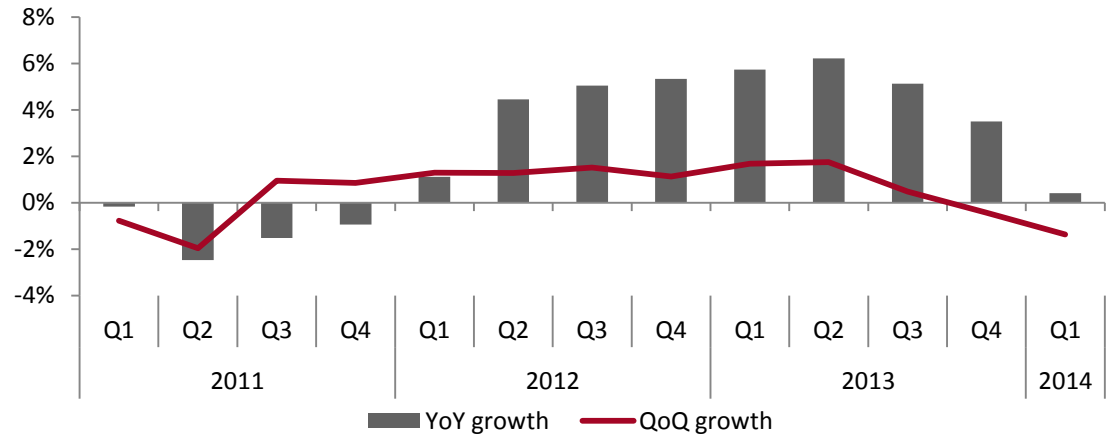
The main fixed income issuance by Bahrain-domiciled names has involved a CHF125mn (USD138.8mn) five-year Euro-bond by Investcorp in June. The bond carries a fixed coupon of 4.75%. Gulf International Bank issued a SAR2bn bond with a tenor of five years in May. The floating coupon is set at 3-month SIBOR + 72.5 bps.

Labor market continuity

While the private sector continued its year-on-year growth, employment figures experienced a slight drop in 1Q14 compared to 4Q13. Quarter-on-quarter growth, which has been relatively stable around 1.5% during 2012 and early 2013, is now slowly declining and has dipped below

the 0% mark since the fourth quarter of 2013. The median wages for Bahraini nationals rose to BHD511 a month in Q1, up 0.6% YoY.

Total private sector employment growth (excl. domestic workers)

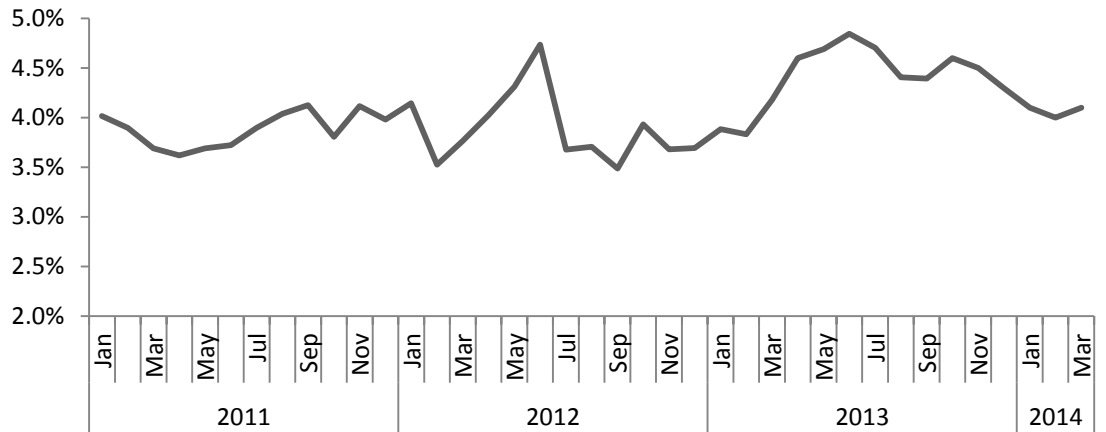


Source: Social Insurance Organization

Unemployment in the Kingdom has remained stable and new initiatives are underway to stimulate job creation for school leavers.

Bahrain unemployment as measured by the Ministry of Labor remains low and stable around the 4% mark. The Ministry is in the process of launching a new BHD30mn National Employment Project to support job creation for young Bahrainis. The program is designed to employ 4,000 university graduates, 2,000 diploma holders, and 4,000 high school graduates.

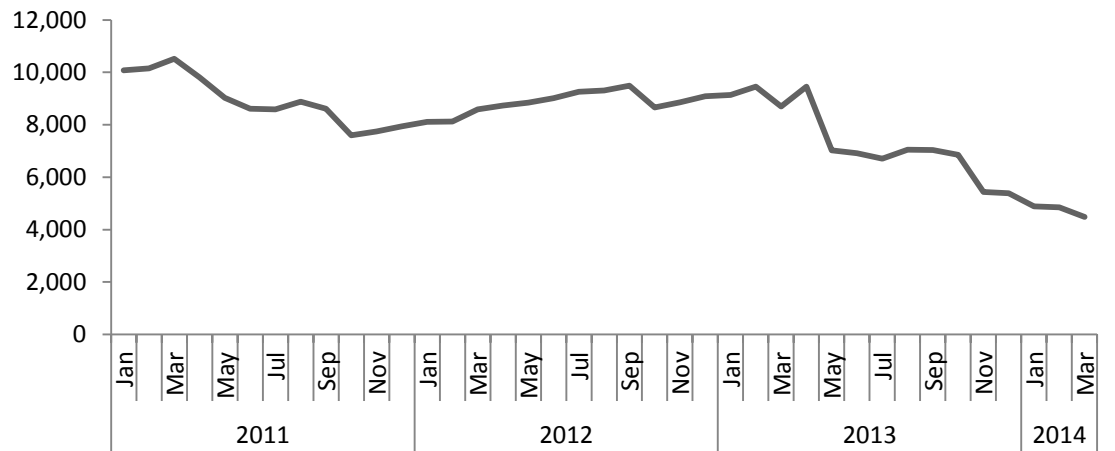
Unemployment rate (%)



Source: Ministry of Labor

Reaching 153,525 Bahraini workers during 1Q14, Bahraini employment witnessed annual growth of 3.9%. This outpaced the growth in expatriate employment which rose by an annual rate of 1.6% to 508,002. Total employment in the Kingdom increased by 2.2% YoY to reach 661,527.

Number of vacancies reported by the Ministry of Labor



Source: Ministry of Labor

Favorable external assessments

Bahrain continues to score well on indicators of the ICT readiness.

Bahrain continues to feature prominently in the top 30 economies in The Global Information Technology Report 2014, produced by the World Economic Forum in cooperation with INSEAD. The report provides an overview of the current state of ICT readiness in 148 economies. Stable at 29th place worldwide, Bahrain continues its robust performance. It is less costly to access ICT services (25th) and uptake by individuals is one of the highest in the world (14th), with a very high number of internet users (10th); the number of households with a personal computer (3rd) is similar to that of the Nordic countries. The Kingdom has a strong vision to develop the sector (14th) and offers a wide range of services online.

Bahrain occupies the 33rd position worldwide out of 138 economies in terms of enabling trade. The World Economic Forum “Global Enabling Trade Report 2014” assesses the performance of economies, in four areas: market access; border administration; infrastructure; and the operating environment. Bahrain demonstrates solid performance across many indicators in the analysis. Bahrain importers and exporters benefit from a sound operating environment (28th) that is conducive to trade with easy accessible finance (10th) and ease of access to loans (7th) and ease of hiring foreign labor (21st) and from a very good transport infrastructure (32th), in particular when it comes to seaport facilities (11th), the quality of air and road transport (both at 24th position). The kingdom benefits from a high number of individuals using the internet (10th) and the provision of government online services (9th).

Bahrain news

- ▶ Bahrain has been elected as International Labor Organization (ILO) board member for the new term 2014-2017
- ▶ Bahrain has clarified its treatment of capital-boosting instruments under Basel III rules and drafted separate rule books for conventional and Islamic banks, proposing they both come into effect in January 2015.
- ▶ Bahrain Airport Services (BAS) Aircraft Engineering Training Centre (BAETC) has signed a MoU with UAE's Alpha Aviation Academy (AAA), the region's largest multi-crew pilot licence facility. The MoU aims to enhance the aviation training of both entities for both engineers and pilot cadets.
- ▶ The National Health Regulatory Authority (NHRA) confirmed a new national pricing plan, including price ceilings, which is part of a GCC plan to unify cost of medication.
- ▶ Gulf Petrochemical Industries Company (GPIC) reported that it has achieved the highest production rate in its history during 1Q14 with a total of 460,029 metric tonnes of methanol, ammonia, and urea were produced.
- ▶ Bahrain hosted the Global Symposium for Regulators 2014, a 3 day summit for telecommunication regulators under the theme of capitalizing on the potential of the digital world.
- ▶ Bahrain hosted the first MENA Angel Investors Summit organized by Tenmou, Bahrain's business angels company, with the EDB as a strategic partner. The summit showcased Bahrain's investment environment and the efforts made to support entrepreneurs and create various partnership opportunities.
- ▶ CBRE, the global real estate consulting firm, was awarded the contract for property management and retail leasing for Enma Mall in Riffa
- ▶ A plan to establish a national health insurance program for Bahrainis and expatriates in both the public and private sectors has been given the green light.
- ▶ According to Saudi Aramco, construction contracts for a new crude oil pipeline between Saudi Arabia and Bahrain are expected to be tendered by the end of the year. The cost of the 115km pipeline which will transport crude oil from Aramco's Abqaiq plant to Bahrain is estimated at USD350mn
- ▶ The EDB met delegates from China and Malaysia to showcase investment opportunities in Bahrain as well as further strengthen bilateral ties.
- ▶ Bahrain hosted the 13th meeting of the Middle East Regional Monitoring Agency Board. The board praised Bahrain's role in managing the Agency's operations centre which is located in the Kingdom.
- ▶ Bahrain in late June inaugurated a 5 MW solar power plant in Awali. The USD25mn facility will deliver more than 8,000 MW of clear energy.

- ▶ The Muharraq Waste Water Treatment Plant was opened in late June. The USD250mn facility has a capacity of 100,000 cu m per day. Implemented by three private companies, the project is part of the strategic plan for sanitary services adopted by the Ministry of Works in 2010.

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