



Bahrain Economic Quarterly

June 2017

SUMMARY

2017 OFF TO A GOOD START

The opening months of 2017 have witnessed a general strengthening of the global economic outlook. The non-oil economy in the Gulf has benefited from this even as oil output cuts have translated into more subdued headline growth. Bahrain's performance in this environment has continued to be characterised by remarkable resilience, thanks in large part to substantial infrastructure investments.

✦ **Bahrain's annual economic growth rate was 2.9% in 1Q17.** This was in line with the performance seen in 2016. The strong growth materialized in spite of a small contraction in the oil sector along with minimal expansion in Government Services. The momentum is supported by a record infrastructure pipeline

✦ **Non-oil growth accelerated sharply from the end of 2016.** The rate of growth in Bahrain's non-oil economy in Q1 reached an annual 4.4%, which was clearly ahead of the 3.7% pace seen during 2016 as a whole. The fastest growth was recorded in Hotels & Restaurants, Financial Services, and Transportation & Communications. Business confidence has remained resilient

✦ **Regional headline growth hit by oil output cuts.** 2017 is likely to see a clear deceleration in the regional aggregate growth rate. This will be primarily due to oil output cuts following last year's OPEC+ agreement. By contrast, growth in the non-oil sector is gradually accelerating as companies and consumers adapt to the new fiscal realities. Regional non-oil growth is set to increase from last year's 2% to approximately 3% this year

✦ **Renewed oil price volatility.** After several months of steadily increasing prices, the oil market has been hit by renewed volatility since April. This is primarily reflective of the slow progress in eliminating the supply overhang as the effects of the OPEC cuts have been partially countered by higher US production. Nonetheless, prices are generally expected to continue to edge up as the market slowly rebalances itself

Bahrain economic outlook

	2016	2017f	2018f	2019f
Real GDP growth, %	3.0%	2.5%	2.4%	2.2%
Non-hydrocarbons sector	3.7%	3.2%	3.9%	2.8%
Hydrocarbons sector	-0.1%	-0.1%	0.0%	0.0%
Nominal GDP growth, %	2.4%	6.8%	6.0%	5.1%
Inflation (CPI %)	2.8%	1.8%	3.0%	3.0%
Current account (% of GDP)	-4.6%	-3.8%	-3.8%	-3.8%
Fiscal balance (% of GDP)	-13.5%	-8.8%	-7.4%	-6.4%
Crude Oil Arabian Medium (USD)	43	52	55	55

Source: Bahrain Economic Development Board

SUMMARY	2
GLOBAL ECONOMY	3
THE GCC REGION	8
BAHRAIN	18
KEY SECTORS	35

GLOBAL ECONOMY

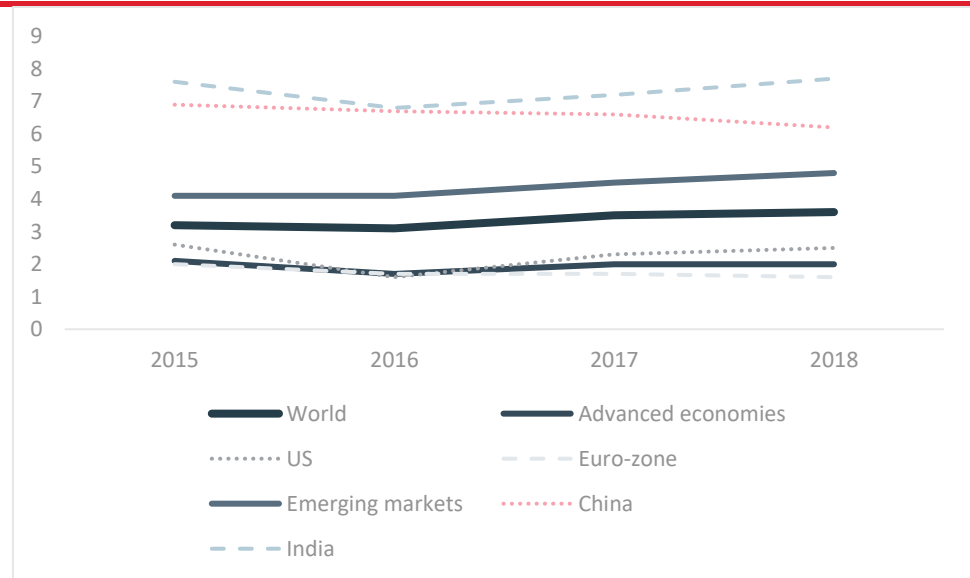
A RECOVERY TAKES SHAPE

Even though the global economic environment remains uneven, the tentative recovery that became evident during the winter has generally continued to gather momentum. Activity in China has benefited from stimulus measures by the government while virtually all advanced economies are showing signs of faster growth.

Even as expectations regarding substantial near-term stimulus in the US have been scaled back, most economic indicators have proven resilient. After a prolonged bout of weakness, the Euro-zone has experienced a clear improvement in sentiment and performance. Even Japan is posting faster growth. These developments are beginning to prompt some new thinking about monetary policy tightening even as global inflationary pressures remain subdued.

The International Monetary Fund (IMF) has now increased its global growth forecast to 3.5% for 2017 as a whole followed by a slight further acceleration to 3.6% in 2018.

Global growth prospects (real growth in major economies, %)



Source: International Monetary Fund, World Economic Outlook, April 2017

Central banks begin to contemplate normalization

The brighter outlook for the global economy is raising the prospect of central banks moving away from their unusually loose monetary policy stance. The US Federal Reserve has been leading the way in this respect and raised its benchmark interest rate a second time this year on 14 June. The Federal funds rate now stands at 1-1.25%. In spite of mixed economic data and subdued inflation, the rate increase was justified by moderately improving economic activity along with robust labour market conditions.

Economic data from most advanced economies has improved while Chinese growth continues to be sustained by stimulus measures

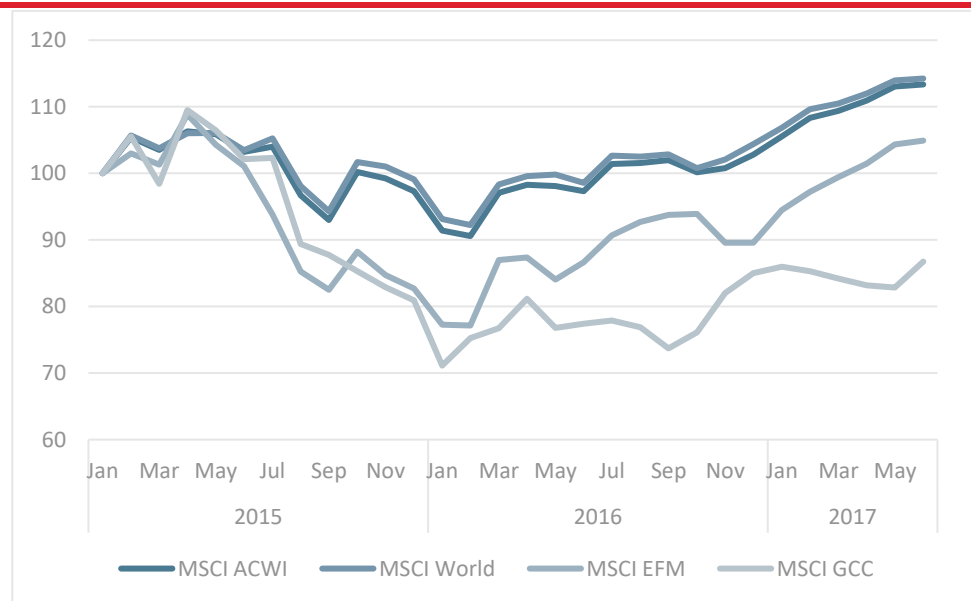
The Fed signalled that another rate increase, along with some unwinding of the post-crisis asset purchases, was likely this year. The balance sheet reduction is expected to be gradual starting with an initial cap of USD10bn, which would be increased every quarter to a limit of USD50bn. The Fed balance sheet currently stands at around USD4.5trn.

The median rate expectation for the end of the year now stands at 1.4%, although market analysts have grown increasingly skeptical of the possibility of another rate increase given the subdued inflation data. The Fed itself expects economic conditions to remain mixed over the coming months. While unemployment is expected to edge down from last year's 4.7% to 4.3% this year, core inflation is also set to remain below target with a slight decline from last year's 1.7% to 1.6% this year. Three further rate increases are expected in 2018 and 2019 alike, which would take the median rate to 2.9% by the end of 2019.

Even as the Fed is clearly leading the way on normalization, also other major central banks globally have suggested that the stronger economic data is triggering something of a rethink. President Mario Draghi recently commented that deflationary pressures in the economy are giving way to reflationary forces. Even Governor Mark Carney of the Bank of England suggest that a retreat from monetary stimulus might become necessary. Such steps should reduce the likelihood of a significant divergence in monetary conditions between the US and other major economies.

This apparent shift in the tone of monetary policy makers in late June triggered a sell-off in global bond markets. Yields for the US 10-year Treasuries rose from less than 2.15% to more than 2.30% within a week. Similar trends were observed in other major markets. By contrast, equity market performance has remained generally strong with most major indices near all-time highs of the end of June.

Global equity market performance (Jan 2015 = 100)



Source: MSCI

There is growing confidence that the monetary policy cycle is beginning to turn toward greater tightening in most major economies

Volatility returns to the oil market

The output cuts agreed by leading OPEC and other producers at the end of 2016 proved generally effective in drawing a line under the oil price and ensuring remarkable stability in the USD50-55 per barrel range during much of the spring. Over time, however, volatility began to return to the markets as a result of a number of factors:

In spite of continued output controls, oil prices have become much more volatile as the desired market rebalancing has proven elusive

- ✦ In spite of historically very high compliance with the deal, observers were increasingly tilting toward the view that the original OPEC deal would not be sufficient to rebalance the market and that further interventions would be required. Among other things, production by OPEC members, such as Libya and Nigeria, is increasing and both are exempt from the current quota regime following a period of internal conflict. Speculation about whether or not the agreement would be extended inevitably resulted in bouts of volatility
- ✦ US shale producers have proven remarkably quick to capitalize on the more benign price environment and above all the expectations of rising prices, which allowed them to sell forward. US crude production rose from 8.5 mbd in October to 9.3 mbd in May 2017. The swift supply response in North America has countered much of the OPEC+ cut. US production growth since October 2016 has negated roughly 80% of the Saudi cut or some 27% of the total cuts made under the OPEC-led deal
- ✦ Even though the global economy is showing signs of slightly accelerating growth, there is concern about the growth of oil demand. Oil inventories have defied expectation of major drawdowns and the demand data from some major consumers has been mixed

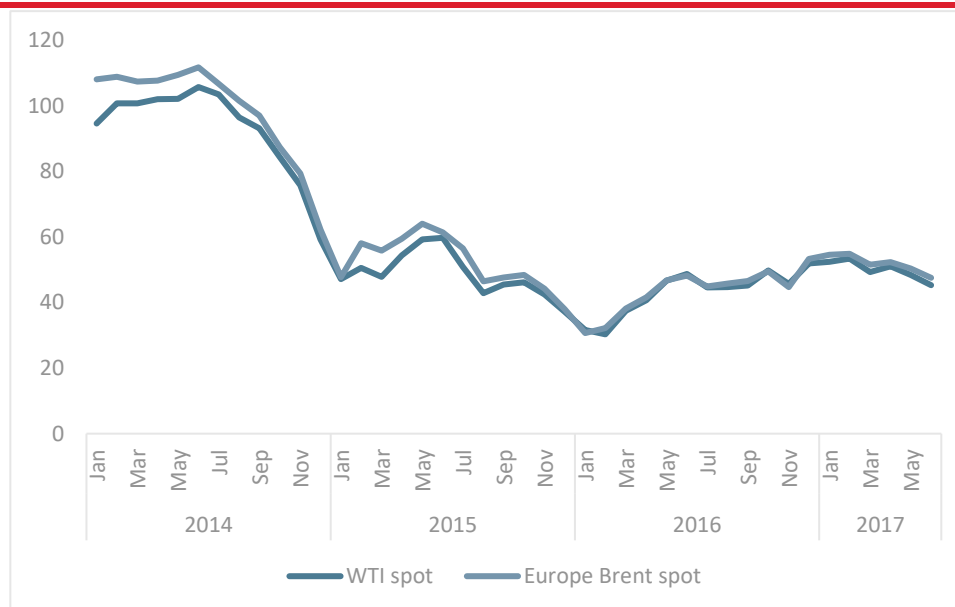
This volatility has tended to be amplified financial market dynamics.

The current market realities in late May prompted OPEC, along with significant other producers, to agree to extend their production cuts for another nine months. Saudi Arabia further underscored its willingness to revisit the policy as needed. The agreement involves 24 countries that jointly account for 55% of global oil production. Instead of price stability, however, the deal extension unleashed a bout of oil price softness. The Brent benchmark has shed more than 20% of its January high, and nearly all of that has materialized since the initial deal by OPEC and its partners was struck. This in part reflected market disappointment over the fact that the cuts were not deeper and no formal exit plan was provided.

Oil ultimately closed Q2 with some renewed signs of firming after the Brent benchmark had temporarily dipped below USD45 per barrel, posting 10-month low of USD44.8 on 21 June. It eventually ended June at USD47.9 per barrel following a 5.2% gain during the week. All in all, June proved the weakest month of 1H17 for oil prices with the monthly average price for Brent falling below the USD50 mark for the first time, declining some 5% YoY.

The positive price reversal at the end of Q2 was triggered in part by weaker production data from the US. The EIA reported the largest weekly drop in US output – 100,000 b/d – since July 2016. Also the number of oil rigs posted its first fall since January. The gasoline and distillate stock continued to edge down even if US crude inventories have resisted expectations of a fall. In spite of the reversal, oil prices remained down by some 15% since the beginning of the year.

Monthly average crude oil prices (USD/barrel)



Source: US Energy Information Administration

Global oil demand and supply dynamics (mbd)

	IEA	OPEC	EIA*
2016 Global oil demand (mbd)	96.6	95.1	96.92
Advanced economies	46.8	46.9	46.85
Developing economies	49.7	31.4	50.07
China	11.9	11.5	12.44
2017 Global oil demand (mbd)	97.8	96.4	98.46
Advanced economies	46.9	47.1	47.14
Developing economies	50.9	32	51.32
China	12.3	11.8	12.78
2016 Global oil supply (mbd)	96.9	95.8	97.17
OPEC	39.3	32	39
Non-OPEC	57.6	57.3	58.17
2017 Global oil supply (mbd)	-	-	98.3
OPEC	-	-	39.22
Non-OPEC	58.3	58.1	59.08

*Petroleum and other liquids data

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

Implications for Bahrain

Recent months have highlighted the probability of continued oil price volatility even if the price range itself appears to be stabilizing. At the same time, the monetary policy bias globally is beginning to tilt toward further tightening:

- ✦ Even as oil price dynamics look generally favourable, the recurring pattern of volatility is underscoring the strategic importance of economic diversification
- ✦ The prospect of monetary conditions growing gradually tighter should encourage bank lending but also underscores importance of managing leverage in the economy

THE GCC REGION

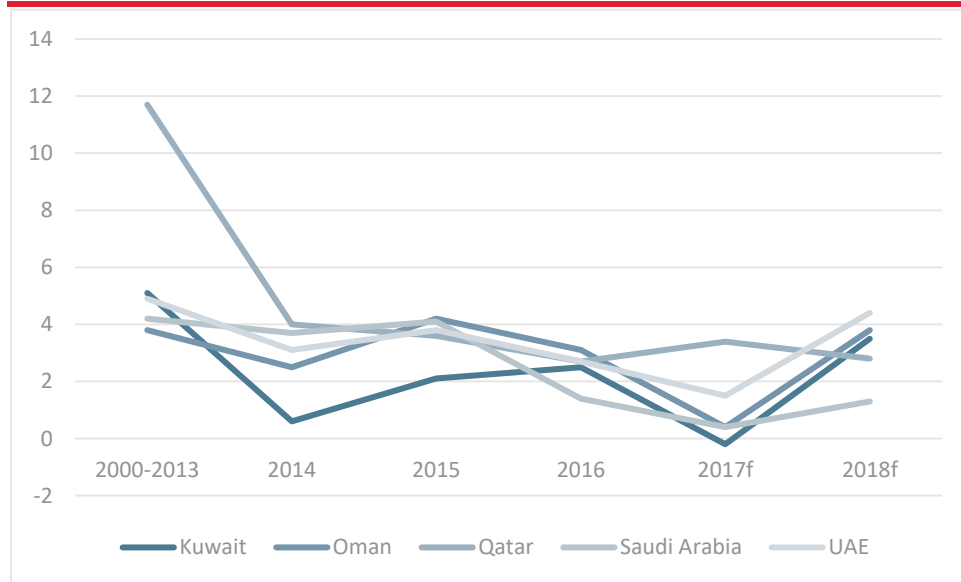
OIL OUTPUT CUTS DELIVER SLOWER GROWTH

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 GCC non-oil economy is showing further signs of rebounding from the initial shocks of sharply lower oil prices and an unprecedented government commitment to fiscal consolidation. The IMF now expects non-oil growth in the GCC to accelerate from an annual pace of just under 2% in 2016 to 3% in 2017.

By contrast, the region's oil producers have complied conscientiously with the OPEC+ deals on oil output cuts in a bid to normalize the supply overhang in the market. In the case of Saudi Arabia, the actual cuts have exceeded those formally agreed upon at the end of last year. This is likely to entail a negative growth contribution from the hydrocarbons sector which, even with the non-oil rebound, risks leaving headline growth only in the positive territory, especially for regional economies with large oil sectors. Under the circumstances, economies such as Saudi Arabia, Kuwait, and Oman, are unlikely to achieve overall of real GDP growth in excess of 0-1%. The more diversified regional economies are likely to fare somewhat better. However, the base effect of reduced oil production this year, along with the ongoing non-oil rebound, should allow for much stronger growth in 2018.

GCC real GDP growth, %



Source: International Monetary Fund

Non-oil fundamentals strengthen

Business confidence in the region has been characterized by generally positive dynamics, although it has once again proven sensitive to oil price variations. After a long positive streak on the back of increased oil price optimism in the spring, the regional Purchasing Manager's Indices shed some of their gains in the late spring as bears reappeared in the oil market. Even as the Saudi and UAE

PMI's retreated from their recent highs, they have consistently remained ahead of the lows posted last year.

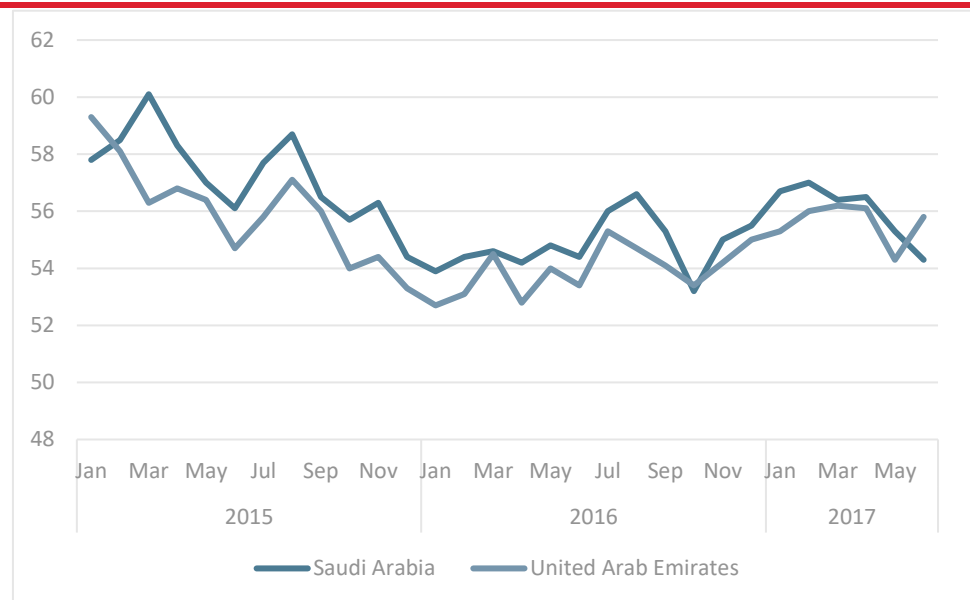
The Saudi PMI eased from its April high of 56.5 to 55.3 in May and further to 54.3 in June, which marked the lowest reading since October 2016. In spite of the slight weakening of the index in May-June, the average during the first half of the year was 56.0, which was clearly ahead of the 2016 all-year average of 54.8. The index dynamics appear to reflect the continued sensitivity of the economy to oil price movements.

Even though the improvement in regional business confidence stalled in Q2, the H1 average was clearly ahead of last year's readings

While the UAE PMI also dropped from 56.1 in April to 54.3 in May, it subsequently rebounded to 55.8 in June. The reversal was driven by increased output and new order growth. The average PMI reading during the first half of the year was 55.6, which was clearly ahead of the 53.4 figure seen during the corresponding period in 2016. However, only 13% of the companies surveyed now expected higher output in 12 months' time. In both countries, increased economic optimism has had only a very limited impact on job creation which has tended to be barely expansionary.

The Emirates NBD Dubai Economy Tracker reached a 26-month high of 57.7 in April and declined somewhat to 55.0 in May. Echoing the broader national PMI, this rebounded to 56.6 in June thanks to increased output and new order growth. Seasonal effects from Ramadan further supported activity. Margins have remained under pressure as companies have competed on price cuts in the face of some input inflation.

Emirates NBD Purchasing Managers' Index



Source: Emirates NBD, Markit

The intermediate economic data for the region has remained mixed in reflection of the conflicting forces created by hydrocarbons sector retrenchment and the gradual normalization of the oil sector. Saudi Arabia's GDP shrank by an annual 0.5% in 1Q17, the first YoY contraction since 2009. This was led by a 2.3% decline in the oil sector as a result of the OPEC-led output cuts. Also the non-oil government sector contracted, albeit very marginally, by an annual 0.1%. By contrast, the non-oil private sector saw an acceleration in its growth from an annual 0.5% in 4Q16 to 0.9% in 1Q17.

Since then, however, economic data continues to show a somewhat improving picture in April, albeit with elements of volatility. For instance, point of sale transactions rose by an annual 11.4% in April, followed by a further 6.4% in May. However, ATM withdrawals have remained negative in YoY terms.

Saudi GDP growth is expected to be barely positive following the continuation of the OPEC production quotas. The oil sector is projected to contract by slightly more than 1% this year, which will largely counter the expected 1% growth in the non-oil economy. Non-oil growth should benefit from improving liquidity and some acceleration in budgeted spending, especially in the area of projects where only 11% of the budgeted amount was spend in Q1.

In the UAE, provisional Government data suggests that the country's economy expanded by 3.0% in 2016, down from 3.8% in 2015. The positive momentum benefited from the hydrocarbons sector which expanded by 3.8% whereas the non-oil economy grew by 2.7%. Transportation & Storage was the single fastest growing sector of the economy, posting a 7.4% YoY gain in real terms. Reflecting a recovery in tourism, the Accommodation & Food Services sector expanded by 5.7%. Manufacturing expanded by 6.0% and construction by 3.0%. By contrast, the Trade sector, reflecting fiscal consolidation and increased economic uncertainty, grew by just 0.5%.

The Central Bank's Economic Composite indicator pointed to 3.1% non-oil and 3.3% headline growth in 1Q17. This benefited from continued expansion in the oil sector, by 3.6%, a trend that is due to be reversed in the months ahead. Indeed, full compliance with the OPEC targets would mean a 2% YoY decline in oil production. This could bring the headline growth figure closer to 2% as oil accounts for roughly a third of the country's GDP.

In Kuwait, non-oil economic activity has held up well in the face of consolidation in the oil sector. Even if consumer confidence has been somewhat fragile, renewed momentum in project implementation is likely to deliver non-oil growth of 3.5% or more this year. Increased capital spending is anchored in the new Kuwait National Development Plan which envisages investments of KWD34bn up to 2020. This increased nonoil activity will likely mark an improvement on the 3.4% pace estimated in 2016. By contrast, the all-important oil sector will likely post a sharp contraction due the OPEC cuts. This could reduce the oil sector GDP by some 7.5% and bring the headline GDP growth rate below zero (by more than 2%) before an expected rebound in 2018.

Oil prices drive fiscal rebalancing

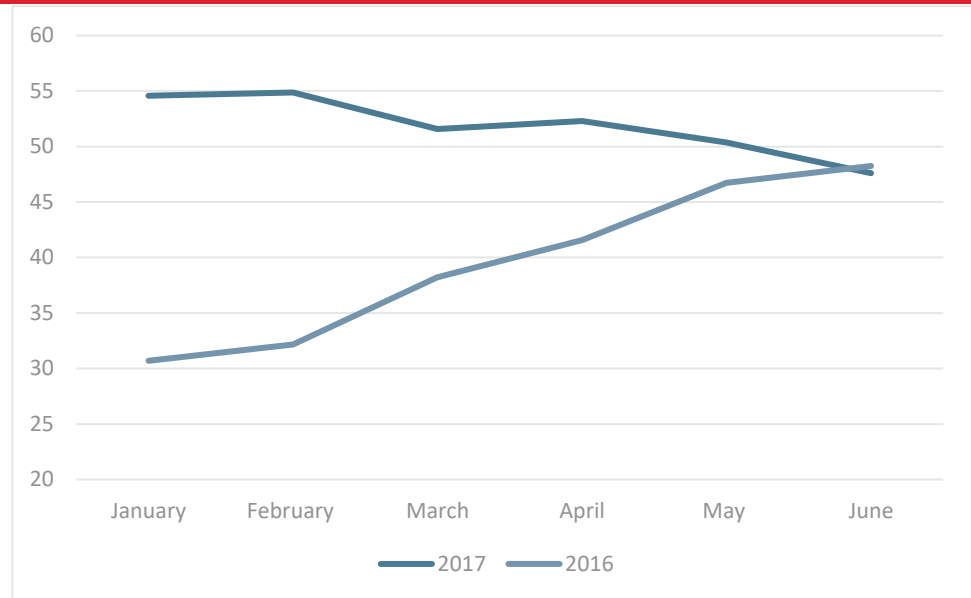
The fiscal outlook for the region has improved markedly thanks to stronger oil prices in 1H17 as compared to 1H16 along with various revenue diversification and expenditure rationalization measures. The average Brent price in 1H17 was USD51.9 per barrel – some 31.1% higher than the USD39.6 per barrel average recorded a year earlier. The improvement was particularly pronounced during Q1 – some 60%. By June, the monthly average fell slightly short of that seen a year earlier.

The first-ever quarterly budget performance report by the Saudi Ministry of Finance revealed a 72% YoY increase in government revenues in 1Q17. This was mainly due to oil revenues as non-oil income rose by 1%. Expenditures fell by 3%, with manpower spending declining by 5%. This left

While business confidence remains somewhat fragile, the non-oil sector is showing increasingly consistent signs of strengthening across the region

the fiscal deficit at SAR26.2bn, which compared to a 2016 total deficit of SAR198bn. Overall, the 2017 deficit as a percentage of GDP is expected to fall back into the single figures and reach some 7% of GDP.

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



Source: US Energy Information Administration

Saudi Arabia is initiating a comprehensive Fiscal Balance 2020 program to drive its medium-term fiscal consolidation. Electricity and liquid fuel prices will be linked to reference prices. The ultimate objective is to bring all key utility and fuel prices to pre-determined reference levels by 2020. The program also introduces higher levies for expatriate workers. A SAR1.4trn capital project pipeline will continue to be reviewed with a view to achieving savings. Excise duties and the Value Added Tax will be key additional revenue sources totalling some 1.8% of GDP. Saudi households will be protected from the impact of some of the fiscal consolidation measures through means-tested allowances. The Citizen's Account, a cash payout program for low and middle income Saudis, is due to start in July. At the same time, as the economic growth model adjusts, the authorities are considering a private sector support program worth some SAR200bn. Among the measures envisaged are low-cost loans for labour-intensive industries along with faster approval processes for projects. Excluding the private sector support measures, the planned savings should total some SAR299bn, or 11.4% of GDP.

In Kuwait, Government expenditure fell by 11% to KWD16.1bn under the FY2015-16 budget. This drop materialized in spite of a 13% increase in capital expenditure to KWD2.9bn. At the same time, however, Government revenues plummeted by 38.8% to KWD17.7bn. Oil revenues more than halved to KWD12.1bn.

At the same time, regional governments are seeking new ways to engage the private sector in delivering services that have historically been the preserve of the public sector. Saudi Arabia in June signed contracts with private contractors for the operations and further development of five of its airports: Jeddah, Taif, Qassim, Hail, and Yanbu. The agreements were structured as long-term public-private partnerships and involved companies from Turkey, Germany, Singapore, as well as

Fiscal consolidation is making headway across the GCC. While higher oil prices were a key factor in 1H17, revenue diversification will grow in importance in the months ahead

Saudi Arabia. The program builds on the precedent on the Madinah airport which was built on a BOT basis. Saudi Arabia is planning to privatize 11 airports under its Vision 2030. The Government is also intending proceed with at least four company privatization as soon as this year. These include the Saline Water Conversion Co., one of the planned for power generation companies, and two others.

Oil production curbed by OPEC quotas

Having been a major driver of growth in the GCC until the end of last year, the oil sector is now performing the opposite function. A high degree of compliance with the OPEC+ cuts means that the oil sector is either contracting or about to do so virtually across the region. Saudi Arabia has been leading the way in terms of implementing the deal and shown willingness to produce below its formal quota, which stipulated 486,000 b/d cuts. Since the beginning of the year, Saudi production has remained fairly consistently below the 10 mbd mark.

According to preliminary secondary source data, Saudi Arabia's crude output in the first half of the year was some 3.7% below the corresponding period in 2016. Whereas the Saudi output averaged nearly 10.3 mbd in January-June 2016, the corresponding average for 1H17 was just over 9.9 mbd.

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

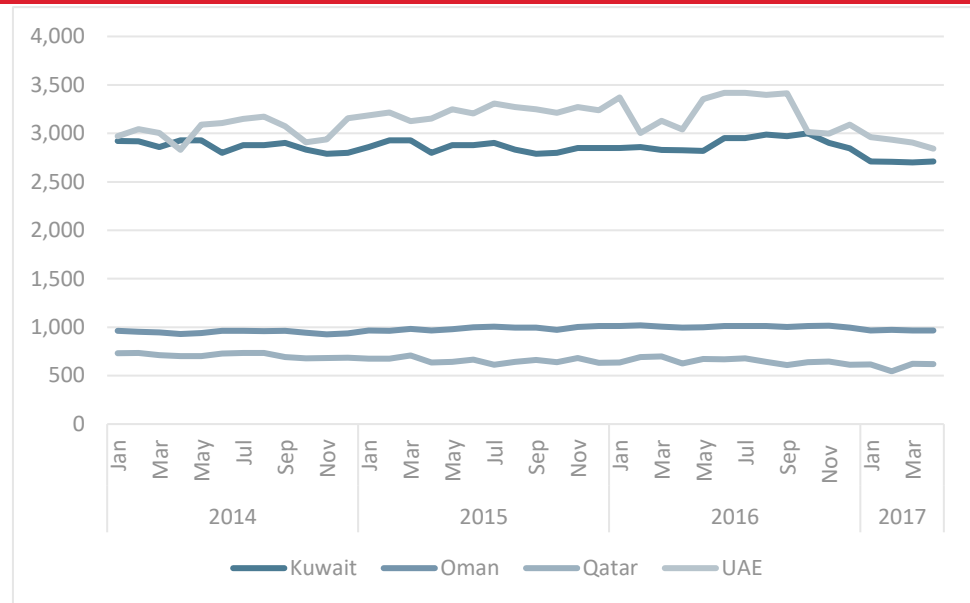


Source: Joint Organisations Data Initiative, Bloomberg

Developments in the rest of the region are broadly comparable. UAE production in 1H17 was an estimated 9.9% below last year's data, based on secondary source data. The average during 1H17 was estimated at 2.9 mbd. In Kuwait the YoY drop in production was some 53%. Output during January-June 2017 averaged just over 2.8 mbd.

Key producers across the GCC have cut their oil output in response to OPEC's current quota regime

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



Source: Joint Organisations Data Initiative, OPEC, Bloomberg

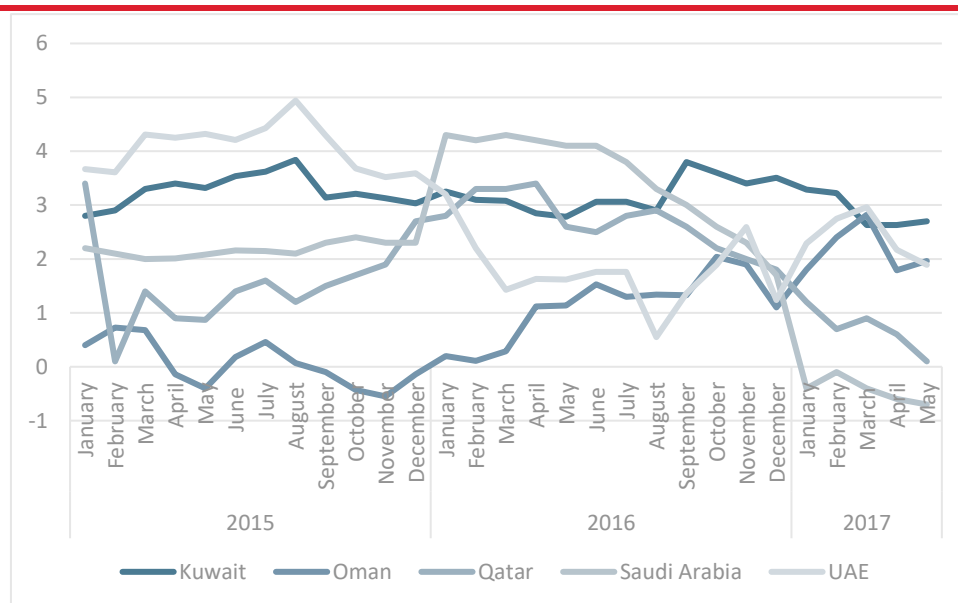
Modest price pressures

Consumer price pressures have remained minimal across the region with Saudi Arabia seeing deflation since the turn of the year

Echoing the pattern observed during Q1, inflationary pressures across the region have been generally moderate, in some cases virtually non-existent. Saudi Arabia has been experiencing mild deflation since the beginning of the year. The Saudi Consumer Price Index contracted by an annual 0.7% in May. At the other end of the spectrum, Kuwait saw the fastest pace of consumer price increases in 1H12, although the trend has been fairly consistently down. Headline consumer price inflation in May stood at 2.7%.

The low rate of inflation across the region to an extent mirrors global trends and the relative weakness of imported inflation. Similarly, housing costs have been held in check by strong increases in regional housing stock at a time of relatively subdued demand. Also, the inflationary impact of the initial waves of subsidy cuts in most of the region has generally worn off.

Consumer price inflation, %



Source: National statistical agencies

Sovereign borrowing needs continue to dominate the financial landscape

Consolidating an established pattern, bond and sukuk issuance by GCC sovereigns has been the key driving force of the regional financial market development. Little change in this regard is expected in the short term even as the fiscal rebalancing makes headway. The IMF expects the regional economies to run cumulative deficits of USD240bn until 2021. This would translate into a reduction in the regional aggregate deficit from 12% of GDP in 2016 to 6.5% this year and 4% in 2018. The GCC is expected to account for just under a third of all emerging market sovereign bond issuance globally this year.

In a benchmark event from the regional fixed income markets, the Saudi government in April issued a USD9bn international sukuk. Thanks to strong investor interest, with the order book exceeding USD33bn, the amount raised was increased from the originally target of USD5bn. The Dollar-denominated offering was the largest sukuk offering anywhere to date. It accounted for 60% of global sukuk issuance in 1H17.

Going forward, the Saudi Government has suggested that it intends to raise some SAR70bn from the domestic bond markets during the year. Plans for an international bond offering of some USD10bn in 4Q17 are, similarly, under consideration. Oman issued a USD2bn bond in May with three-fold oversubscription.

Overall, Moody's Investor Services expects some USD32.5bn off GCC sovereign issuance this year, as compared to USD38.9bn the year before. The high volume of sovereign issuance has fuelled some potential concern about Government financing needs crowding out private capital. Overall bond issuance in the GCC has already exceeded USD42.7bn in the first half of the year. The annual total in 2016 was some USD69.1bn.

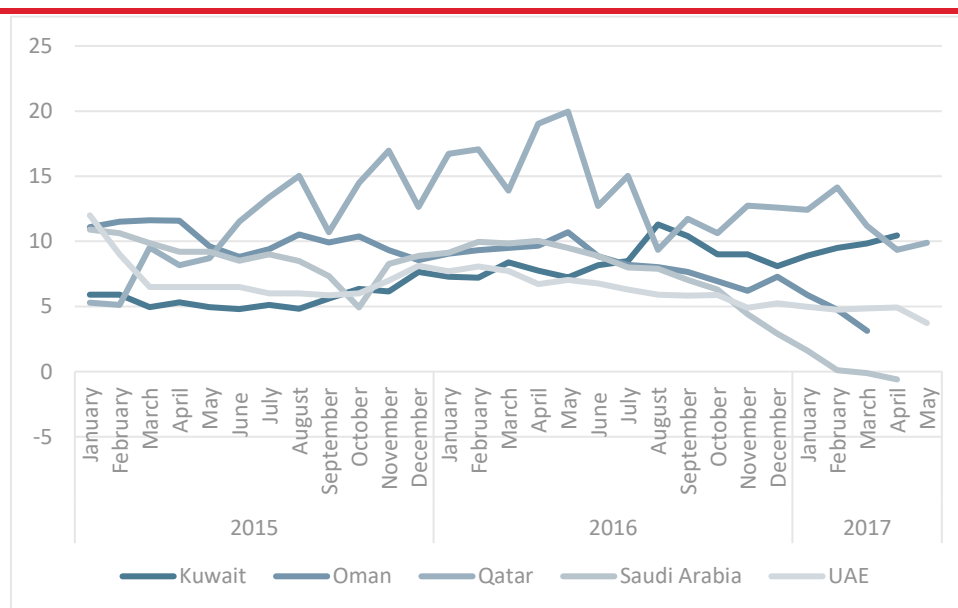
The regional fixed income market is beginning to challenge the erstwhile dominance of banks as a source of capital

Regional corporate bond and sukuk issuance has been dominated by banks and utilities. Running counter to an established pattern of an overwhelmingly bank-centric financial sector architecture, the fixed income markets are increasingly eclipsing bank lending – notably syndicated loans – as a source of long-term capital. Mubadala Development Co. placed a USD1.5bn bond, which was nearly four times oversubscribed. Oman Electricity Transmission Co raised USD500mn with a 10-year tenor. National Bank of Kuwait placed a USD750mn offering in May.

In the sukuk space, Saudi Aramco launched a landmark SAR11.25bn (USD3bn) in April. This was part of a SAR37.5bn program. The Islamic Development Bank placed a USD1.25bn sukuk in April. Damac Properties issued a USD500mn sukuk in April. Qatar Islamic Bank placed a USD750mn sukuk in May.

The sukuk markets were rattled by a decision by the Abu Dhabi-listed Dana Gas to declare USD700mn of its sukuk invalid. The company's Shariah advisors had discovered that the offering, which was due to mature in October, was not compliant with the relevant standards and was therefore deemed unlawful in the UAE. The company offered to exchange the sukuk for new Shariah-compliant notes.

Bank credit growth, %



Source: Regional central banks

In spite of some downward pressure, the growth of bank credit in the GCC has remained generally resilient. The overall liquidity situation in 1H17 benefited somewhat from higher oil prices as well as sovereign bond and sukuk issuance. Kuwait in fact has seen an acceleration in bank loan growth to around 10% a year, albeit very much thanks to faster lending growth to the public sector. Oman and the UAE have seen the annual pace of credit growth decelerate below the 5% mark. In Saudi Arabia, YoY growth in bank credit to the private sector turned negative in March for the first time in at least 11 years. However, long-term credit is growing quite robustly.

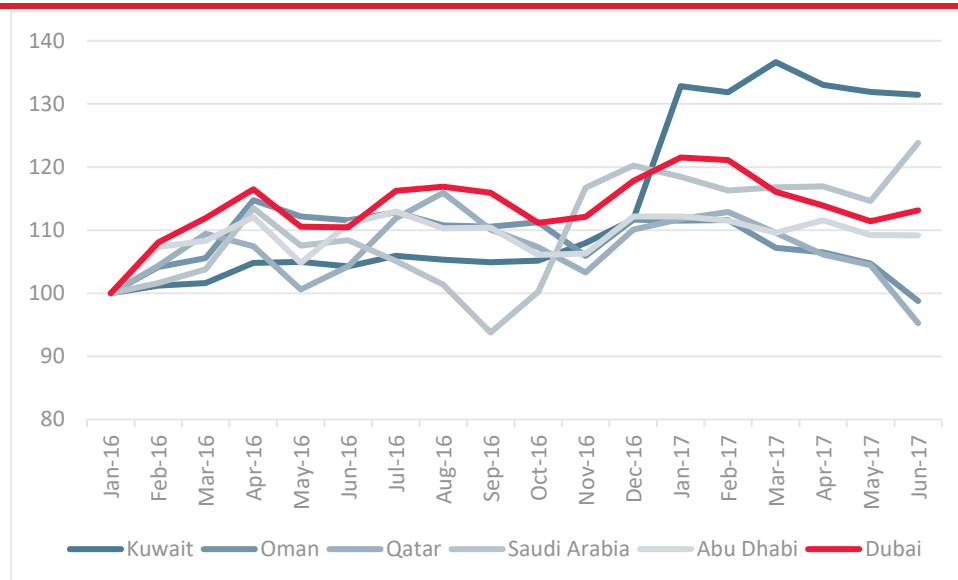
While syndicated loans are still growing, they are clearly ceding substantial ground to the bond and sukuk market. Regional syndicated loans total some USD78bn last year, up from USD70bn the

Most regional bourses drifted down in Q2 as a result of more volatile oil prices

year before. In 1H17, however loan syndications dropped 65% to USD19.2bn, which in fact was the lowest figure in four years. At the same time, bond issuance rose 46% to USD42.7bn. In a landmark deal, the Abu Dhabi Water and Electricity Authority (ADWEA) in May closed an AED3.2bn financing package for the world's largest solar plant with a capacity of 1,177MW.

In response to the changed economic realities, new initiatives are underway to support bank lending in certain areas. Saudi Arabia's first mortgage refinancing firm has started approaching banks to buy their mortgage portfolio in order to boost lending for homes. The state-owned company has a capital of SAR5bn and will further collaborate with the Government's Real Estate Development Fund to invest SAR5bn in mortgage portfolios. Saudi banks currently have mortgages worth SAR116bn, a figure that the authorities are hoping to eventually boost to SAR550bn.

GCC equity market indices (January 2016=100)



Source: Regional stock exchanges

Reflecting the loss of positive momentum in oil prices, most regional bourses drifted slightly lower during Q2. The main exceptions were Saudi Arabia and Qatar. In Saudi Arabia, the most recent Government reshuffle triggered a rally at the end of the quarter by general consolidating positive expectations around the authorities' economic agenda. Qatar's dispute with its neighbours had the opposite effect in Doha. Overall, Saudi Arabia was the only regional exchange to post positive growth during the quarter and expanded by 6.1%. At the opposite end, Qatar shed 13.1%. The other regional exchanges posted relatively small changes. Saudi Arabia, Kuwait, and Bahrain were the only regional bourses to close the first half of the year with a positive net gain. Kuwait led the way with a 17.8% increase. Saudi Arabia advanced by 3%. Qatar shed 18.5%, virtually all of it in June.

1H17 marked a welcome revival in the GCC IPO activity. The ten offerings in Q1 marked the highest regional total in five years. IPO activity was dominated by the launch of Saudi Arabia's Nomu parallel market on 26 February 2017. The new market saw eight listings representing companies with a total share capital of SAR820mn listed during the first half of the year. One more launched its IPO. The largest one of the companies was Raydan Co. with equity capital of SAR225mn. The

main market of Tadawul saw the listing of three REITs with a total equity capital of SAR1,063mn. Qatar saw the listing of the Investment Holding Group in a USD138mn offering. The ENDB REIT was listed on Nasdaq Dubai after a USD105mn sale.

In a major development for the regional capital markets, MSCI indicated that it would consider Saudi Arabia's inclusion in its Emerging Markets benchmark index by the end of the year. The Saudi market has continued to adopt measures to drive its continued convergence with global standards. Tadawul adopted the international norm of a T+2 settlement cycle. The role of foreign investment has continued to grow gradually 60 Qualified Foreign Investors currently operate on the Saudi market. The Saudi market also introduced provisions for short selling.

Implications for Bahrain

Even as non-oil growth is strengthening across the region, the tight liquidity conditions at a time of subdued oil prices will reduce the role of positive spill-overs from the rest of the region:

- ✦ The current issues relating to the relationship between Qatar and its three GCC neighbours, namely Saudi Arabia, the UAE, and Bahrain, are expected to have a very limited impact on the Kingdom's business environment. Access to and from Saudi Arabia, the GCC's largest economy, remains unaffected whilst there is complete freedom of movement across all other countries in the region
- ✦ The growth of visitor flows from the rest of the region is likely to remain fairly measured. However, Bahrain is showing some indications of being able to capitalize on its proximity and competitive costs at a time when consumers are most price sensitive
- ✦ The improving prospects for the non-oil economy should contribute to a gradual improvement in transit trade. Regional investment flows are likely to grow more slowly

BAHRAIN

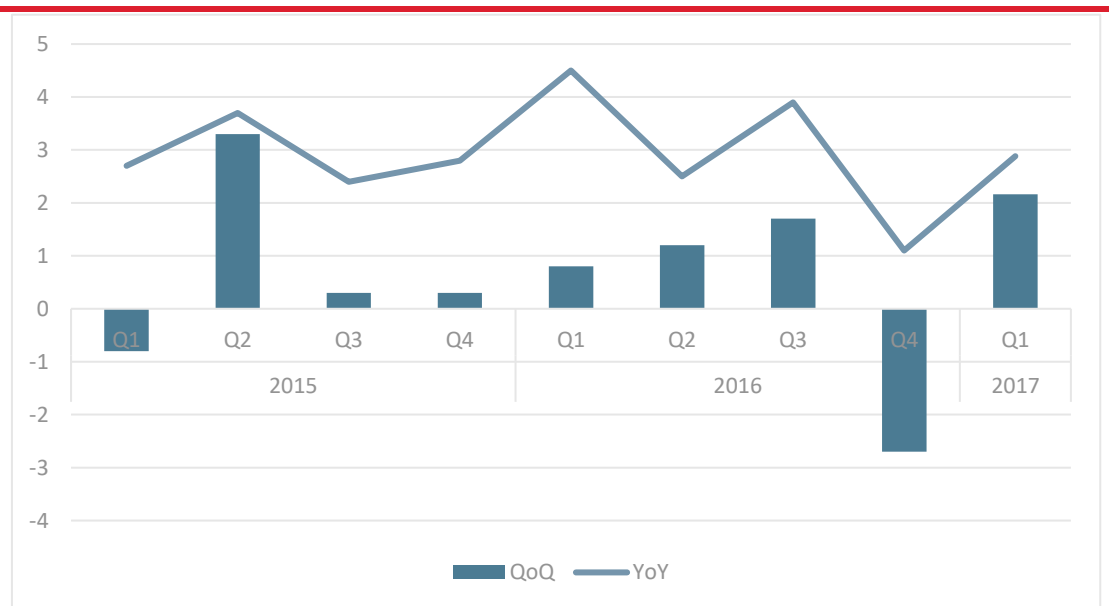
2017 OFF TO AN ENCOURAGING START

*Non-oil growth
accelerated in the
opening months of 2017*

The Bahraini economy has continued to display remarkable resilience with the non-oil sector seeing an acceleration in its growth during Q1. More than reversing a slight softening in the closing months of 2016, the non-oil sector expanded by an annual 4.4% in real terms during the first three months of 2017. Practically all of this growth was generated by the non-oil private sector as growth in Government Services was virtually flat in YoY terms. By contrast, the oil sector recorded a small 3.3% YoY real drop in its output.

The headline annual real growth rate of the economy reached 2.9% in 1Q17. As a result of markedly higher oil prices, nominal GDP expanded by an annual 10.4%. Compared to the last quarter of 2016, the economy expanded by 2.2% in real terms. This marked a return to the pattern of accelerating QoQ growth since the second half of 2015 which was briefly interrupted by the 4Q16 reversal. The pick-up in growth was reflective of a strong momentum in the infrastructure space but also reflected the positive liquidity and confidence implications of higher oil prices during the quarter.

Real GDP growth

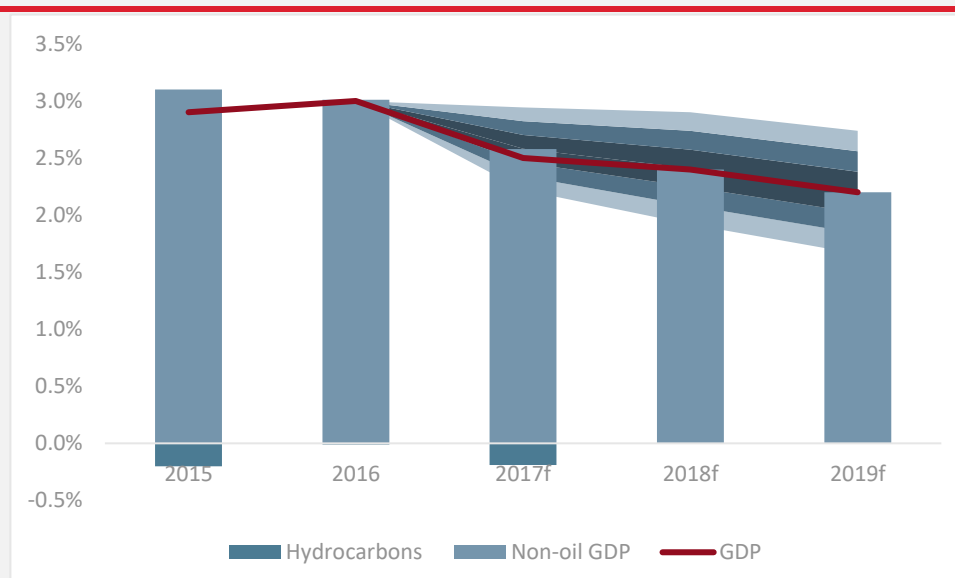


Source: Information & e-Government Authority

Forecasts: Some growth moderation likely in the medium term

	2016	2017f	2018f	2019f
Real GDP growth, %	3.0%	2.5%	2.4%	2.2%
Non-hydrocarbons sector	3.7%	3.2%	2.9%	2.8%
Hydrocarbons sector	-0.1%	-0.1%	0.0%	0.0%
Nominal GDP growth, %	2.4%	6.8%	6.0%	5.1%
Inflation (CPI %)	2.8%	1.8%	3.0%	3.0%
Current account (% of GDP)	-4.6%	-3.8%	-3.8%	-3.8%
Fiscal balance (% of GDP)	-13.5%	-8.8%	-7.4%	-6.4%
Crude Oil Arabian Medium (USD)	43	52	55	55

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

Projected real GDP growth contribution

Economic activity in Bahrain is likely to be shaped by a combination of continued strong infrastructure activity and public sector rationalization. This year and next are expected to see a major build-up in activity by the GCC Development Program as well as other investment projects. At the same time, the 2017-2018 budget points to further fiscal consolidation, which will weaken the traditional role of the public sector as a growth driver, much in line with developments in the rest of the region.

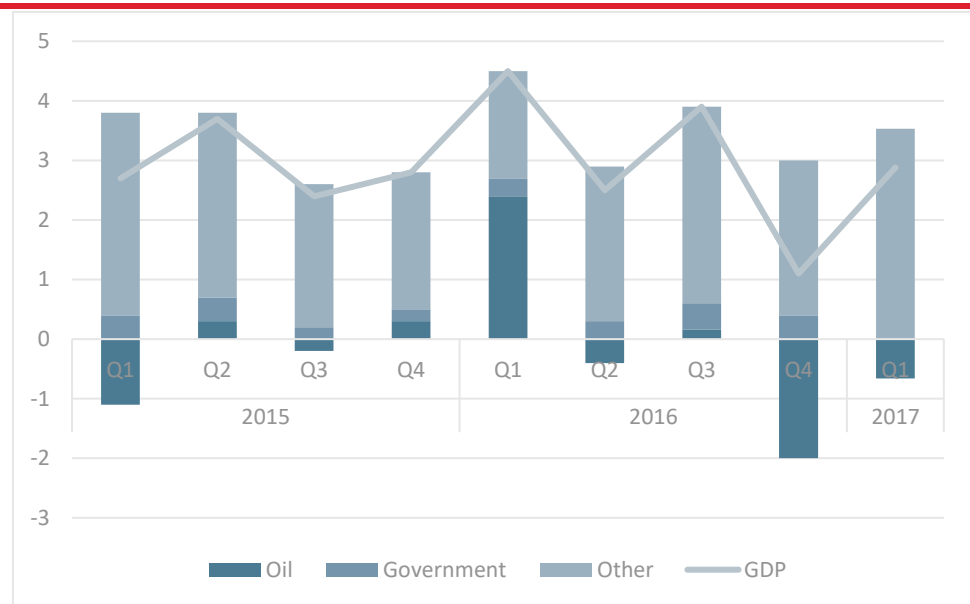
Headline growth in the economy is likely to moderate somewhat in the coming years, although the infrastructure pipeline does present some upside risks.

Inflationary pressures are likely to be minimal in the near term. However, the implementation of VAT in 2018 should push them up somewhat for a while, as happened with past subsidy reforms.

The non-oil sector posts another strong quarter

After a slight weakening in non-oil growth drivers during the closing months of 2016, growth in the Bahrain private sector rebounded sharply in 1Q17. Overall, the non-oil sector expanded by an annual 4.4% in real terms. This compared to a rate of 3.9% in 4Q16 and the 3.7% rate recorded during 2016 as a whole. Encouragingly, this strong growth was entirely thanks to positive momentum in the private sector. Government Services expanded by a marginal 0.1% YoY during Q1. Bahrain saw the registration of 3,798 new economic units in Q1. 1,289 of these were in the construction sector in reflection of the rapid build-up of infrastructure activity in the Kingdom.

Real GDP growth composition



Source: Information & eGovernment Authority

Hotels & Restaurants emerged as the fastest growing single sector during Q1 when it posted a 12.3% YoY real rate of expansion. This contrasted sharply with the 2% pace recorded during 2016 as a whole. The Financial Services sector built on its strong performance last year and expanded by an annual 8.3%. This compared to an annual rate of 5.2% in 2016. Transportation & Communications was the third fastest growing sector of the economy with an annual real growth rate of 8.2% in Q1. This represented a clear acceleration over the 2016 average of 3.2%.

In something of a departure from recent patterns, the Social & Personal Services sector saw its growth decelerate to a still respectable 6.3% -- down on a 2016 average of 9.1%. Somewhat surprisingly, growth in the Construction sector decelerated 3.2% after a 2016 average of 5.7%. This is likely to be a temporary drop in view of the continued expected build-up in infrastructure projects.

In a slight departure from the recent norm, non-oil growth was led by Hotels & Restaurants, Financial Services, and Transportation & Communications

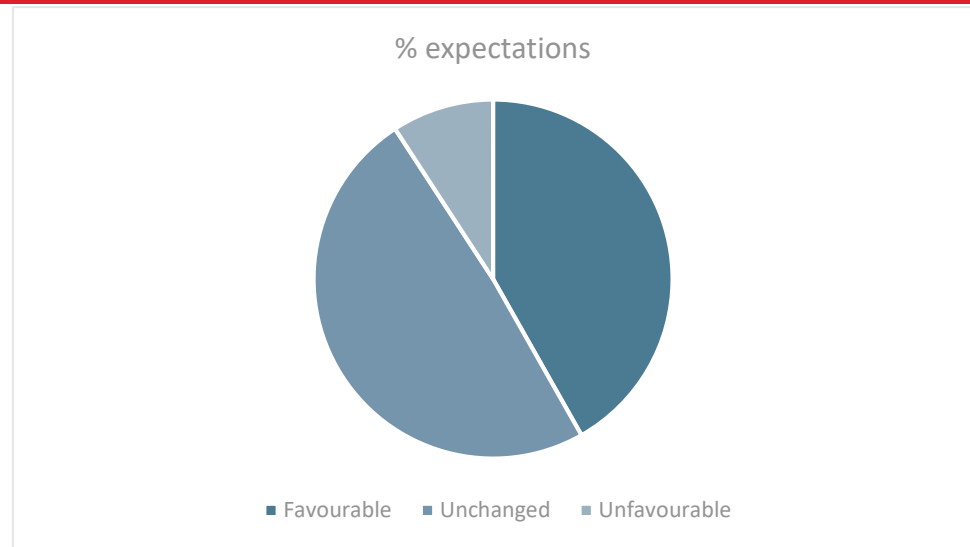
	2015	2016			2017
YoY growth	Annual	Annual	Q1	Q4	Q1
Crude Pet. & Nat. Gas	-0.9%	-0.1%	12.1%	-10.5%	-3.3%
Manufacturing	4.1%	1.3%	1.2%	-0.1%	0.4%
Construction	6.4%	5.7%	5.4%	4.5%	3.2%
Trade	1.7%	3.0%	2.2%	4.3%	3.6%
Hotels & Restaurants	3.0%	2.0%	1.5%	3.1%	12.3%
Transp. & Comm's	5.9%	3.2%	3%	2.7%	8.2%
Social & Pers. Serv.	6.9%	9.1%	8.4%	7.7%	6.4%
Real Est. & Bus. Act.	2.8%	2.8%	0.5%	4.1%	4.5%
Finance	1.7%	5.2%	3.1%	6.3%	8.3%
Government	2.2%	2.5%	1.1%	3.0%	0.1%
Other	7.7%	3.6%	5.5%	6.6%	6.6%
GDP	2.9%	3.0%	4.5%	1.1%	2.9%

Source: Information & e-Government Authority

The relative dynamism of the non-oil economy has gone hand in hand with resilient business confidence in Bahrain. According to a survey conducted by the Information & e-Government Authority in May, 41.8% of the business polled expected improvements in the business environment in the coming months. 49% of the respondents foresaw static conditions while 9.2% expected a deterioration in the environment facing them. 24.8% of the respondents were positive about the situation in Q1 whereas 17% expressed an unfavourable opinion.

The current issues relating to the relationship between Qatar and its three GCC neighbours – including Bahrain – are unlikely to change the situation much. Access to and from Saudi Arabia remains unaffected and there is complete freedom of movement across all other countries in the region.

Bahrain business confidence survey, 2Q17



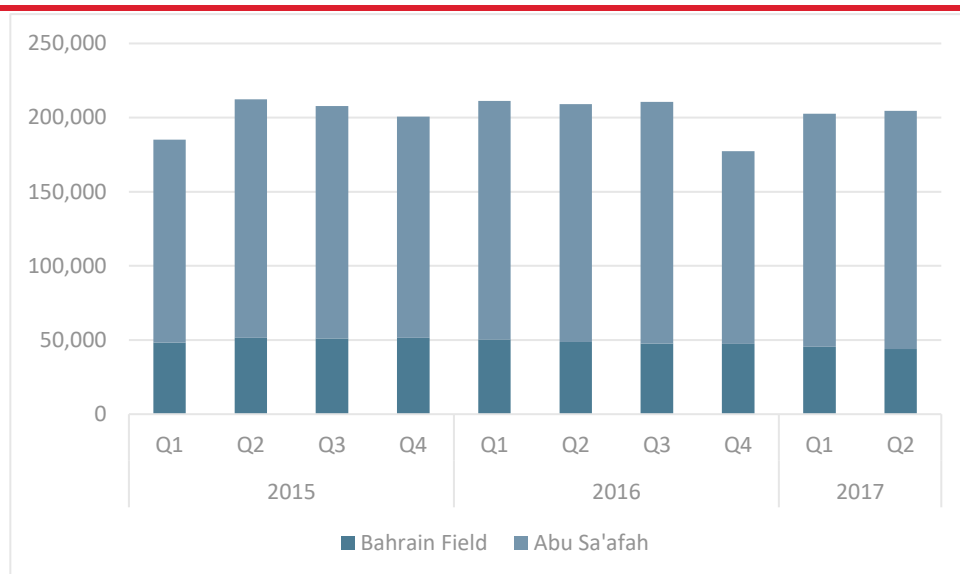
Source: Information & eGovernment Authority

Steady oil production during the first half of 2017

Oil production in Bahrain averaged 203,556 b/d during the first six months of the year. The quarterly output rose by 2.1% between Q1 and Q2. The daily average output in Q1 reached 202,526 b/d whereas the Q2 average stood at 204,575 b/d. However, since 1H16 saw unusually high output levels, with consistently above-capacity production from Abu Sa'afah, Bahrain's oil production actually declined in YoY terms. The decline in Q1 was 4.1% followed by 2.2% in Q2.

Production from the two main fields diverged during 1H17. The offshore Abu Sa'afah field saw above-capacity production throughout the period, reaching an average of 157,070 b/d in Q1 and 160,680 b/d in Q2. The Q2 average was in fact marginally ahead of the corresponding period in 2016. By contrast, the onshore Bahrain Field has continued to see a very gradual, slight decline in its output. The Q1 average of 45,456 b/d was followed by 43,896 b/d in Q2. These figures translated into a 9.7% YoY drop in Q1 and a 9.8% YoY fall in Q2.

Oil production has remained broadly flat in 1H17 and declined slightly as compared to the same period of 2016

Crude oil production, b/d

Source: National Oil and Gas Authority

New project drivers emerge

Current infrastructure project activity is being led by the USD3bn Alba expansion project which includes a new, sixth pipeline along with a new power station. This is followed by the USD1.1bn airport expansion and a USD355 Banagas gas plant. In a major new departure, expressions of interest were solicited in late June for the construction of the King Hamad Causeway which will connect Bahrain with Saudi Arabia and serve as a platform for the GCC railway.

The overall infrastructure project pipeline in the Kingdom, as measured by MEED Projects, stood at USD81.9bn in mid-June, up by 12.7% in YoY terms. Contract awards in June total USD55mn and included a USD30mn award for infrastructure works on the second phase of the Bahrain Investment Gateway project by Manama Developments. The Ministry of Housing awarded a USD25mn package of infrastructure works for the Ramli Housing Project.

Apart from its involvement in the Alba expansion project, the Government holding company for non-oil assets, Mumtalakat, will be driving project activity in several sectors. Through its Edamah subsidiary, Mumtalakat is investing in five major domestic real estate developments with an aggregate value of over BHD400mn. These include the Sa'ada waterfront development in Muharraq, a North Hawar ecotourism development, the Terminal multi-storey carpark in Adliyah, Versailles Plaza, and the Sharwa retail strip in Isa Town. Mumtalakat has also set up a new Bahrain Institute for Pearls and Gemstones, Danat, to develop further the island important pearling legacy, including a testing lab.

Some key strategic decisions are likely to create new drivers to propel the infrastructure story forward in the coming years:

- ✦ The Government's National Renewable Energy Action Plan set a 5% target for renewable as a proportion of energy consumption in 2025. This proportion is to increase further to 10% in 2035. The total installed capacity of the Bahraini power sector in 2015 was 3,000

A number of strategic initiatives will support project activity in the years ahead

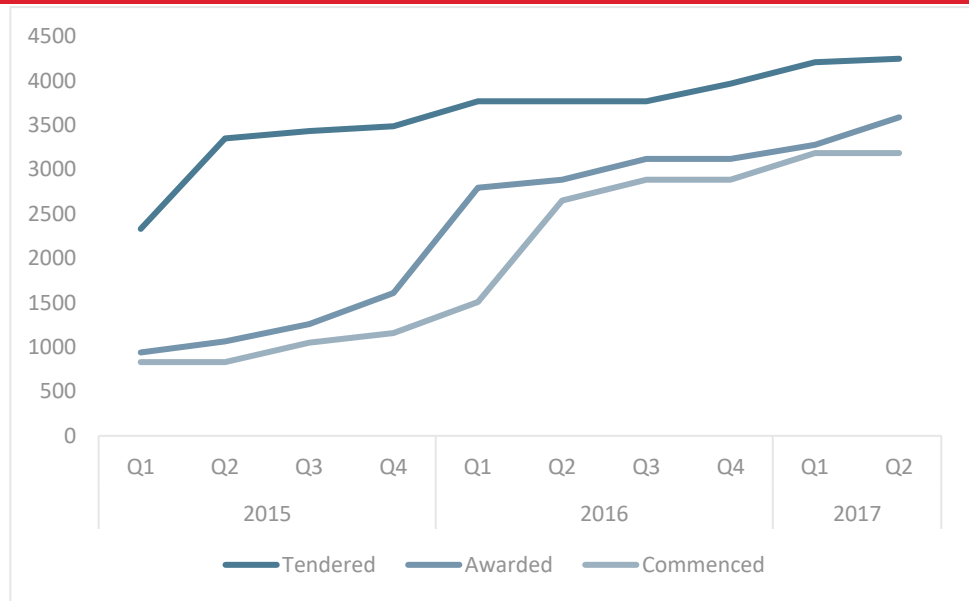
MW, which is projected to rise to 5,393 MW by 2030. The plan encourages rooftop solar installations, solar power stations, wind farms, and waste-to-energy projects. Renewable energy requirements are to be introduced for major infrastructure projects. Program execution is in the hands of the Sustainable Energy Unit which was set up in November 2014. The first renewable energy project in Bahrain was a 5 MW photovoltaic scheme commissioned in July 2014. Germany's Juwi Solar is currently building pilot scheme with a 3 MW photovoltaic solar component and a 2 MW wind component

- ✦ The Sustainable Energy Unit has also produced a National Energy Efficiency Action Plan which is composed on 22 initiatives. These address issues such as building standards, lighting specifications, household appliances, air conditioning, district cooling, smart metering, and utility tariffs. The plan also includes green building initiatives
- ✦ In the area of telecommunications infrastructure, Bahrain is working to put in place a national fibre optic broadband network covering all business areas and 95% of residences. The plan is expected to cost BHD23mn. Broadband coverage currently stands at 60%. The mechanics of infrastructure provision on the island are set to change as a single national network will be handed over to a new company called Netco which will provide services to all telecommunications operators. The plan is to establish the new entity as a private, publicly listed company.
- ✦ Project activity should benefit further from the new Real Estate Organisational Law which was approved by the Parliament in June. Composed of 109 articles, the landmark piece of legislation is seen as instrumental for standardizing the regulation of an important sector. Among other things, the law addresses the issue of regularizing infrastructure development for new areas. All new projects in the country will have to pay additional fees of BHD12 per square metre toward infrastructure development. The levies are charged on the rentable or sellable area. The effective rate of the levy is estimated at roughly 3%. The law further sets prison sentences of up to two years and fines of up to BHD50,000 for those guilty of irregular property deals. Developers of illicit projects can face fines of up to BHD100,000. Only written agreements are to be recognized by law. The law sets up a new regulatory authority to license real estate agents, resolve disputes, monitor deals, oversee the progress of projects, and various other matters

The GCC Development Program is set to further enhance its role as a key driver of economic activity this year as it sees sharp increase in the volume of active projects. The total cumulative value of projects that had commenced by 2Q17 was just under USD3.2bn. This marked a 20.2% YoY increase but was in fact 111.3% higher than the active pipeline in 1Q16. As the latest batch of often multi-year projects makes headway, we can expect a substantial build-up of construction and related activity. Moreover, the total value of awarded projects is expected to increase by nearly another USD1.3bn by the end of the year, which would mark the most rapid increase in the history of the program to date. So far, the cumulative cash flow of the program is still slightly short of USD1bn.

2017 is likely to see the fastest scaling up of GCC Development Programme projects since its inception

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



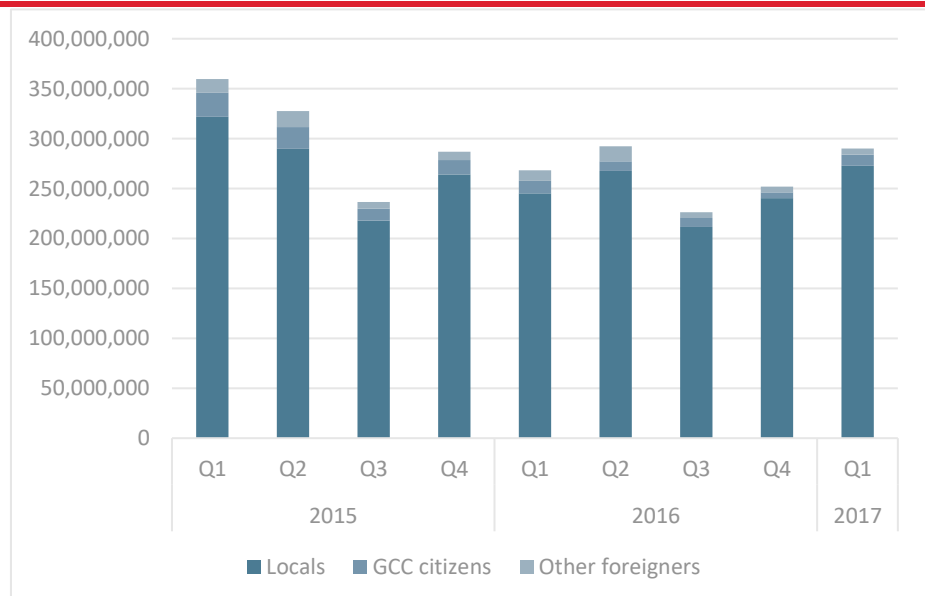
Source: Government sources

The value of real estate transactions rose by an annual 8.1% in 1Q17

In general, the Bahraini real estate sector has shown considerable resilience in the lower oil price environment. According to the quarterly transaction data collected by the Survey and Land Registration Bureau (SLRB), the aggregate value of real estate deals in 1Q17 was BHD290mn. This marked a 15.2% increase on the preceding quarter and was 8.1% ahead of the first quarter of 2016.

Segments of the residential market are seeing considerable new supply growth with for instance Juffair on track to see the number of freehold units rise from 2,800 in 2016 to more than 5,000 by 2018.

Aggregate value of real estate transactions, BHD



Source: Survey and Land Registration Bureau

Bahrain's non-oil export volumes have rebounded sharply since 2H16

Value of non-oil trade continues to edge up

The value of Bahrain's non-oil exports has remained on a general uptrend during the first half of the year. Total non-oil exports of national original reached just over USD2.5bn during the first five months of the year. Re-exports were valued at USD588.3mn. The average monthly value of exports and re-exports was USD621.1mn. This compared to a monthly average of USD450.6mn during the second half of 2016 and hence represented a 37.8% increase. A significant proportion of the improvement was due to increases in metal prices. Aluminium and iron products accounts for a significant proportion of Bahrain's non-oil export bundle.

Non-oil imports have generally fluctuated within the same range as last year. Their total value during the first five months of 2017 was USD5.3bn.

Non-oil trade, USD mn



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

Budget presented

The Government's consolidated final accounts for the year ending on 31 December 2016 showed total revenues of BHD1.9bn and expenditures of BHD3.5bn. The BHD1.6bn deficit amounted to 13.5% of GDP. Oil revenues declined by 10% from 2015 to stand at BHD1.4bn. They accounted for 73.7% of all Government revenues. Non-oil revenues rose by an annual 3.1% to reach BHD461.3mn. Recurrent Government expenditure reached BHD3.1bn while project spending stood at BHD410.9mn. Spending on subsidies fell by some 8% in 2016 and a further 4-5% decline is expected this year. The overall actual Government expenditure was 0.8% lower than in 2015 and 5.6% lower than budgeted. General public sector debts attained a total of BHD8.87bn. Fitch Ratings in its recent review of Bahrain expected hydrocarbons revenues to rise by some 28% this year whereas non-oil income was due to rise by 16%.

The Government's 2017-2018 budget projects revenues of BHD4.5bn over the two-year period on the assumption of a USD55 per barrel oil price. Revenues in 2017 are expected to exceed

The consolidated final accounts showed a deficit of BHD1.6bn for last year

BHD2.2bn, of which BHD1.7bn is due to come from oil and BHD500mn from non-oil sources. 2018 revenues are projected at BHD2.3bn with BHD1.8bn coming from hydrocarbons and BHD560mn from non-oil sources.

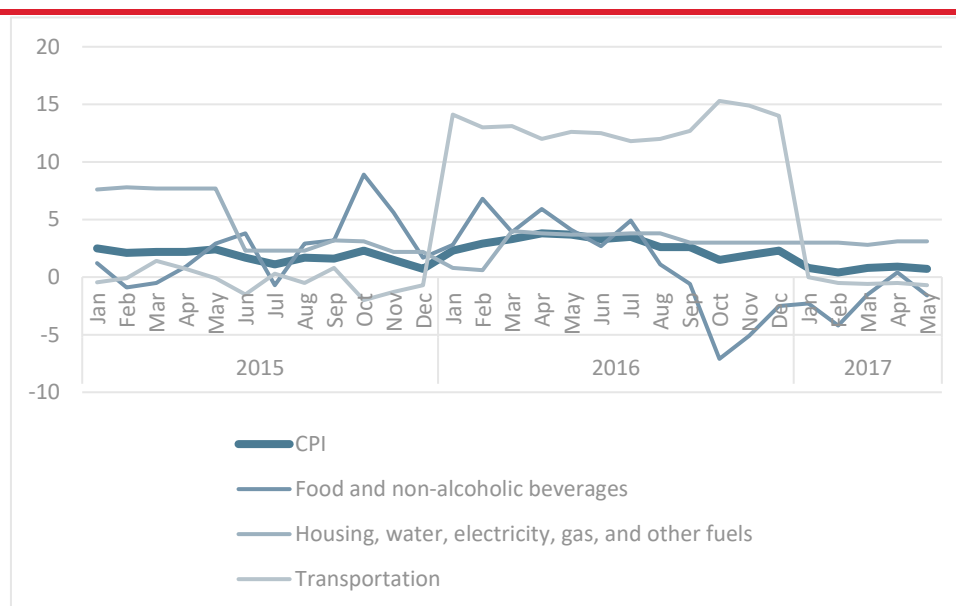
Spending is projected at BHD7bn, split equally between the two years. Project spending is budgeted at BHD700mn and is to be split equally between the two years. The Government is projecting a deficit of BHD1.3bn this year followed by BHD1.2 in 2018. BHD3bn of additional borrowing is expected to be authorized to cover projected BHD2.5bn deficits over the two-year period.

Fading price pressures

In spite of some renewed pick-up during the spring months, consumer prices increases in Bahrain have remained historically subdued. Overall, consumer prices increased by 0.8% during the first five months of the year. During the year to date, the annual pace of CPI inflation troughed at 0.4% in February and peaked at 0.9% in April.

Price pressures have been relatively subdued in most sub-indices. The important category of Food and Non-Alcoholic Beverages has been experiencing deflationary pressures during much of the year to date. While this has been primarily due to the base effect from previous subsidy modifications wearing off, it has also reflected the absence of major supply disruptions globally. The average YoY rate of food price changes since the beginning of the year has been -1.8%. However, the disinflationary pressures are diminishing and April actually saw a small positive reading. A similar base effect is seen in Transportation costs which have been moderately declining a year after the latest subsidy removals. Housing costs, by contrast, have been an important inflation driver, hovering fairly consistently in the range of 3% YoY.

Consumer price inflation, % YoY



Source: Information & e-Government Authority

Consumer price inflation slowed down sharply in 2H16 with food price inflation in fact turning negative

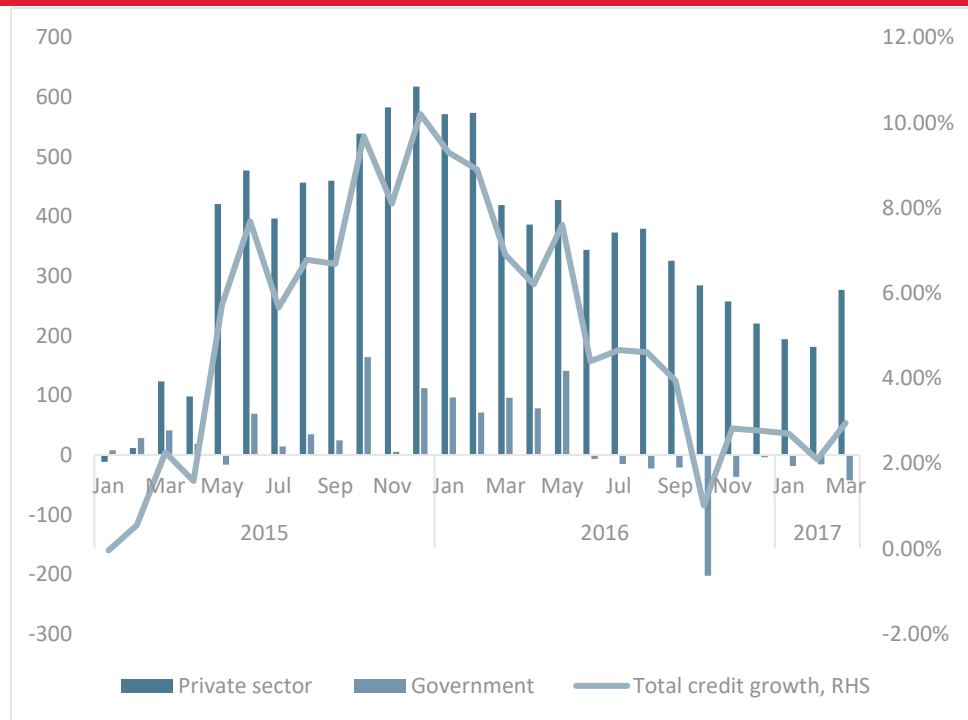
New loan growth moderates

Credit growth by retail banks has been relatively subdued in recent months

The Bahraini banking sector has remained resilient during a challenging economic cycle. A review by KPMG of more than 90% of the region's listed banks found that the net profits of Bahraini banks grew by 10% in 2016. The capital adequacy of Bahraini banks was 19.2%. The banks reviewed achieved 1.3% return on assets and 6% return on equity.

In spite of the underlying strength in the sector, new loan growth – echoing developments in the rest of the region – has moderated from the double-digit rates seen around the turn of 2016. The total value of outstanding loans by Bahraini retail banks increased by an annual rate of just under 3% in March. This marked a clearly improvement of the opening months of the year and was led by loans to the private sector. By contrast, bank credit to the General Government has been declining moderately but consistently since the summer of 2016.

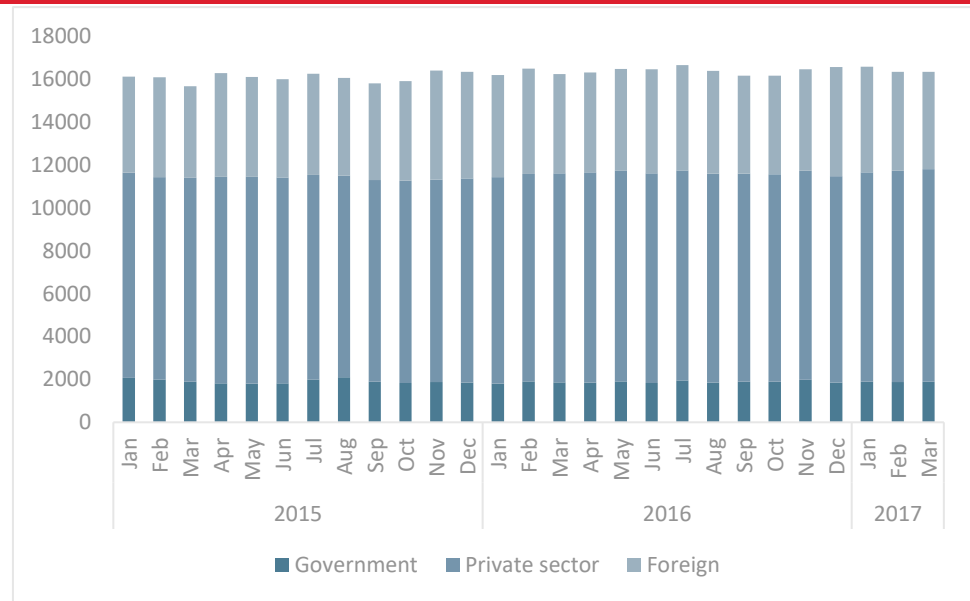
YoY growth in credit issued by retail banks, BHD mn



Source: Central Bank of Bahrain

Overall bank deposits in the retail sector declined somewhat during Q1 to reach BHD16,344.1mn as of the end of March. This marked a 1.4% fall in QoQ terms but in annual terms, the deposit base expanded by 0.7%.

Deposit liabilities to non-banks, BHD mn



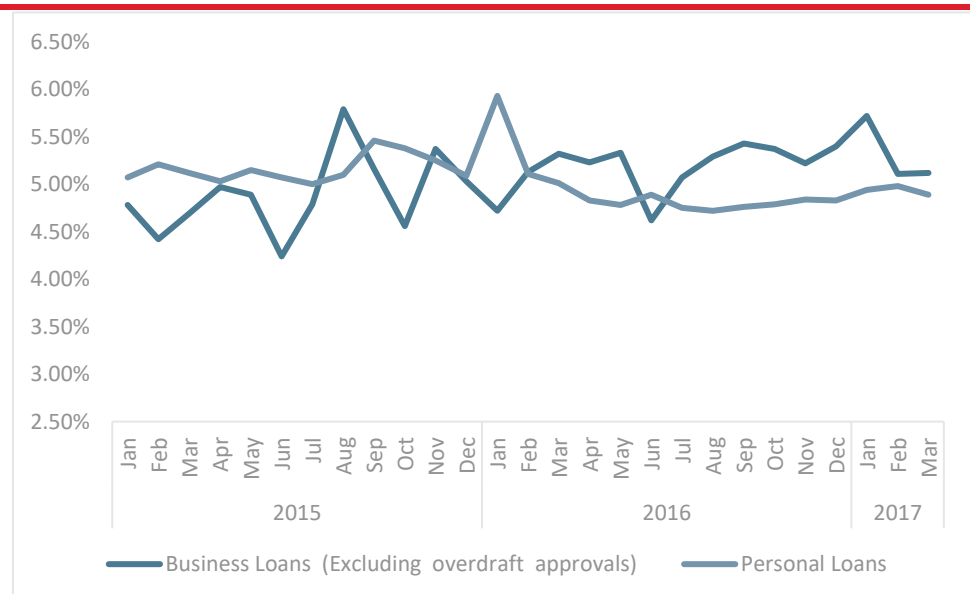
Source: Central Bank of Bahrain

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

In spite of the gradual trend toward monetary tightening in the US, the cost of credit in Bahrain has remained relatively stable. The cost of business loans (excluding overdraft approvals) by conventional banks averaged 5.3% in Q1. This compared to 5.1% a year earlier. The cost of personal loans (excluding credit cards) actually dropped from 5.4% to 4.9% over the same period.

The CBB immediately echoed the interest rate decision of the US Federal Reserve on 14 June. It increased its main policy rate, the one-week deposit facility, from 1.25% to 1.5%. The overnight deposit rate was increased from 1% to 1.25%, the one-month deposit rate from 1.75% to 2.15%, and the lending rate from 3% to 3.25%.

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



Source: Central Bank of Bahrain

Capital markets fairly flat

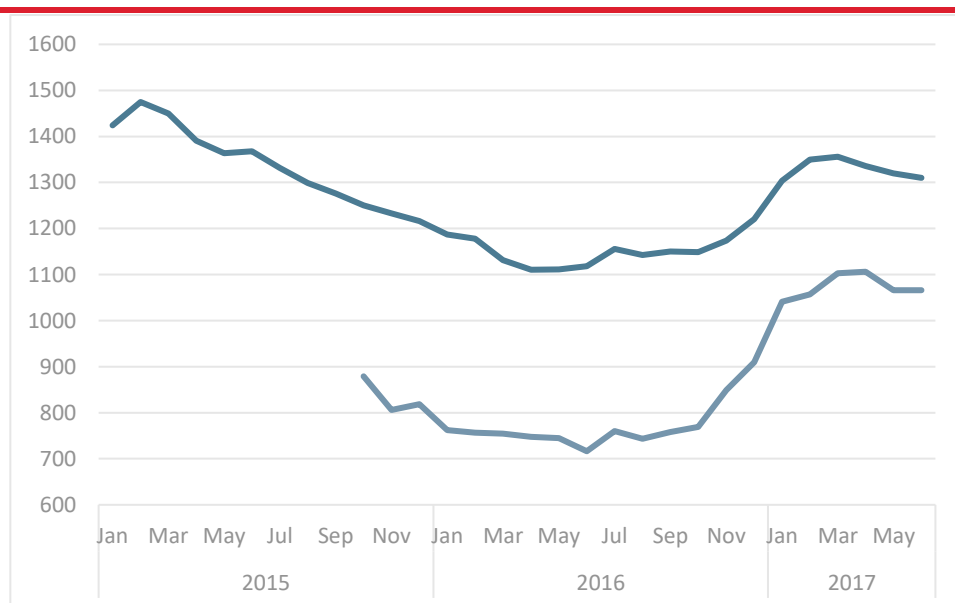
Bahrain Bourse closed the first half of 2017 with a 7.3% net gain

Following an impressive rebound in the second half last year, Bahrain Bourse joined the other regional exchanges in pausing for breath in the first half of the year. The All-Share Index peaked in March and has been gradually declining since then. It closed the first half of the year at 1,310.04. This was up 7.3% during the first six months of the year but down 3.4% from the March closing.

The Bahrain Islamic Index has largely mirrored these dynamics. It was up 17.2% YTD at the end of June, but down 3.6% from its April close.

The capitalization of the Bourse as of the end of June stood at BHD7.78bn. Commercial banks accounted for 49.4%, investment companies for 25.8%, and the service sector for 12.3%.

Bahrain All Share Index and Bahrain Islamic Index

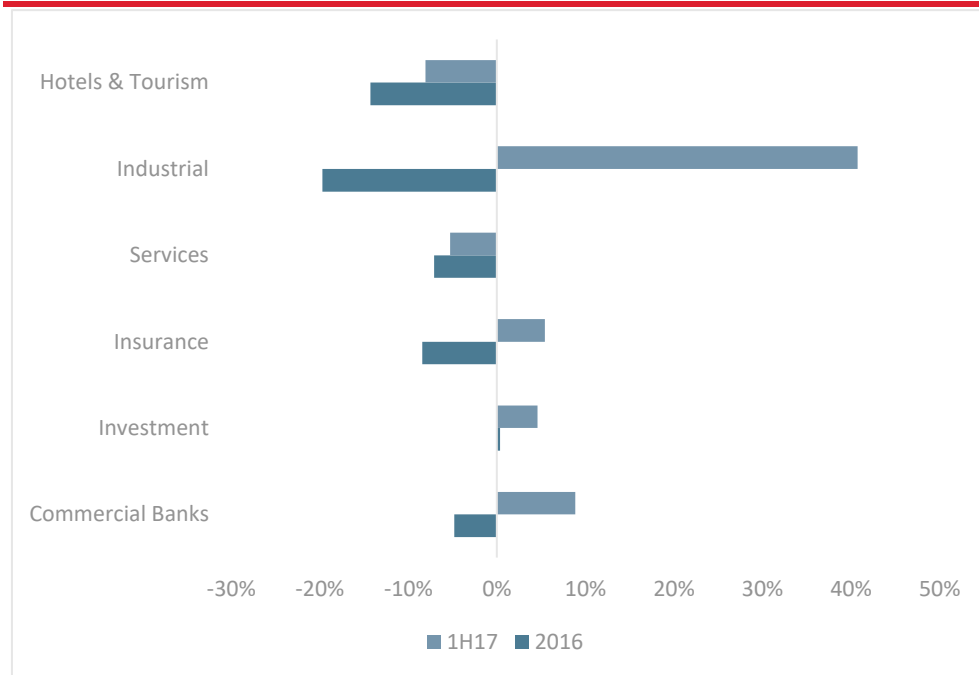


Source: Bahrain Bourse

The performance of individual sectors has been characterized by a slight loss of momentum in financial services as compared to Q1 but a sharp improvement in manufacturing. Overall, the Industrial index improved by 40.8% during 1H17 in a sharp reversal from a decline of 19.7% in 2016. The Commercial Banks sector advanced by 8.9% during 1H17 whereas the Investment index posted a 4.6% and Insurance index rose by 5.4%. The only two sector indices to post year-to-date losses during the first six months of the year were: Hotels & Tourism which declined by 8.1%, and the Services index, which saw a 5.3% drop.

Bahrain Bourse in June announced a plan to set up a separate company to provide securities depository, custodial, and settlement services. The company will be known as Bahrain Clear and it will operate as a fully owned subsidiary of Bahrain Bourse. Bahrain Clear will expand the services of the Central Registry to include the distribution of cash dividends into shareholder bank accounts and the management of general meetings of listed companies. It will provide securities lending and short-selling services and support margin trading. It will further offer various mutual fund services.

Sectoral stock market indices, 2016-1H2017



Source: Bahrain Bourse

The fixed income space has been dominated by short-term issuance by the Central Bank. The Government placed two one-year Treasury bills with a total value of BHD325mn. Most issues were significantly oversubscribed and the yields remained broadly in line with those observed in Q1.

In the private sector, Al Baraka Banking Group in May placed a USD400mn Tier 1 sukuk. The offering was structured as a perpetual sukuk. The issue was five times oversubscribed with bids of USD1.6bn as compared to an initial objective of USD300mn. The sukuk has a *mudaraba* structure with the profit rate for the initial five-year term set at 7.875%. Standard Chartered Bank served as global coordinator and the joint lead manager. The offering will be listed on the Irish Stock Exchange. Al Baraka Banking Group is licensed as an Islamic wholesale banks by the CBB and listed on Bahrain Bourse and Nasdaq Dubai. It has a long-term rating of BBB+ by the Islamic International Rating Agency and BB+ by Standard & Poor's. The Group operated in fifteen countries through more than 700 branches.

Al Baraka Banking Group placed a successful USD400mn perpetual sukuk in May

Issue date	Issue	Value, BHD mn	Maturity, days	Average interest/ profit rate, %	Average price, %	Over- subscript ion, %
2 Apr 2017	Treasury bill No. 1645	35	182	2.36	98.819	202
5 Apr 2017	Treasury bill No. 1646	70	91	2.23	99.439	233
12 Apr 2017	Treasury bill No. 1647	70	91	2.24	99.438	193
13 Apr 2017	Sukuk al ijarah No. 140	41.8	182	2.37		161
19 Apr 2017	Sukuk al salam No. 192	43	91	2.23		142
26 Apr 2017	Treasury bill No. 1648	70	91	2.23	99.44	221
3 May 2017	Treasury bill No. 1649	70	91	2.22	99.442	110
10 May 2017	Treasury bill No. 1650	70	91	2.22	99.442	119
11 May 2017	Sukuk al ijarah No. 141	26	182	2.37		220
14 May 2017	Treasury bill No. 1651	35	182	2.39	98.808	100
17 May 2017	Treasury bill No. 1652	70	91	2.17	99.454	125
24 May 2017	Sukuk al salam No. 193	43	91	2.2		205
31 May 2017	Treasury bill No. 1653	70	91	2.2	99.448	111
1 Jun 2017	12-month Treasury bill No. 33	225	365	2.98	97.072	227
4 Jun 2017	Treasury bill No. 1654	35	182	2.38	98.813	196
7 Jun 2017	Treasury bill No. 1655	70	91	2.17	99.457	203
14 Jun 2017	Treasury bill No. 1656	70	91	2.16	99.450	258
15 Jun 2017	Sukuk al ijarah No. 142	26	182	2.37		148
21 Jun 2017	Sukuk al salam No. 194	43	91	2.33	99.414	100
28 Jun 2017	Treasury bill No. 1657	70	91	2.22	99.442	162
29 Jun 2017	12-month Treasury bill No. 34	100	365	3.08	96.983	132
2 Jul 2017	Treasury bill No. 1658	35	182	2.45	98.776	128
5 Jul 2017	Treasury bill No. 1659	70	91	2.33	99.414	100

Source: Central Bank of Bahrain

New job creation moderates in Q1

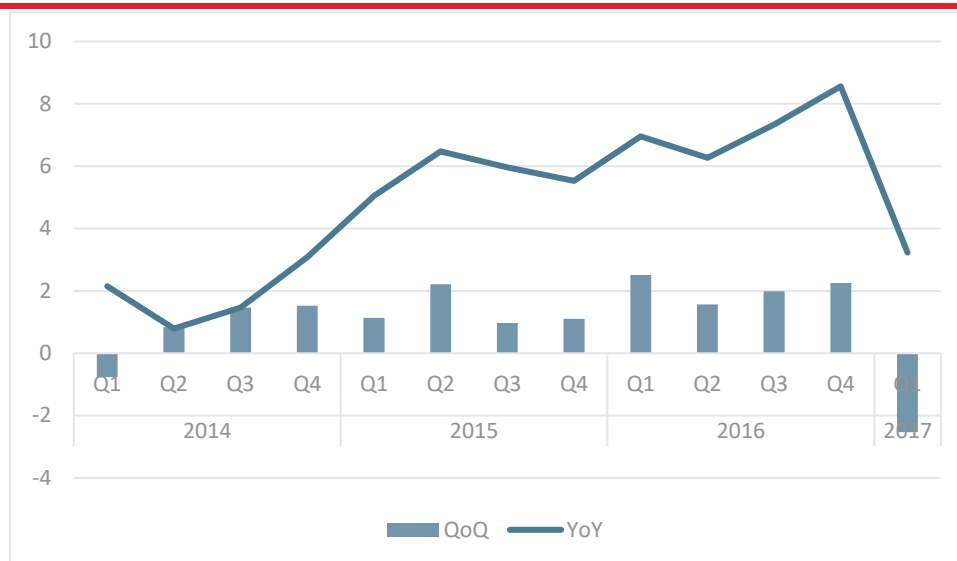
Private sector job creation has remained robust with a 8.6% YoY increase in the number of new jobs in Q4

New job creation in Bahrain decelerated to an annual pace of 3.2% in Q1 as the total number of jobs reached 767,292. Reflecting the continued importance of large infrastructure projects for economic growth, the number of jobs held by non-nationals rose to 610,510, which represented a 4.8% YoY increase. The number of Bahraini jobs stood at 156,782.

The Labour Market Regulatory Authority issued a total of 55,571 work permits in Q1. 46,098 of these were regular permits while 921 were issued to investors and 8,552 to dependents.

The median monthly wage of Bahrainis rose to BHD533, which marked a 3.1% YoY increase. Encouragingly, wage growth was faster in the private sector where a 4.3% total gain took the average to BHD408. Public sector salaries rose by a more modest 1.3% to reach an average of BHD695.

Change in total employment, %



Source: Labour Market Regulatory Authority

External assessments

Index/report	Description	Global rank	MENA rank	Key strengths highlighted
Travel & Tourism Competitiveness Report by World Economic Forum	Measures the factors and policies that enable the sustainable development of the travel and tourism sector. Based on four key pillars: enabling environment, policy and enabling conditions, infrastructure, national and cultural resources	60	3	Recognizes Bahrain's achievements in: ✦ Government prioritizing the T&T sector ✦ Effectiveness of marketing and branding ✦ Good tourism services infrastructure
Visa Restriction Index by Henley & Partners	Ranks economies by the number of countries that their citizens can travel visa free	66 (out of 218)	4	Bahrainis have visa-free access to 38 countries and visa upon arrivals in 36 countries
Global FinTech Hubs Review by Global FinTech Hubs Federation	A composite of three indices: Global Financial Centres Index, Doing Business, Global Innovation Index. Considers self-evaluation of factors such as government support, innovation culture, proximity to expertise and customers, foreign start-ups, and regulation	36 (out of 44)		Recognizes Bahrain as a "new global FinTech hub." Key positives include: ✦ Excellent Government support, regulations, and proximity to customers ✦ Good innovation culture, proximity to expertise ✦ Good availability of innovative foreign start-ups
World Happiness Report by UN Sustainable Development Solutions Network	Derives a composite indicator of happiness based on six factors: GDP per capita, social support, healthy life expectancy, freedom to make life choices, generosity, perceptions of corruption	41 (out of 155)	5	Bahrain's main strengths are recognized as: ✦ High GDP per capita ✦ Strong social support ✦ Healthy life expectancy

KEY SECTORS

RESILIENT INVESTMENT FLOWS

Foreign investment flows increase

In spite of challenging global and regional trends, FDI in Bahrain has continued to increase in 2015-2016

Foreign direct investment inflows have continued to grow in Bahrain in spite of global and regional challenges. According to the 2017 edition of the *World Investment Report* published by the United Nations Conference on Trade and Development (UNCTAD), inward FDI into Bahrain totalled USD282mn in 2016, some 3.6% of the total fixed capital formation in Bahrain during the year. FDI remained extremely important for the Bahraini economy with the total inward FDI stock standing at USD228.6bn, or just under 90% of GDP. This figure is unrivalled in the GCC and compares to a global average of 35% and a developing economies average of 30.4%. In the Middle East region (West Asia) as a whole, the inward FDI stock equalled 22.7% of the regional GDP in 2016.

The Economic Development Board in 2016 supported USD280mn worth of investment projects in the Kingdom and this total is likely to be exceeded this year. Foreign investors last year created 1,600 new jobs in the country while the total achieved during the first six months of 2017 was an almost comparable 1,500.

According to the 2015 FDI survey undertaken by the Information & eGovernment Authority, inward FDI in 2015 totalled BHD103mn (USD273mn). The main sources of inward direct investment were Kuwait (BHD158mn), Saudi Arabia (115mn), Qatar (60mn), and Germany (58mn). The main sector benefiting from FDI inflows were Financial Services (BHD121mn).

Key FDI drivers in Bahrain highlight the importance of quality regulation and human capital, both of which are central to the Kingdom's value proposition

An econometric analysis of all the available UNCTAD data on Bahrain showed that the statistically significant drivers of FDI inflows are very closely linked to the Kingdom's value proposition. They tend to reflect the importance of regulation and human capital in critical factors bringing capital into the country, although the full effects of changes in conditions are usually only felt after a minimum of at least three years. Of a total of 17 possible factors affecting FDI, 11 were found to be significant. These reflected the importance of the macroeconomic environment, including factors such as unemployment, inflation, and growth – locally and globally. They included indicators of the regulatory and governance environment, factors such as the Economic Freedom Index, the World Bank governance indicators, the ease of Doing Business, and control of corruption. They also reflected the value of the quality of and access to human capital: indicators such as secondary education enrolment and education expenditure.

Rebalancing regulation and innovation in finance

Increasing regulation has been one of the main shapers of financial services globally since the onset of the financial crisis in 2007-2008. The adoption of a growing tally of new regulations has forced market participants to de-risk their operations and recapitalize in ways that can be expected to reduce the probability of systemic crises. Under the mounting regulatory pressure, financial institutions have often found themselves being able to do less and for instance in Europe, weaker financial intermediation is often held up as one of the causes of historically modest growth.

A pioneering FinTech sandbox was launched by the Central Bank of Bahrain in June

One of the consequences of this new environment has been an incipient debate about striking the right balance between regulation and growth. Especially in the US, there are growing signs of a desire to revisit the post-crisis equilibrium and de-regulate certain activities with a view to stimulating faster growth.

While this debate is at an early stage, another increasingly important development reshaping financial services is the growing importance of innovative new technologies. This has in some cases been a response to regulation, an attempt to achieve greater efficiency and better service in a more restrictive environment. But it is also, encouragingly, a development with the potential to achieve some of the objectives of tighter regulation with less regulation. Among the real and potential benefits of FinTech are greater transparency, more efficient markets, faster intermediation, and the elimination of information asymmetries that in the past resulted in risks. Among other things, FinTech has the potential to take financial services to customer segments that to date have been underserved or entirely excluded from formal intermediation. This aspect is of particular relevance for the development of Islamic FinTech in many emerging economies.

It is increasingly widely accepted that this new trend has the potential to fundamentally reshape the way financial services are delivered and consumed. It is in recognition of this new reality that the Central Bank of Bahrain (CBB) took another major step toward creating a FinTech ecosystem in the Kingdom when it issued its Regulatory Sandbox Framework Directive in mid-June to drive innovation in financial services. This builds on an earlier initiative in 2014, when the CBB initiated two new license types - payment services and card processing services - marking the entry of non-banking companies into banking services. To date Bahrain has issued 14 licenses for these two activities.

The CBB sandbox is a virtual space which is legally part of the national jurisdiction. It is open to innovative companies from all over the world and designed as a platform for them to tap the dynamic markets of the GCC region. It is also a resource for existing CBB license holders. Applicants must satisfy the CBB's criteria on innovation and customer benefits, as well as technical test. The sandbox allows companies to test and develop their services without the restrictions of many of the rules applied to established market players. Companies can operate in the sandbox for a period of nine months with the option to extend for another three. The new facility is expected to drive the development of activities such as payments, blockchain, crypto-currency, RegTech, robo advice, and insurance technology.

Crowdfunding is a key focus area which is designed to create new mechanisms for pooling capital for the country's growing start-up ecosystem. The CBB will launch new regulations for crowdsourcing this summer, including provisions for Shariah-compliant funding. The Bahrain Economic Development Board is collaborating with Singapore Fintech Consortium and Trucial Investment Partners to further develop the FinTech ecosystem and regulatory framework in the Kingdom. It is also expected to further enhance ties between the Gulf and South-East Asia in the area of financial services and ICT. Plans are underway to launch a physical FinTech hub in Bahrain later this year.

Among other things, the sandbox can encourage deeper collaboration between banks and non-bank service providers. As examples of the growing impact of technological change on the way

financial services are delivered, two Bahraini companies have recently announced mobile wallets. This technology allows consumers to pay for their purchases by just placing one's mobile phone on a point-of-sale terminal:

Two local companies have launched innovative electronic wallet payment solutions

- ✦ The AFS Wallet launched by Bahrain-based Arabian Financial Services utilizes Quick Response technology and will have near-field communication capability. Customers further enjoy services such as cash back on purchases, cross-broader remittances and wallet-to-wallet money transfers. AFS intends to launch its mobile wallet with banks, telcos, retailers, and other partners elsewhere in the Middle East and Africa
- ✦ The BENEFIT Company, in collaboration with FOO Technologies, has created the National Mobile Electronic Wallet (BenefitPay), which uses e-payment software. This allows customers to download a smartphone app and settle payments without the use of cash or cards. It also allows all electronic company registration holders to receive payments through the system

Bahrain-domiciled Gulf International Bank in June received a conventional retail banking license from the CBB. It has been providing retail services in Saudi Arabia under its Meem brand since 2015. Following its expected launch next year, Meem in Bahrain will be the first digital bank in the region and therefore contribute in important ways to the developing FinTech ecosystem.

Building ties in innovative technology

Bahrain in May hosted the China High-Tech Fair Bahrain Forum in connection with the visit of a high-level Chinese business and government delegation to the Kingdom. The event served a venue to develop new ties between Bahrain and the Shenzhen region of China, both at the government and business level. The event showcased opportunities within Bahrain's ICT sector.

Three deals were signed during the event between the Bahrain Economic Development Board and the China Hi-Tech Transfer Centre; the Shenzhen Belt and Road Economy and Technology Cooperation Association; and the Shenzhen Cross-Border E-Commerce Association. The two sides agreed to maintain regular close contacts. There will be a regular exchange of information regarding the business environment and investment projects. Leading Chinese companies already active in Bahrain include Huawei, Bank of China, CPIC, Dragon City, China Harbour Engineering Company, and CIMC.

Industrial investments advance

Several large-scale manufacturing investments in Bahrain are making steady progress:

- ✦ Construction site works on Alba's Line 6 project began Q2. The USD3bn project covers an area of approximately 60 hectares. The funding for the project is expected to be fully finalized by the end of Q3. Production is due to start in 2019
- ✦ Garmco (Gulf Aluminium Rolling Mill Company) is completing a USD55mn capacity expansion which is due to be fully operational in November. The new facility will increase Garmco's annual production capacity of aluminium slabs by 120,000 tn

The China High-Tech Fair Bahrain Forum in May brought connected local ICT companies with their counterparts in Shenzhen

- ✦ Work is ongoing on the LNG Terminal within the industrial area of the Khalifa bin Salman Port. The facility, which has a capacity of 4.1bn cubic metres per year is being developed on a public-private partnership basis. The terminal will consist of an LNG vessel used as a floating storage unit along with on-jetty regasification. The construction is funded through a USD741mn loan involving nine international and regional banks. The facility is set to make Bahrain the third country in the GCC to receive regular LNG imports after Kuwait and the UAE. The new facility will help ensure the Kingdom's energy security at time when power demand is continuing to grow and important manufacturing projects are making headway

Bahrain is also attracting a number of innovative manufacturing companies, especially into its Bahrain International Investment Park in Hidd which has emerged as a key hub for many of these new investments. Invested capital at the facility has reached USD2bn. The 247 hectare business park was developed by the Ministry of Industry, Commerce, and Tourism. During the first half of 2016, some 45,000 sqm of land was allocated to new companies taking the total occupation level to 81.

May saw the ground-breaking ceremony for a USD16mn Armacell facility which is expected to create 140 jobs. The company is a global leader in flexible insulation foams. The new 10,000 sqm facility will supply Armacell customers across the GCC and parts of Africa

Developing Bahrain's leisure tourism offering

Leisure attractions are an important element of Bahrain's appeal to outside visitors. They are also an important growth focus for tourism in the GCC region with total assets estimated at some USD52bn. Bahrain can boast a diverse offering of leisure facilities to tourists:

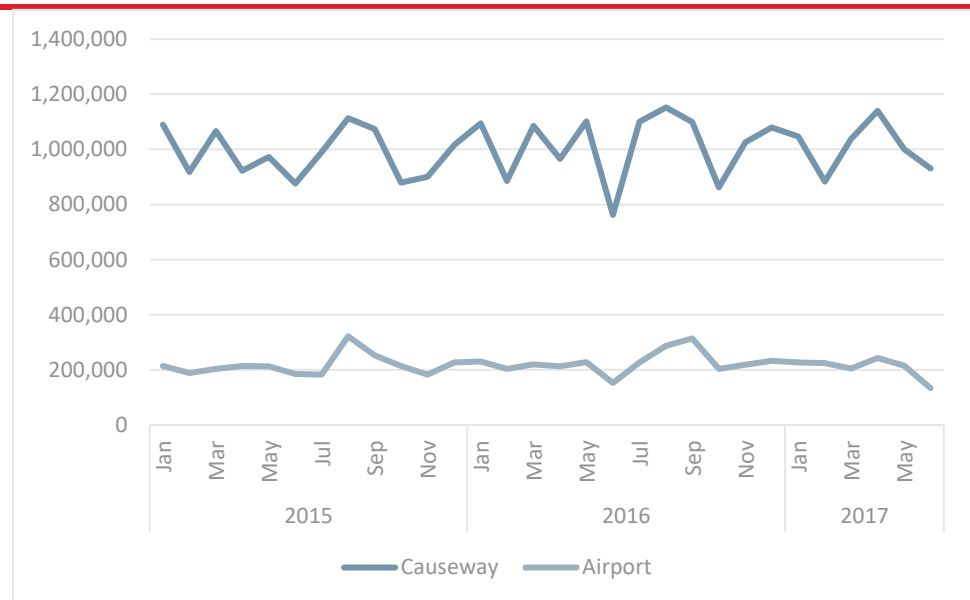
- ✦ The country is home to a number of cultural and heritage sites. These include two attractions on the UNESCO World Heritage List: Bahrain Fort and the Pearling Trail of Muharraq. The fort alone currently attracts an annual visitor flow of nearly 115,000. Other attractions in this area include Al Fateh Fort, Arad Fort, Al Khamis Mosque, the Tree of Life, the Bahrain National Museum, and the National Theatre
- ✦ Among commercial attractions, the Al Areen Wildlife Park & Reserve in the south of the island draws an annual visitor flow of nearly 200,000. Adhari Park draws some 800,000 visitors a year. Other popular venues include the Lost Paradise of Dilmun Park and the Wahooo! Waterpark. More recent or planned developments include Gravity, new developments in Hawar Islands, Diyar Al Muharraq, the Khalifa bin Salman Port, Al Sahel Resort, Dilmunia Mall, and the Bahrain Marina Club

In spite of significant areas of strength, the leisure tourism segment in Bahrain presents considerable untapped potential, which has prompted some of the existing facilities to develop further expansion plans. In addition, there is deemed to be considerable appetite for additional indoor family entertainment venues as well as more culturally attuned offerings, most notably for Saudi visitors which account for a lion's share of the tourists coming to Bahrain. More than 80% of Saudi and Bahraini residents are potential users of new developments in this area.

Visitor flows into Bahrain grew at an annual rate of 2.4% in 1H17

Visitor numbers into Bahrain have continued to increase steadily in spite of slower growth in the GCC region. Bahrain received a total of just over 6mn inbound visits across the King Fahad Causeway during 1H17. This marked a 2.4% increase over the 5.9mn total recorded during the corresponding period in 2016. The number of airport arrivals rose 0.1% from 1,247,808 to 1,249,020. A new Ramadan and Eid Shopping Festival took place during the month of June. Hotel revenues in Bahrain are estimated to have reached BHD3.2mn during the Eid al Fitr holiday break. Occupancy levels for five-star hotels were 80%, according to the Bahrain Tourism and Exhibitions Authority. Bahrain is expected to see the launch of 15 new hotels and beachfront resorts with a combined investment of USD10bn over the next five years. Five-star facilities in the Kingdom currently number 18 and there are 48 four-star hotels.

Visitor arrivals by port of entry



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

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