



Bahrain Economic Quarterly

June 2018

SUMMARY

A REGIONAL RECOVERY TAKES SHAPE

The economic outlook for the GCC region has strengthened palpably with the oil markets returning to a balance and output levels beginning to edge up. Business confidence has shown resilience in the face of fiscal consolidation while strategic investments are providing stronger non-oil momentum.

- ✦ **Q1 growth in Bahrain was hit by maintenance on the offshore oil field.** Q1 saw a small 1.2% YoY drop in headline real GDP as a result of a 14.7% YoY contraction in the oil sector. However, non-oil growth continued at close to 2% and there are indications of the infrastructure-linked growth drivers strengthening again
- ✦ **Growth in the non-oil sector was below a recent trend but likely to strengthen.** Non-oil growth decelerated to an annual 1.9% in Q4. This was comparable to the 2.5% rate seen in 4Q17 but far short of the 4.8% pace achieved during 2017 as a whole. However, construction sector growth accelerated markedly in Q1 and business confidence indicators are favourable
- ✦ **GCC business confidence has rebounded and oil market normalization is laying the foundation for a more broad-based expansion.** After a very subdued 2017, growth in the GCC is showing signs of accelerating again. The rebalancing of global oil markets has prompted OPEC to terminate its output controls at a time when GCC producers hold most available spare capacity. The non-oil sector has rebounded and is benefiting from renewed project activity and improving liquidity
- ✦ **Global growth remains strong but trade-related disputes are emerging as a structural challenge.** The US economy, especially, is displaying strong dynamism in spite of monetary tightening. However, escalating trade disputes are emerging as a mounting concern and may, in combination with higher interest rates, test especially emerging market growth

Bahrain economic outlook

	2016	2017e	2018f	2019f
Real GDP growth, %	3.5%	3.8%	3.4%	3.0%
Non-hydrocarbons sector	4.3%	4.8%	4.3%	3.8%
Hydrocarbons sector	-0.1%	-0.7%	-0.5%	0.0%
Nominal GDP growth, %	3.5%	9.6%	9.4%	5.6%
Inflation (CPI %)	2.8%	1.4%	2.2%	3.5%
Current account (% of GDP)	-4.6%	-3.8%	-2.3%	-2.1%
Fiscal balance (% of GDP)	-13.4%	-10.1%	-7.6%	-7.1%
Crude Oil Brent (USD)	44	53	68	65

Source: Bahrain Economic Development Board estimates

SUMMARY **2**

GLOBAL ECONOMY **3**

THE GCC REGION **9**

BAHRAIN **18**

KEY SECTORS **34**

GLOBAL ECONOMY

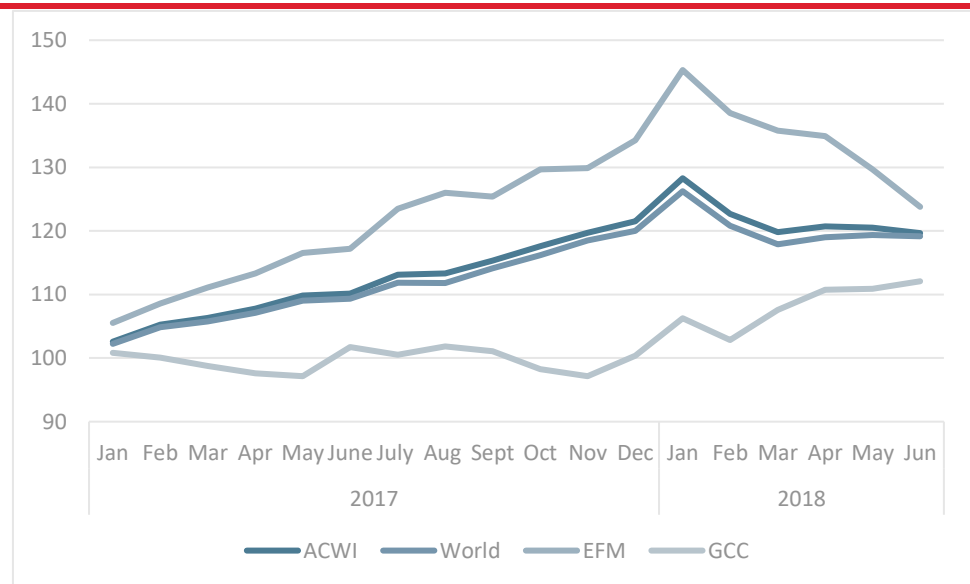
NEW RISKS CLOUD GROWTH MOMENTUM

The global economy has continued to perform fairly well during the spring months. However, important asymmetries are becoming evident. Above, while the US is now amidst its second-longest period of expansion to date, the economic data from most other major economies has tended to be more mixed and there is renewed concern over slower growth in China. Beyond this, the growth outlook is overshadowed by three main issues:

- ✦ The drawn-out period of ultra-loose monetary policy is coming to a close. This will check available liquidity and hence market valuations. The investor bias in favour of emerging markets and riskier investments is likely to be tested as advanced economy returns improve. The cost of maintaining large levels of leverage accrued in a low rate environment is set to increase
- ✦ The prospect of significant and protracted trade disputes appears to have increased, which will result in new uncertainties and risks weakening what has been a leading growth driver globally during the postwar era
- ✦ Political risk factors remain a major concern and can deliver significant discontinuities

The performance of financial markets has reflected this more uncertain environment. While positive fundamentals are continuing to drive growth, the steady gains of last year have given way to more volatile and uneven performance. Reversing the pattern observed last year, the advanced markets have tended to outperform the emerging markets.

Global equity market performance (Jan 2017 = 100)



Source: MSCI

Especially US growth remains robust but global prospects are clouded by increased political risk and gradually tighter monetary conditions

The end of easy money

The US Federal Reserve has led the retreat from the unusually permissive monetary conditions that have prevailed for the past decade. The increasingly robust recovery of the US economy along with fiscal stimulus measures has pushed the Fed toward a progressively more hawkish stance in terms of normalizing rates.

The Open Market Committee on 13 June increased the policy rate to a corridor of 1.75-2.0%. The Fed has now increased its rate seven times by a total of 175 bps since December 2015. The increase was accompanied by generally upbeat commentary about the “solid” US economy as well as a decision to abandon the long-standing pledge to maintain a low rate stance for an extended period. The tightening cycle in the US is set to continue with the Fed projecting two more 25 bp rate increases this year. However, the Fed also signaled its willingness to tolerate inflation above its 2% target if doing so would permit strong economic performance. The Fed described its current policy stance as “close to neutral.” After a drawn-out period of subdued inflation, price pressures are now finally beginning to make themselves felt. The Consumer Price Inflation index rose by an annual 2.8% in May, which marked a six-year high. Even core inflation, which excludes energy and food, has moved higher and stood at 2.2%.

The US retreat from monetary stimulus is likely to be followed by other key central banks as well, albeit with a lag and possibly very gradually. For instance, the Fed-Europe Central Bank (ECB) policy rate differential now stands at 227.5 bps, which is the highest since 2007. In general, both the growth dynamics as well as inflationary pressures have tended to be more subdued in other major economies. While the ECB has signaled that it will end its asset purchase program by the end of the year, it also indicated that it would be “patient” on policy tightening and would likely not increase rates before the second half of 2019.

Trade tensions escalate

The US administration enforced its 25% tariff on steel and 10% on aluminium imports on 1 June 2018. The measure is based on Section 232 of the Trade Expansion Act of 1962 which permits tariffs when an article is imported into the US in quantities or under such circumstances “as to threaten or impair the national security.” The measure, which involves also some of the US’ closest allies, has triggered a cascade of countermeasures and threats of further actions. In response, the EU in late June introduced tariffs on EUR2.8bn worth of US goods ranging from motorcycles to orange juice. Most products will be subject to a 25% tariff. The US, in response, has mooted a 20% tariff on cars imported from the EU. Europe has drafted potential retaliatory action in response. Also Canada and Mexico have introduced new measures.

Beyond this, the US Trade Representative in mid-June imposed tariffs on up to USD50bn worth of Chinese imports. These included ICT and engineering products which have been deemed particularly vulnerable to IPR violations. Most of these measures came into force in early July. China in response announced a 25% tariff on USD50bn worth of US imports, including soybeans and other agricultural products. The US raised the prospect of further retaliation with officials tasked to identify USD200bn worth of goods to which an additional 10% levy could be applied. Further protectionist measures are possible also in connection with an ongoing Section 301

Market expectations regarding interest rates have been moving in a hawkish direction. US is well ahead of other major economies in monetary tightening

Global trade tensions have accelerated markedly in recent months and a drawn-out trade war is now seen as a real prospect

investigation as well as a number of other trade-related initiatives. Total US merchandise imports from China reached USD505bn in 2017. This compared to USD154bn of exports.

Although the current trade disputes are not new, they have finally begun to test market confidence more directly than hitherto. The potential economic impact of a full-blown trade war could be significant. The OECD estimates that a 10% increase in trade costs between the US, the EU, and China could lower global growth by 1-1.5 percentage points in the medium-term. The World Bank has suggested that an escalating trade dispute could have the potential to deliver an economic shock analogous to the financial crisis. A recent estimates suggests that a global increase in tariff could reduce international trade by 9%. Confidence effects are potentially significant and could curb investments.

While the focus of tensions to date has been on merchandise exports, there is a possibility that it could come to involve other areas as well, such as services, as well as direct and portfolio investments. There has been growing speculation of measures such as restrictions on cross-border M&A, licensing delays or restrictions, a revival of “currency wars,” and various other regulatory and administrative measures. For instance, the Chinese Renminbi has depreciated by 3.3% vis-à-vis the US Dollar in June.

A new chapter for oil

OPEC has been pursuing output controls since late 2016 in a bid to balance the international oil market where a glut had brought prices to historic lows. This year has seen the achievement of that stated objective with the consequence of far greater oil market sensitivity to supply disruptions. Some of such challenges have been structural in nature, notably the political crisis in Venezuela and President Trump’s decision to impose sanctions on Iran following the US withdrawal from the Joint Comprehensive Plan of Action nuclear accord. Venezuelan output has fallen some 700,000 b/d below its baseline. Iranian exports have reportedly already dropped by some 500,000 b/d from 2.7 mbd in May. Last time around, US sanctions reduced Iranian output from nearly 4 mbd in 2019 to 2.5 mbd in 2012. The International Energy Agency (IA) has suggested that Iran and Venezuela could see their production fall by up to 30% by the end of next year. In this environment, oil prices have been rising almost continuously since the middle of 2017 and reached a three-year high in May.

In response to this new state of affairs, the OPEC quota regime, which also involves key non-OPEC partners, came under review in the OPEC meeting of late June. The members formally agreed to work toward full compliance with the January 2017 production cut agreement. This marks a major change from the current state of affairs where OPEC production has been well below the agreed limits – by as much as 700,000 b/d as of May. Even though the non-OPEC partners have exceeded their targets by 230,000 b/d, this was far from sufficient to compensate for the shortfall.

The OPEC decision is unlikely to significantly change the oil market balance in the short term. Indeed, oil prices rose in response to the news. One of the practical challenges is relatively limited available spare capacity. Saudi Arabia, the UAE, and Kuwait between themselves are estimated to have a total cushion of 2.75 mbd, which equals as much as 85% of the OPEC spare capacity. Moreover, apart from the continued risks in Venezuela and Iran, there have been output and

export disruptions in other member states, notably Angola and Libya. Perhaps in light on this, the latest OPEC agreement did not stipulate any formal time lines or country quotas. Saudi Arabia has signalled its commitment to price stability and vowed that global supplies would be boosted by nearly 1 mbd. However, other OPEC members have suggested that the increase will be far smaller.

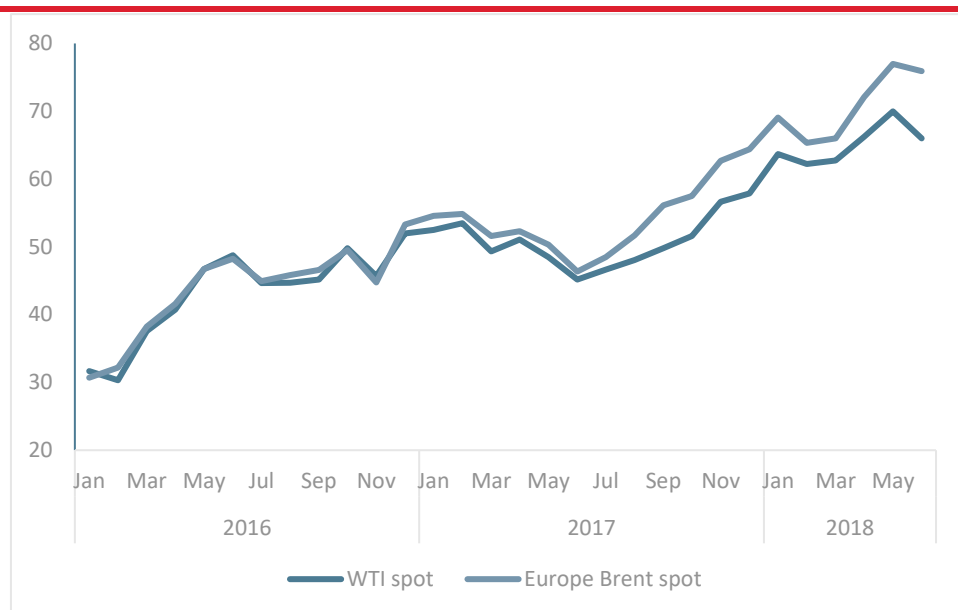
The new market environment represents a significant departure from the pattern of recent years where North American shale production was seen to be provided a flexible response to tighter conditions elsewhere:

- ✦ US production rose to 10.9 mbd in early June having been consistently running above 10 mbd since early February. With the total on track to exceed 11 mbd, infrastructure constraints in the form of insufficient pipeline capacity are making themselves felt. This limits the ability of American producers to export even though they now have the legal right to do so. Moreover, most US producers have an interest in maintaining the current price floor which is allowing them to make profits. This is a significant departure from the earlier scenario of pushing for increased output in a low-price environment in order to achieve the cash flow required to service typically substantial debts. June saw some declines in the US rig count to 858. The US Energy Information Administration expects US crude production to increase by 1.4 mbd this year. This would likely be enough to match global demand growth but would not accommodate further supply disruptions. Growth in 2019 is projected at 1.0 mbd
- ✦ Thanks to the strength of the domestic economic recovery, the US has seen some declines in stockpiles
- ✦ The ongoing trade policy stand-off with China and other countries may entail risks for hydrocarbons and product exports. China has indicated that oil could be targeted as part of retaliatory action

Under the circumstances, a near-term price decline below the current range seems highly unlikely and there are several upside risks. OPEC and its partners have signalled a desire to ensure relative price stability but their ability to achieve this may have to come at the expense of spare capacity, which would likely further cement the floor of the current price range. Overall, oil prices now look increasingly likely to remain in the current range of USD65+ per barrel for the remainder of the year.

Oil prices have reached a higher range and limited spare capacity implied increased sensitivity to market disruptions

Monthly average crude oil prices (USD/barrel)



Source: US Energy Information Administration

Global oil demand and supply dynamics (mbd)

	IEA	OPEC	EIA*
2017 Global oil demand (mbd)	97.8	97.1	98.5
Advanced economies	47.4	47.4	47.2
Developing economies	50.4	49.7	51.3
China	12.4	12.3	13.3
2018 Global oil demand (mbd)	99.3	98.7	100.3
Advanced economies	47.7	47.8	47.7
Developing economies	51.6	50.9	52.6
China	12.9	12.7	13.7
2017 Global oil supply (mbd)	97.4	96.6	98.0
OPEC	39.2	32.4	39.3
Non-OPEC	58.1	57.9	58.7
2018 Global oil supply (mbd)	-	-	100.5
OPEC	-	-	39.2
Non-OPEC	59.9	59.6	61.2

*Petroleum and other liquids data

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

Implications for Bahrain

The global environment has mixed implications for Bahrain:

- ✦ The tightening global liquidity environment should put some upward pressure on the cost of capital and underscores the continued importance of fiscal reform for the sovereign. The ongoing withdrawal of ample stimulus has the potential to produce bouts of market volatility
- ✦ The higher oil price environment will support the fiscal overhaul while increased production by Saudi Arabia and other producers should strengthen positive spill-overs from the rest of region, eg more tourism, investments, re-export trade, etc.
- ✦ The more charged atmosphere around international trade policies is potentially a serious concern for market confidence and even global growth. It underscores the importance of regional integration and economic diplomacy

THE GCC REGION

GROWING OPTIMISM

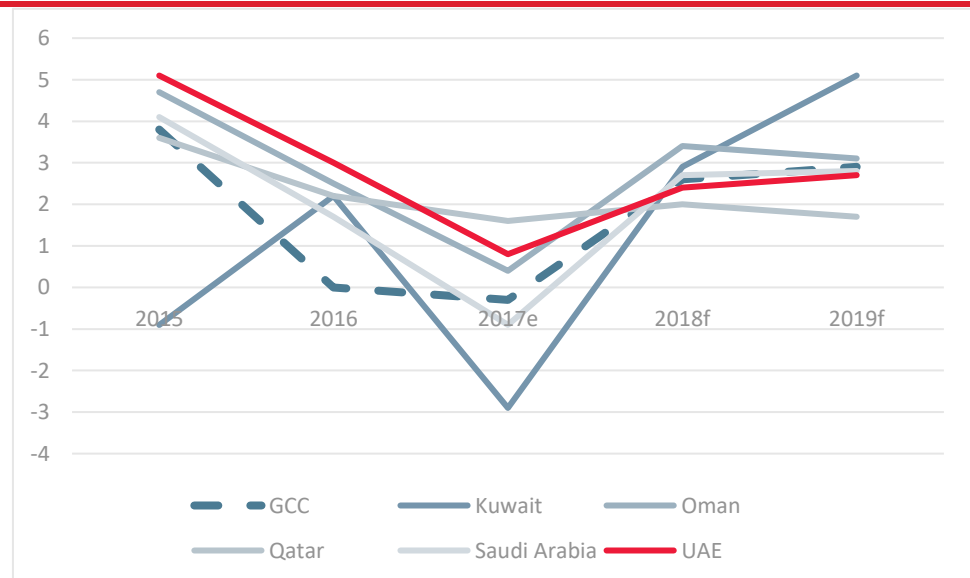
2018 is likely to see a steady acceleration in growth, with non-oil expansion accelerating and the oil sector slated for some expansion

The GCC economies are well positioned to see a significant improvement in their economic performance this year as compared to the very subdued outcome for 2017. A number of factors are coinciding to make for a brighter outlook:

- ✦ The pronounced improvement in oil prices since the second half of last year has boosted confidence as well as liquidity conditions in the banking system
- ✦ The rebalancing of the global oil markets has allowed OPEC to start increasing production again. The leading three GCC producers account for nearly all of the spare capacity among the organization's membership. After a year of output cuts, the hydrocarbon sector is now set to make a positive contribution to growth
- ✦ After a period of fiscal consolidation, the ongoing fiscal reform measures are being balanced by more regulatory reform and other growth-oriented measures. This is countering the confidence and growth impact of fiscal consolidation and boosting the longer-term growth potential of the regional economies

The overall real GDP growth rate in the region is set to accelerate from an estimated -0.3% in 2017 to 2.6% this year, according to the Institute of International Finance (IIF).

GCC real growth dynamics, %



Source: Institute of International Finance

Growth dynamics strengthen

Growth in Saudi Arabia is showing signs of accelerating after a very subdued 2017. Headline real growth reached an annual pace of 1.2% in 1Q18. Non-oil growth was still relatively lacklustre with a 1.6% YoY gain and small declines were observed in construction and retail. The oil sector posted

a small 0.6% YoY gain. Saudi Arabia saw an 18% YoY in budget spending in Q1, although capital spending dropped by 11%. With both oil and non-oil drivers set to strengthen in the course of the year, headline growth is projected to reach around 2.5% this year.

The Economic Composite Indicator of the UAE Central Bank pointed to YoY growth of 1.2% in Q1. This was led by 3.1% expansion in the non-oil economy. Economic growth during the year as a whole is projected to reach 2.7% in an acceleration from an estimated 1.5% in 2017. Non-oil growth is set to accelerate to 3.9% from last year's 3.4%, partly thanks to a range of stimulus measures. The Government of Abu Dhabi recently announced an AED50bn stimulus package, which is designed to accelerate payments to private contractors and boost employment. Dubai is offering some tax relief and introducing 10-year visas for skilled professionals. Corporate regulations will be simplified.

Kuwait's GDP expanded by 1.6% YoY in 1Q18. The non-oil sector performed well, expanding by 3.1% but also the oil sector now posted a 0.7% YoY gain. Non-oil growth was above all led by manufacturing and telecommunications, but a clear improvement was observed also in the trade sector, in line with generally stronger consumer confidence. Overall, Kuwait's economy is set to record the sharpest growth rebound in the region from last year's 2.9% contraction to 2.5-3.0% expansion this year. Even with the delayed budget approval and slower than expected project implementation in certain areas, non-oil growth looks set to firmly exceed 3%.

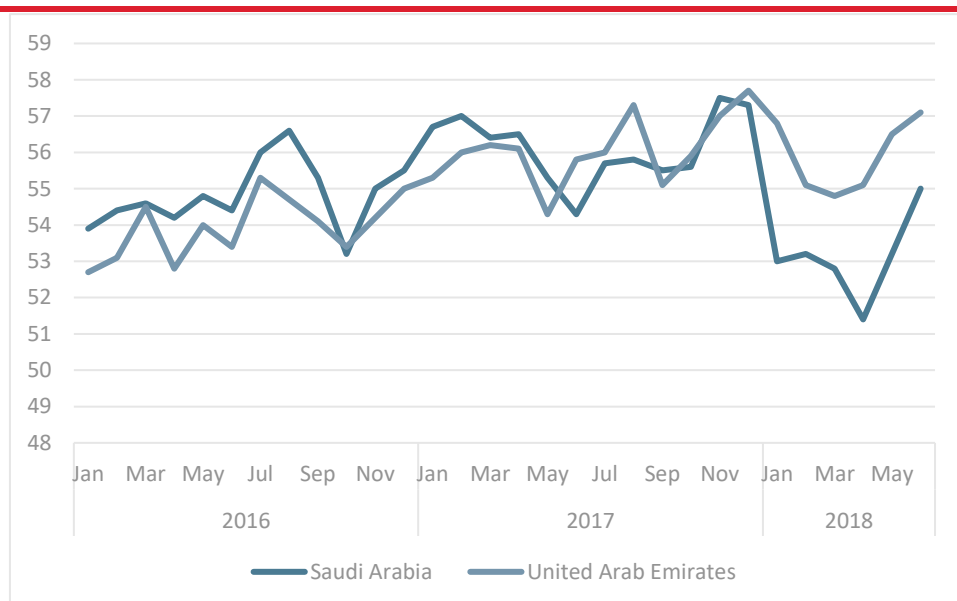
The Qatari non-oil sector rebounded by 4.9% YoY in Q1 whereas the hydrocarbons sector still contracted by 2.3%. Headline growth reached 1.4%. Qatari growth is expected to accelerate to 2.5% this year. The non-oil economy is projected to expand by 3.5% with the hydrocarbons sector set to post a 1.5% expansion.

The Omani economy is amidst a pronounced rebound from near-flat growth in 2017. Headline growth of around 3% seems achievable this year.

Forward-looking indicators suggest that the outlook for the region is growing brighter after a relatively slow start in Q1, which was mainly due to the introduction of VAT and other fiscal consolidation measures. Both the Saudi and the UAE Purchasing Managers' Indices reached year-to-date high in June: 55.0 in Saudi Arabia and 57.1 in the UAE. However, businesses are often making headway through greater efficiency and more competitive pricing. Under the circumstances, the employment impact of the stronger economy has remained very modest. Partly as a result, UAE companies in particular are reporting capacity constraints in response to stronger order books. This naturally has the potential to trickle down into renewed jobs creation over the coming months. The Emirates NBD Dubai Economy Tracker declined marginally in June – from 57.6 to 56.0. However, business optimism rose to the highest level so far.

A pronounced growth acceleration is underway across the region following a somewhat slow Q1

Emirates NBD Purchasing Managers' Index



Source: Emirates NBD, Markit

The oil sector looking to regain its forward momentum

After leading the effort to rebalance the global oil markets, the regional OPEC members have begun to somewhat relax their output controls. In line with a general increase in OPEC production since the Vienna agreement, Saudi Arabia boosted its output in May-June, with a particularly sharp increase observed in June – by an estimated 500,000 b/d – to a reported total of 10,700. This is comparable to the peak levels reached in late 2016. During the preceding year and a half, Saudi production had hovered steadily around the 10mbd mark.

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



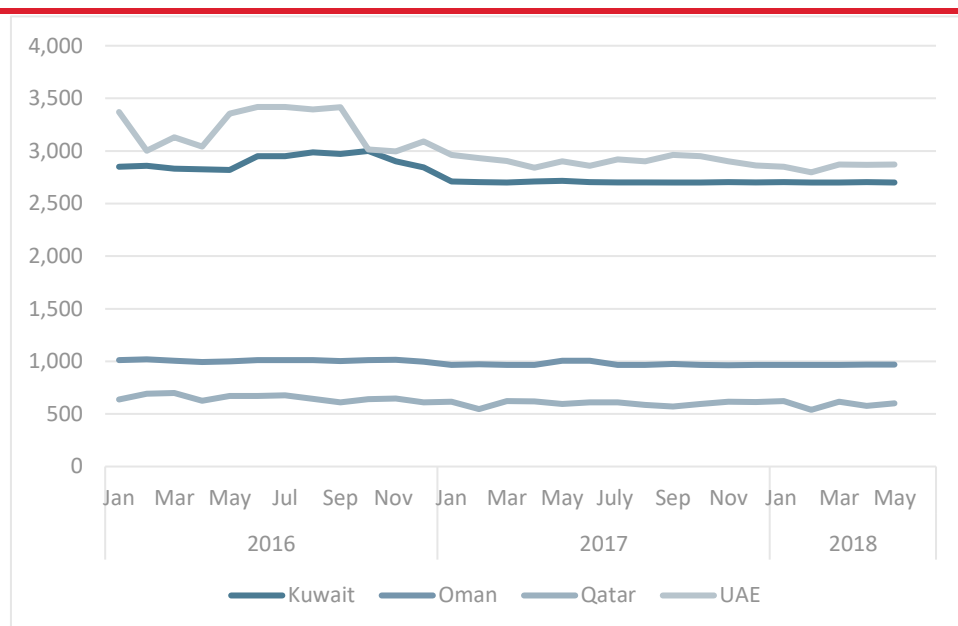
Source: Joint Organisations Data Initiative, OPEC, Reuters

Saudi Arabia saw a sharp increase in its oil output following the Vienna agreement

The other regional producers have held their production in line with the OPEC+ deal, although companies are looking to boost their output as well as capacity in the months ahead. In Oman, the hydrocarbons sector will benefit further from the Khazzan tight gas project which should reach full capacity in 2019.

Reflecting region-wide efforts to diversify the hydrocarbons sector by capturing more of the value chain, Abu Dhabi National Oil Company has also announced plans to spend AED165bn on the downstream energy sector. The objective is to double refining capacity and triple petrochemical production by 2025. Furthermore, the company is planning partial privatizations and six competitive oil and gas concessions.

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



Source: Joint Organisations Data Initiative, OPEC, Bloomberg

Subdued price pressures

Consumer Price Index readings across the region are marked by a clear dichotomy. Saudi Arabia and the UAE, which introduced VAT as of the beginning of 2018, have observed a clear increase in consumer prices since last year. In the rest of the region, by contrast, price pressures have been very subdued with the headline rate of annual CPI rises remaining firmly below 1%.

Moreover, even in the UAE and Saudi Arabia, the initial impact of the VAT spike has been waning fairly consistently in recent months. This underscores the relative absence of significant inflationary pressures in the region. Among the key factors are the following:

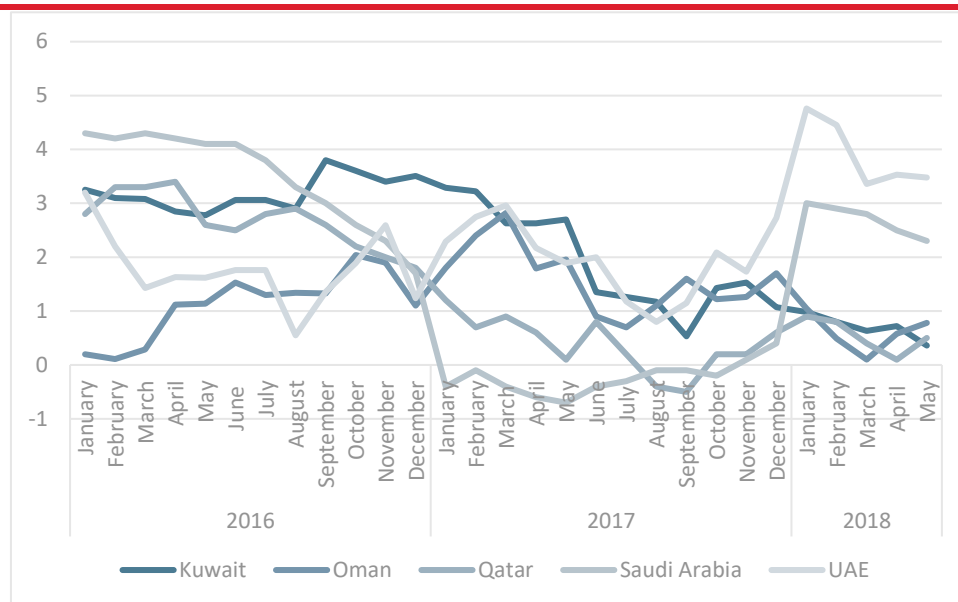
- ✦ The global food markets have not seen major supply disruptions in recent months
- ✦ Housing costs have been contained by the significant increase in new supply in recent years which the market is still absorbing. Much of the region is continuing to see house price and rental deflation, although markets are typically showing signs of returning to a balance. For instance, the Saudi Real Estate Price Index fell by an annual 1.5% in Q1, as opposed to a 3.3%

Inflationary pressures are generally weakening even in countries that introduced VAT

drop in Q4. Property prices in Abu Dhabi declined by an annual 7.8% in Q1, as compared to a 4.2% YoY drop in Dubai, according to the REIDIN Price Index. Dubai rents fell by an annual 7.5%. Abu Dhabi saw a comparable 7.8% drop. The Kuwait markets appear to be close to rebalancing

- ✦ The renewed strength of the US Dollar has entailed minimal imported inflation due to the Dollar pegs of the GCC currencies (USD-dominated basket in the case of Kuwait)

Consumer price inflation, %



Source: National statistical agencies

Financial market conditions improve

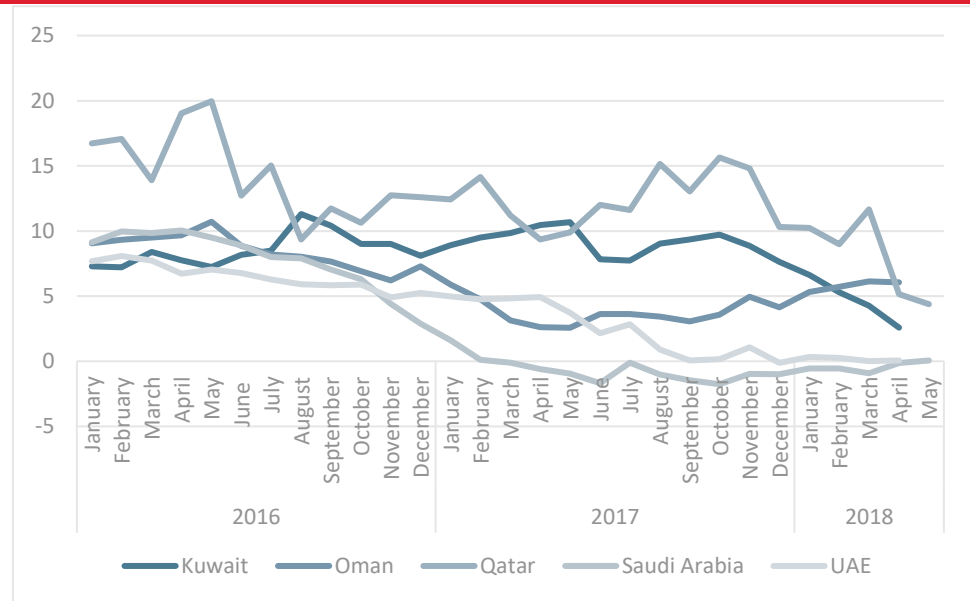
The recent deterioration in liquidity conditions may be over

After a drawn-out period of generally deteriorating liquidity conditions in a low oil price environment, a new narrative seems to be taking shape in the regional banking sector, however gradually. Even though YoY credit growth in the region's two largest economies – Saudi Arabia and the UAE – is still historically subdued, the negative trend has been reversed. Notably, new credit growth in Saudi Arabia has turned positive after a year of small YoY declines. While Oman has also seen some improvements, lending growth has continued to decelerate in Kuwait and Qatar.

The cost of capital is continuing to edge up with US tightening which the regional central banks have typically matched. For instance, in Saudi Arabia, SAMA raised its repo and reverse repo rates to 2.5% and 2.0%, respectively. On the other hand, proactive efforts are underway to develop the sector and overhaul regulations. The new Saudi Financial Development Program seeks to increase the size of financial assets from 192% GDP in 2016 to 201% by 2020, an estimated total of SAR6.3trn. It further pursues financial markets diversification with the goal of increasing the share of capital market assets (equity market capitalization and outstanding debt issuances registered at the exchange) from 41% to 45%. Bank financing for SMEs is projected to rise from 2% to 5% of lending and mortgage financing from 7% to 16%.

The Central Bank of Oman in April relaxed its capital and credit exposure rules in a bid to boost liquidity. Conventional bank lending in 2017 fell to 3%, the slowest growth rate in more than a decade. Among other things, the minimum capital adequacy ratio was reduced from 12 to 11%. Oman is the only Gulf country to see a decline in bank profitability.

Bank credit growth, %



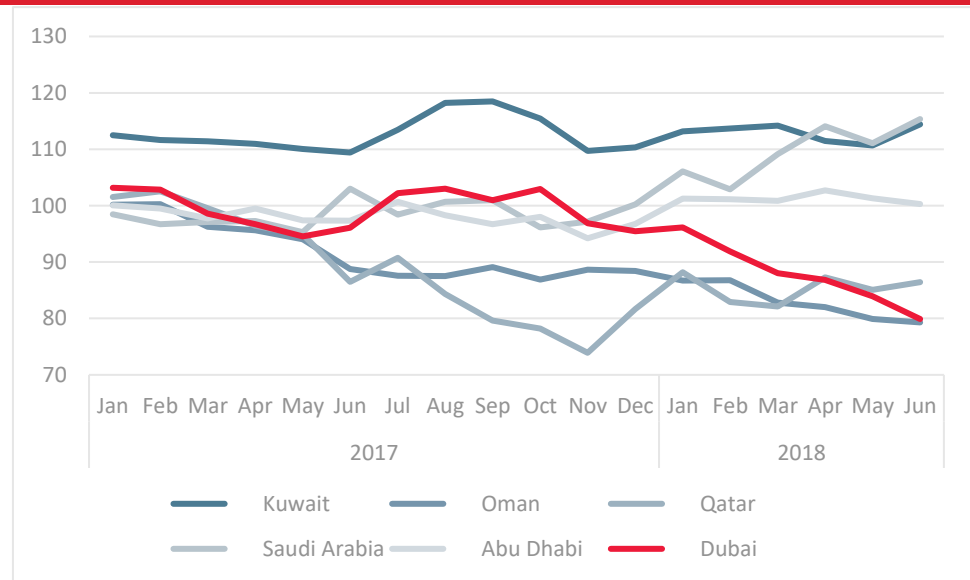
Source: Regional central banks

Equity markets in Saudi Arabia and Kuwait are benefiting from their inclusion in benchmark indices

The performance of the regional equity markets has been variable in 1H18. Saudi Arabia has been the strongest performer, benefiting in part from the inclusion of its stocks in international benchmark indices. Following similar moves by FTSE Russell, MSCI in June decided to include Saudi Arabia in its emerging markets index. This may ultimately generate inflows of some USD40bn, which compared to market capitalization of some USD500bn. Kuwait was put on review for a possible upgrade by MSCI.

During the first half of the year, the Tadawul All Share Index rose by 15.8%, which made it the third best performing market globally and the leader among emerging markets. Dubai and Oman have seen fairly sustained declines this year, with the rest of the region more or less flat. The Qatari market rose by 5.9% during 1H18 and the Abu Dhabi index by 3.7%. Oman declined by 10.3% and Dubai by 16.3%.

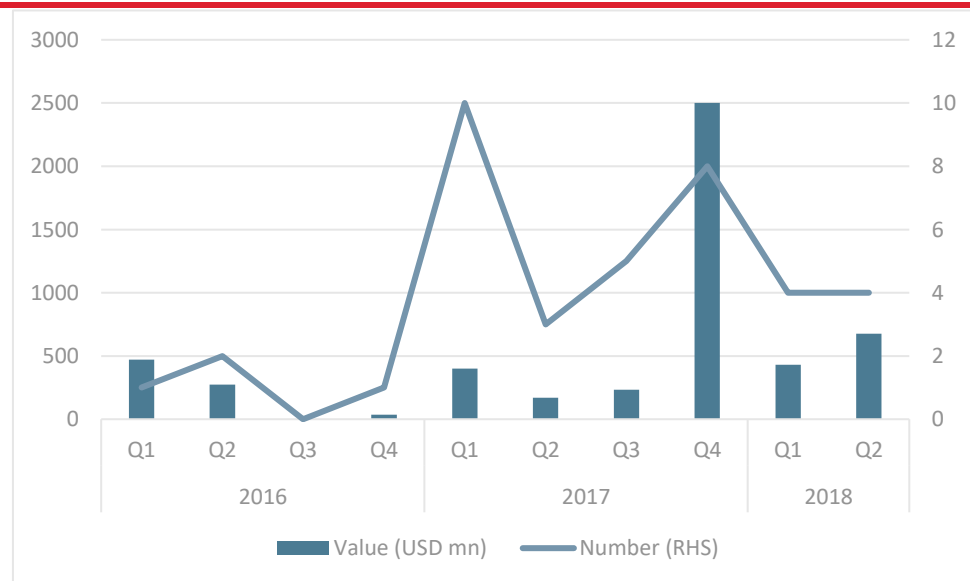
GCC equity market indices (end-December 2016=100)



Source: Regional stock exchanges

Primary market activity has continued to revive gradually, although it has so far this year fallen far short of the bumper quarter of 4Q17. New listing activity has been entirely concentrated in Saudi Arabia and consisted of real estate investment trusts (REITs), which have quickly emerged as an important new asset class in the Kingdom. Tadawul now has 12 listed REITs with an aggregate market capitalization in excess of USD2bn. Saudi Arabia is likely to remain an important hub of IPO activity also going forward. The country's privatization program aims to raise SAR35-40bn by 2020. Target companies include football clubs, flour mills, and the water desalination sector. Plans are afoot also to corporatize ports.

GCC quarterly IPO activity



Source: PricewaterhouseCoopers, Regional exchanges

Fixed income issuance has continued to advance as an increasingly important plank of the regional financial system even though fiscal deficits declined by some 43% in 2017. As estimated USD175bn

1H18 IPO activity was dominated by Saudi REITs

was raised in the GCC bonds and sukuk market during 2017, much in line with the 2016 total of just under USD170bn. Local issuance by regional central banks made up USD70bn of the 2017 total.

Sovereign issuance has continued to dominate the fixed income space also this year. Saudi Arabia issued a USD11bn international bond in April. The fourth international offering of its kind was composed of tranches of seven, 12 and 31 years. Subscriptions reached USD51bn and pricing was up to 210 bps over US Treasuries. The Government also plans to raise SAERO-70bn domestically. In April-May, the Ministry of Finance sold SAR12.05bn of local currency bonds. Furthermore, Qatar placed a USD12bn three-tranche international bond in April.

Additionally, Kuwait may return to the market following parliamentary approval of an increased debt ceiling from KWD10bn to KWD25bn. The new FY2018-19 budget foresees a USD21bn deficit (some 17.5% of GDP), albeit based on a very conservative oil price assumption of USD50bn per barrel. Kuwait has posted deficits for the past three financial years.

Major corporate issuers during the quarter included Abu Dhabi National Energy Co (Taqa) which raised USD1.75bn in an offering that was 4.7 times oversubscribed. Maturities of 7 and 12 offer yields of up to 4.875%. Oman Telecommunications Co issued bonds worth USD1.5bn in April. It offered maturities of up to 10 years and yields of up to 6.625%. Noor Bank issued a USD500mn sukuk in April.

The GCC is emerging as an important element of the global fixed income markets

The rising GCC issuance is making it a globally significant geography for the fixed income markets. The GCC countries now account for 14% of the total EM debt stock and some 12% of the Bloomberg Emerging Market Investment Grade Bond Index. The market stands at USD350bn with some USD200bn worth of corporate debt. Three-quarters of regional issuance in 2017 was absorbed by foreign investors. JP Morgan has begun consultations of including GCC bonds in its EMBI bond index, which would attract benchmark investments into the region. Some USD360bn of capital track the hard-currency emerging market debt indices. The weight of the GCC would be expected to be 12.33%.

Fixed income is seen as an important element of domestic capital market development as well. The Saudi Ministry of Finance appointed five local banks as primary dealers for government securities. A total 26 bond and sukuk issues, with an aggregate value of OMR17.95bn, were listed on the Muscat Securities Market at the end of 2017. Similarly, Saudi MoF has listed 45 bonds and sukuk worth more than SAR200bn on Tadawul. Maturities range from five to ten years. Qatari sovereign bonds have started OTC trading on the Taipei Exchange.

Implications for Bahrain

The regional backdrop is set to become more favourable for Bahrain's growth:

- ✚ Positive spill-overs from the rest of the region are likely to increase as region-wide growth accelerates
- ✚ More benign fiscal and liquidity conditions should support financial market and investment activity

BAHRAIN

OILFIELD MAINTENANCE CURBS Q1 GROWTH

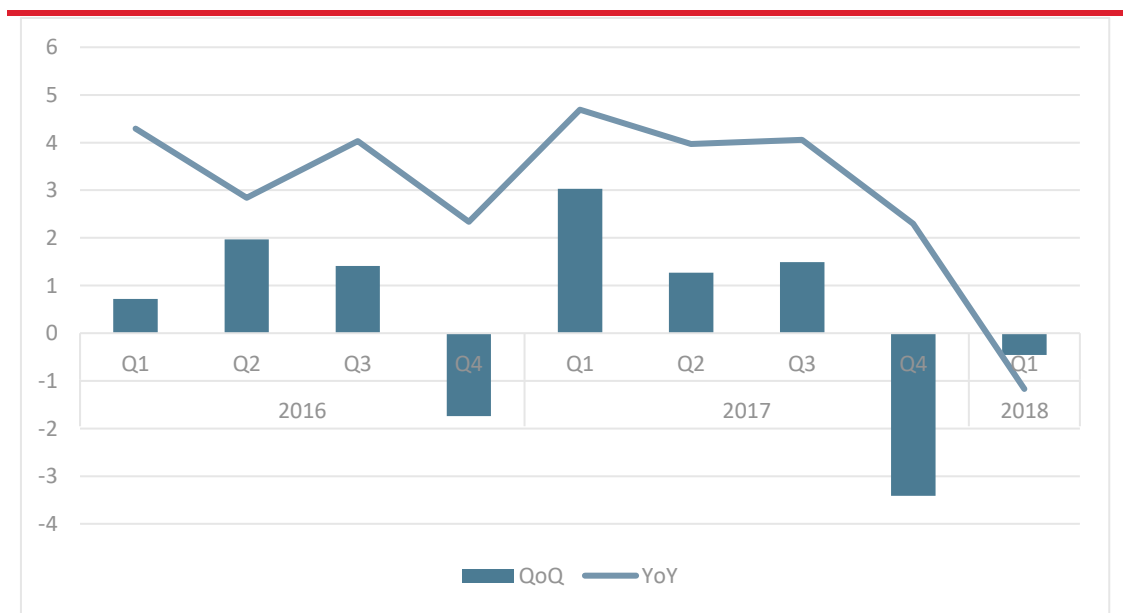
Headline real growth dropped to -1.2% in Q1 due to a maintenance-related 14.7% contraction in the oil sector

The positive trajectory of accelerating growth over the past two years was interrupted by a temporary drop in the oil sector during Q1. Following (revised) 3.8% headline real growth in 2017, the YoY pace of expansion turned negative during the opening months of 2018 due to sharp drop in oil production. The oil sector contracted by an annual 14.7% as a result of maintenance-related output cuts on the offshore Abu Sa'afah field. This resulted in -1.2% YoY headline growth.

Non-oil growth, by contrast, remained firmly positive, although the 1.9% YoY pace of expansion still fell markedly short of the 4.8% rate of non-oil growth achieved during 2017 as a whole. This outcome in fact continued a weakening trend from 2.5% YoY non-oil growth in 4Q17. The QoQ change in growth was -0.5%. This deceleration is likely primarily due to a combination of base effects after a period of accelerating growth as well as the inevitable unevenness in infrastructure project implementation. Among other things, 2017 saw a steady deceleration in construction sector growth, which troughed at 0% in Q2 and came in at 1.8% during the year as a whole. This compared to 5.7% growth in 2016. Encouragingly, the construction sector is now entering a period of renewed expansion with 6.7% real growth recorded in Q1. Given the strength of the forward and backward linkages of infrastructure activity, this reversal should contribute a more broad-based acceleration in non-oil growth in the months ahead.

In nominal terms, Bahrain's GDP expanded in Q1 thanks to significantly higher oil prices that more than countered the drop in output. Bahrain's GDP in current prices rose by an annual 5.1% in Q1. This compared to 9.6% nominal growth during 2017 as a whole, again thanks in part to a sustained recovery in oil prices during the year.

Real GDP growth, %



Source: Information & e-Government Authority

Forecast: Evolving growth drivers

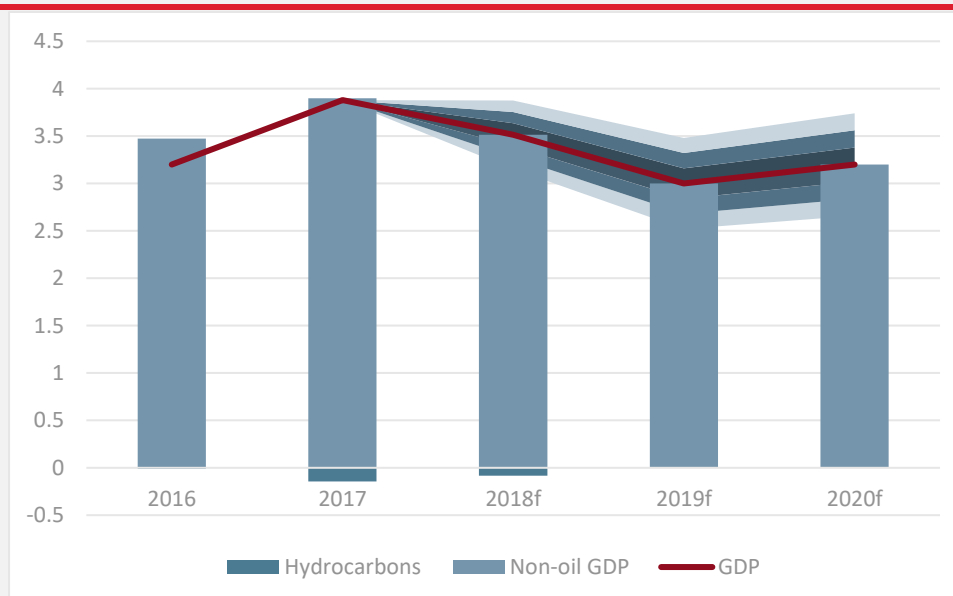
Bahrain economic outlook

	2016	2017e	2018f	2019f
Real GDP growth, %	3.5%	3.8%	3.4%	3.0%
Non-hydrocarbons sector	4.3%	4.8%	4.3%	3.8%
Hydrocarbons sector	-0.1%	-0.7%	-0.5%	0.0%
Nominal GDP growth, %	3.5%	9.6%	9.4%	5.6%
Inflation (CPI %)	2.8%	1.4%	2.2%	3.5%
Current account (% of GDP)	-4.6%	-3.8%	-2.3%	-2.1%
Fiscal balance (% of GDP)	-13.4%	-10.1%	-7.6%	-7.1%
Crude Oil Brent (USD)	44	53	68	65

Source: Bahrain Economic Development Board

In spite of slight deceleration in non-oil growth during 4Q17-1Q18, the near-term outlook for the Bahraini economy remains benign. Construction growth is once again showing signs of accelerating and a number of new projects, led above all by the Bapco Modernization Program, are breaking ground this year. This in turn should underpin a broader positive growth momentum which may benefit further from tactical buying ahead of the VAT introduction. The regional backdrop is likely to become increasingly supportive of growth in Bahrain as the economic transformation makes headway against a generally more positive oil price environment. On the negative side, the gradually increasing cost of capital may curb growth marginally, albeit against the backdrop of a generally favourable liquidity situation in the banking sector. In 2019, the launch of ALBA Line 6 will provide a major impetus to manufacturing sector growth and should support the further development of downstream manufacturing as well.

Real GDP growth composition



Source: Bahrain Economic Development Board, Information & eGovernment Authority

Non-oil activity somewhat weaker but new growth drivers emerge

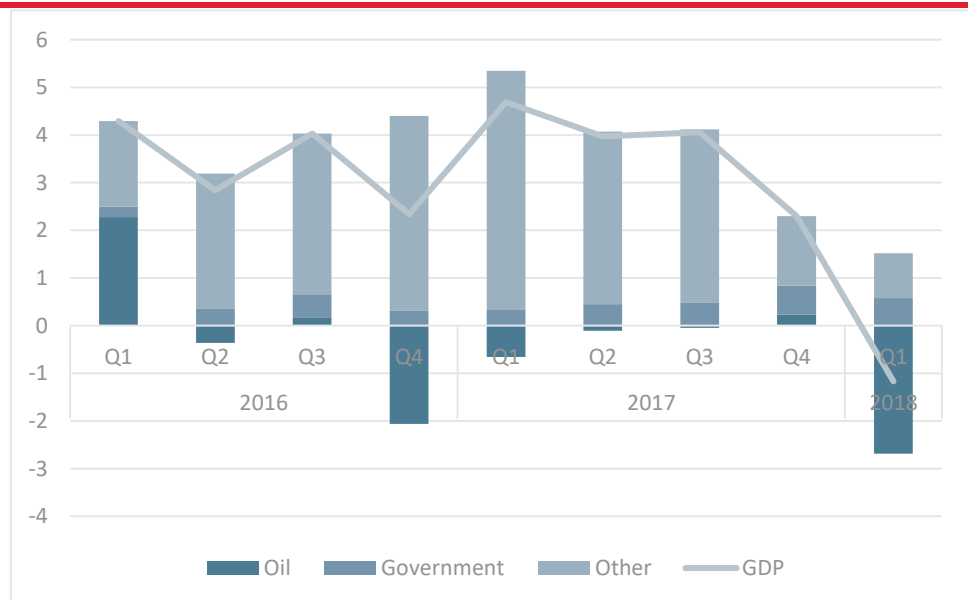
Non-oil growth decelerated to an annual pace of 1.9% in Q1. However, new signs of construction-led momentum are emerging

The six-month period between October 2017 and March 2018 witnessed a deceleration in non-oil growth clearly below its recent trend. This was particularly evident in Q1 when non-oil growth reached an annual pace of 1.9%. The Government Services sector expanded by an annual 4.6% whereas the non-oil private sector expanded by 1.4%.

The sector breakdown of growth was very uneven, in marked contrast to the broad-based positive momentum observed in preceding quarters. The fastest growing single sector in Q1 was Construction which expanded by an annual 6.7%. This in fact marked a sharp acceleration from the 1.8% pace seen during 2017 as a whole and suggests that a new phase of construction-led expansion in the non-oil sector may be upon us after a period of decelerating growth. Historically, construction activity has been an important driver of expansion in other sectors, such as manufacturing, trade, real estate, and financial services. Related to Construction, the Real Estate and Business Activities sector posted 3.7% growth in Q1. The Manufacturing sector expanded by 4.2% in a clear acceleration over the 1.1% pace seen during 2017 as a whole.

The Hotels & Restaurants sector saw an unusual 9.4% contraction during Q1. This may partly be the result of base effects after a robust 9.5 expansion during 2017. However, the hospitality sector number have historically also tended to display some volatility as precisely reporting frequently materializes with a lag. The Trade sector contracted by 2.7%, again in a marked departure from the 8.5% expansion it witnessed during 2017 as a whole. In both cases, the corrections are likely to temporary after a rapid build-up in new supply.

Real GDP growth composition



Source: Information & eGovernment Authority

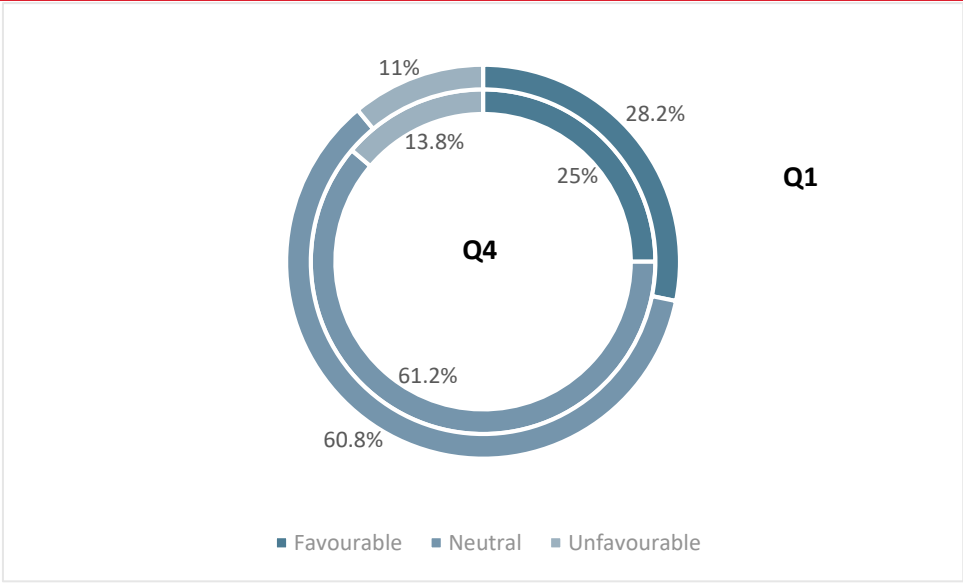
Sector-specific real growth rates, YoY (%)

	2016	2017					2018
YoY growth, %	Annual	Annual	Q1	Q2	Q3	Q4	Q1
Crude Pet. & Nat. Gas	-0.1	-0.8	-3.3	-0.5	-0.3	1.3	-14.7
Manufacturing	5.2	1.1	0.5	-1.0	3.7	1.1	4.2
Construction	5.7	1.8	4.6	0.0	0.8	1.9	6.7
Trade	3.0	8.5	9.3	9.3	7.7	7.9	-2.7
Hotels & Restaurants	1.8	9.5	12.3	13.4	8.6	3.7	-9.4
Transp. & Comm's	2.5	5.4	7.4	7.0	6.6	0.9	0.8
Social & Pers. Serv.	7.8	9.4	10.0	9.7	9.1	8.8	4.1
Real Est. & Bus. Act.	7.4	6.4	10.3	6.8	7.9	1.2	3.7
Finance	4.5	5.0	8.3	7.5	3.5	1.0	-0.1
Government	2.7	3.7	2.6	3.6	3.8	4.8	4.6
Other	0.9	10.4	23.0	10.4	12.1	-3.3	-5.9
GDP	3.2	3.8	4.7	4.0	4.1	2.3	-1.2

Source: Information & e-Government Authority

Recent data on business perceptions tallies with the impression of a temporary growth slow-down. Business perceptions during Q2 were generally stronger than at the beginning of the year. During Q2, 46.4% of the respondents had a positive view of the economic situation – an improvement on 41.1% during the opening quarter of the year. 42.2% reported a neutral perception while only 11% were pessimistic. Interestingly, in spite of a clear increase in optimism, perceptions had become more polarized with the share of both optimists and pessimists increasing.

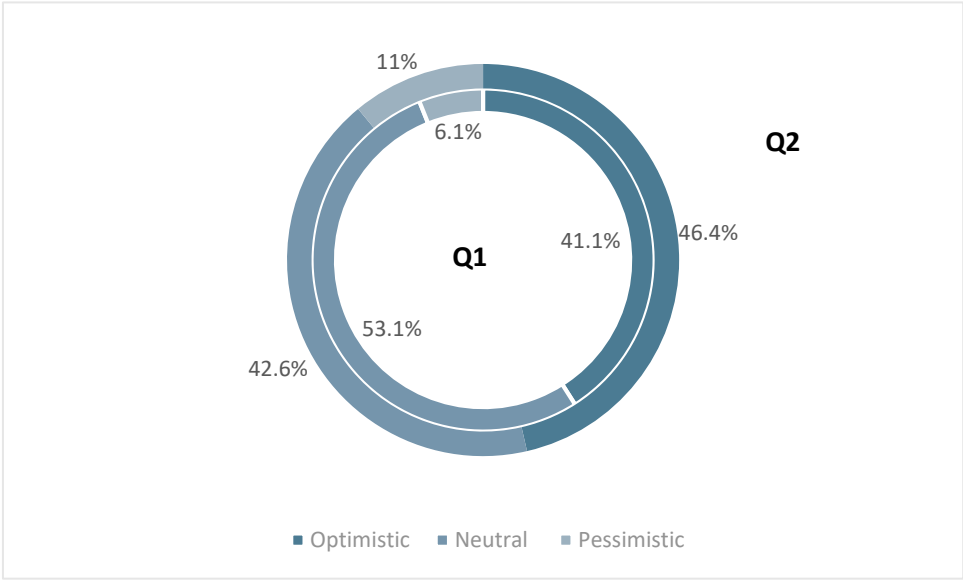
Bahrain QBPS opinions regarding current business performance, 4Q17-1Q18



Source: Information & eGovernment Authority

Forward-looking expectations were broadly in line with the Q4 observations, albeit with a notable increase in the share of optimists and a decline in the share of pessimists. 28.2% of the respondents had a favourable near-term outlook in an increase on 25% in Q4. Most respondents – 60.8% -- expected continuity. This compared to 61.2% in Q4. The share of pessimists declined slightly from 13.8% to 11%. Business optimism was particularly pronounced among large companies and micro-enterprises. The most optimistic sectors were manufacturing (92.3 balance between favourable and unfavourable responses), construction (63.6), and accommodation & food services (40.0).

Bahrain Business Confidence Index, forward-looking expectations for 1-2Q18



Source: Information & eGovernment Authority

Business confidence has improved in the course of 1H18

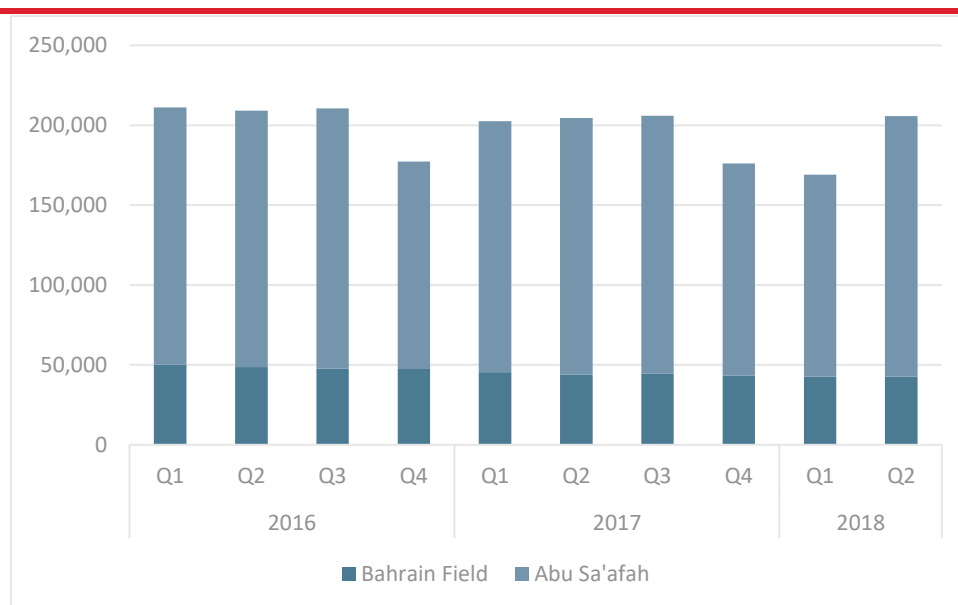
Oil production normalizes in Q2

Oil production in Q2 rebounded from a two-quarter-long period of maintenance-related below-capacity output

Oil production in Q2 rebounded from the maintenance-link drop during 4Q17-1Q18. During that period, output from the Abu Sa'afah offshore field averaged 129,720 b/d, some 13.5% below Bahrain's half of the daily capacity. By contrast in Q2, production rebounded to 163,218 b/d, the highest figure seen in recent years. This rebound was sufficient to bring the first-half average to just under 145,000 b/d.

Production was stable on the offshore Bahrain field where it averaged 42,616 b/d. This was almost identical to the 42,669 b/d average seen in Q1. However, it was 2.9% lower than in Q2 of 2017. Discussions are reportedly underway with Schlumberger about bringing in enhanced recovery techniques to the Bahrain field.

Crude oil production, b/d



Source: National Oil and Gas Authority

Work is also starting on developing the newly confirmed deep gas reserves and the offshore Khalij al Bahrain field which is the largest oil discovery in Bahrain's history. Estimates made by the US oil services company Schlumberger describe the oil field as a borderline "conventional-unconventional play," which suggests that extraction cost could be significantly lower than with many shale fields. Seismic studies conducted to date indicate that the field has 81.5bn barrels of light oil. Tentative estimates of capacity production are around 200,000 b/d, which, if achieved, would double Bahrain's current output. To date, Halliburton has been engaged to drill two wells.

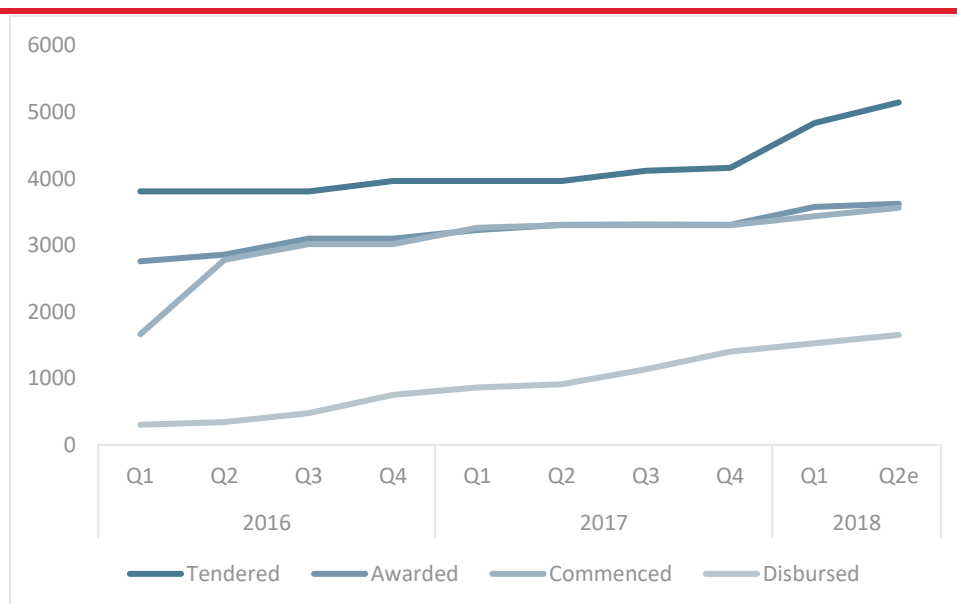
Talks are reportedly underway with Haliburton for developing the pre-Khuff gas resources which are in layers below the Bahrain field. There are plans to drill six wells over a 2-3-year period. The pre-Khuff deposits are split between two formations – Jubah and Jauf – and are estimated to have 10-20trn cu ft of gas. More than 5trn cu ft is expected to be recovered. Capacity production has been estimated at up to 1bn cu ft a day, which would be sufficient to meet local demand.

Renewed momentum from infrastructure

Unprecedented infrastructure investment has been a key source of non-oil growth and continuity for the Bahraini economy in recent years. After a period of rapid build-up, 2017 saw relatively slow growth in the construction sector, even as the secondary effects of infrastructure investments were making themselves felt across the non-oil sector. During Q1, construction activity once again accelerated markedly and there are a number of indications to suggest that the infrastructure narrative maybe about to enter another period of scaling up.

Among other things, the GCC Development Fund saw a rapid increase in the pipeline of tendered projects to a cumulative total of just over USD5.1bn. This compared to less than USD4.2bn at the end of 2017 and should begin to push up the volume of active projects and the related cash flow over the coming year. The cumulative aggregate volume of active projects exceeded USD3.5bn in Q2 while the total cash flow to date rose to some USD1.65bn as compared to USD913mn a year earlier.

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



Source: Government sources

Also private and semi-government projects are making headways. USD170mn of contract awards were reported in Bahrain during the month of April. This included the Amazon Web Services Region, a new Marriott Residence Inn, and two major residential real estate developments: Canal View on Dilmunia Island and Danat al Baraka. The recent Gateway Gulf Investors Forum showcased some USD26bn worth of infrastructure projects open to private investment. Around USD18bn of these are investment ready.

Going forward, significant projects include:

- ✦ The USD4.2bn Bapco expansion, which is expected to boost revenues by some USD1bn. The project is undertaken by a consortium involving Technip FMC, Tecnicas Reunidas, and Samsung Engineering. It will boost the output of the region's oldest refinery from 267,000 to nearly 400,000 b/d

Significant infrastructure investments are breaking ground this year

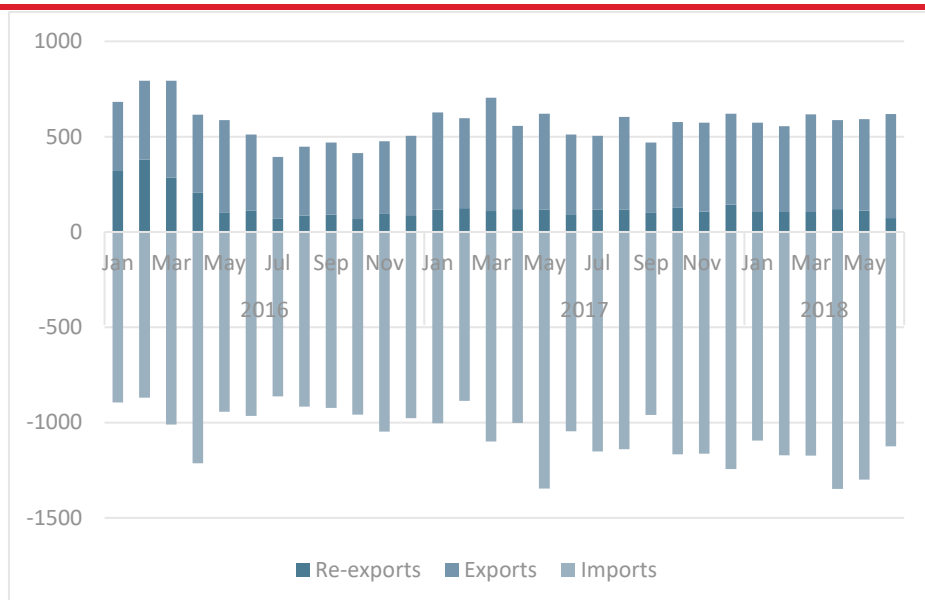
- ✚ Bahrain is currently building a 6mn tn LNG terminal which is likely to be needed for peak time imports. It could also pave the way for regional trading opportunities once connected to a regional gas grid which is being planned
- ✚ USD4bn to be spent over the coming five years on power-related projects ranging the Al Dur 2 power and desalination plant to a 400 kv transmission and distribution network. Bahrain has 3,921MW of existing power generation capacity and 186mn gallons/day of water desalination. The USD2bn Al Dur 2 facility is expected to add 1,200-1,500 MW of power and 50mn imperial gallons a day of desalination capacity. The project is to be executed on a public-private partnership basis with a 20-year purchase agreement. This is in line with most power and water projects in the Kingdom. Peak consumption last year reached 3,572 MW and 166mn gallons, respectively. Power demand is expected to almost double to 6,500 MW according to the 2030 masterplan. Al Dur 2 is expected to be commissioned in 2020. Consortiums led by Acwa Power and Sumimoto have submitted bids for the project
- ✚ Bahrain has also set formal targets for renewable energy which is to account for 5% of all power generation (some 225 MW) by 2025 and 10% by 2035. The Electricity and Water Authority (EWA) is studying concept proposals for a 100 MW PV plan on the Askar landfill site. A developer is expected to be appointed by the end of the year. The first solar project in the country, a 5 MW distributed PV facility, was commissioned in 2014
- ✚ The Ministry of Housing has a target of building 40,000 housing units by 2022. 5,000 of these have been delivered to date and a further nearly 9,000 are due to be made available by the end of the year. An additional 4,000 units are under construction and 7,000 at the tendering stage. The Ministry is overseeing developments in East Hidd, East Sitra, Al Ouyoun, Northern Town (al Madinah al Shamaliyah), Ramli, and Southern City
- ✚ PPPs have been applied in social housing since a BHD208mn pioneering project for 2,400 units in 2012. A new Mazaya scheme allowed individuals to fund their home purchases through bank loans that are guaranteed and subsidized by the government. Beneficiaries of the program contribute 25% of their monthly income toward repayments. Mazaya has been applied to a 3,100-unit, BHD276mn development in Diyar al Muharraq. Mazaya has received 2,650 applications in recent years
- ✚ The Public Transport Masterplan 2030 envisages a 184 km transit network made up of six lines. Work is currently underway to start development of the first phase of a light rail project which will have a total length of 30 km and 20 stations.
- ✚ Bahrain Airport Company has invited bids for the design and construction of a cargo express village. Also the nearby Khalifa bin Salman port is expanding its capacity. It witnessed a 21% increase in cargo volumes and a 7% rise in container traffic in 2017. A new USD1.1bn passenger terminal is due to be completed next year. The airport is expected to see an increase in its passenger capacity from nine to 13mn by 2020
- ✚ Gulf Air expects seven new aircraft by the end of the year. Apart from Boeing 787 Dreamliners, the company is procuring Airbus A320neo's

- ✦ Ajmera Mayfair Global Realty, a partnership between two leading real estate developers from India, announced a USD250mn project in May. The joint venture came together to deliver the tallest residential towers in Bahrain, The Golden Gate Towers, at Bahrain Bay. The project comprises of 750 luxurious mixed residential freehold apartments along with retail in the heart of Bahrain

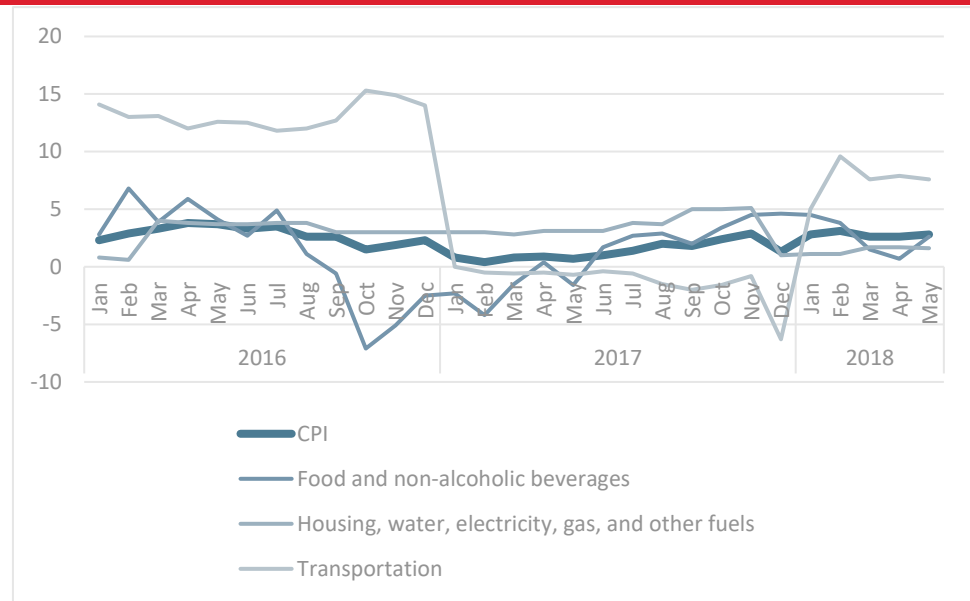
Trade volumes stable

Non-oil trade volumes in Bahrain have been largely stable over the past year. The aggregate value of goods exports of national origin during 1H18 totalled just over USD2.9bn. Re-exports added up to USD618.6mn. Imported merchandise reached a value of USD7.2bn.

Non-oil trade, USD mn



Consumer price inflation, % YoY

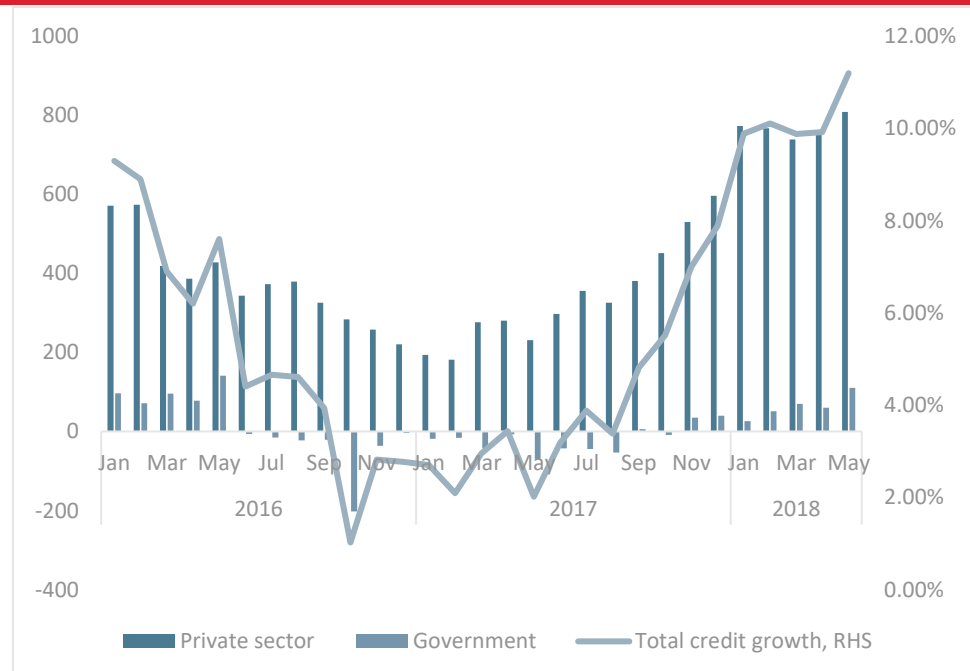


Source: Information & e-Government Authority

Brisk lending and deposit growth

The retail banks in the Kingdom have seen a clear and sustained increase in their activity over the past year. The annual rate of growth of bank loans shot up from 2% in May 2017 to 11.2% in May 2018. While the lending has been primarily due to an increase in new credit to the private sector, also lending to the Government has shown a small increase.

YoY growth in credit issued by retail banks, BHD mn



Source: Central Bank of Bahrain

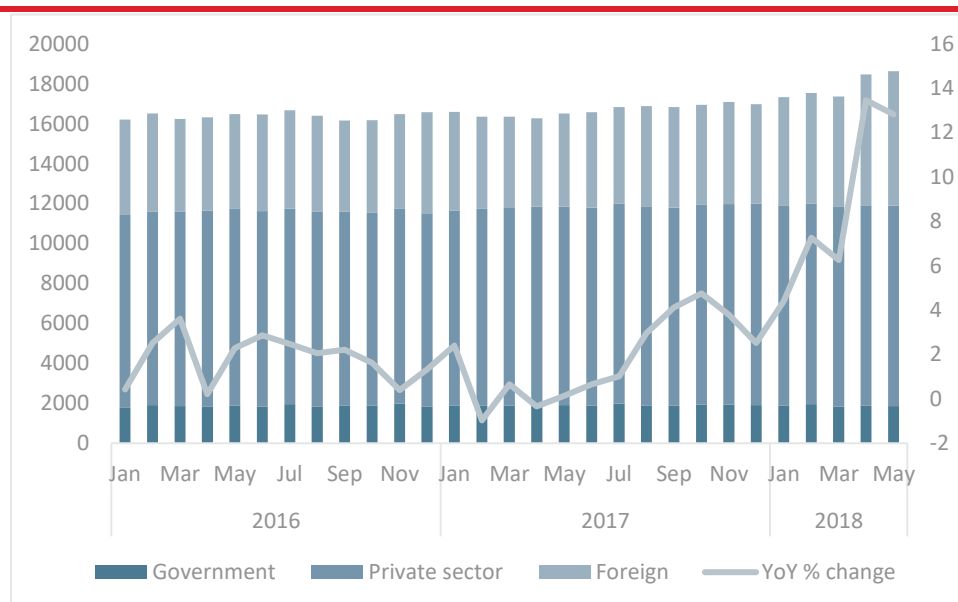
Lending by Bahraini retail banks has accelerated to an annual pace of more than 10%

Deposit growth has accelerated to almost 4% YoY

As of May 2018, loans to the business sector stood at BHD4.84bn and made up 53.1% of the total portfolio of local retail banks. Business lending rose by 14.1% as compared to May 2017. Loans to the Government sector rose by an annual 44.7% to reach BHD356.8mn – still a relatively modest 3.9% of the total loan book. Personal loans saw the slowest pace of growth – 5.7% -- and reached 43% of the aggregate total.

Within the business loan segment, credit to the Construction sector was the largest single component, making up 36.3% of the total. The Trade sector accounted for 23.8% and Manufacturing for 16.6%. The manufacturing sector has seen a particularly rapid increase in credit over the past year in reflection of the several new investment projects in this area. The manufacturing loan books expanded by 36.5% over the past year. In the personal segment, mortgage lending has grown at an annual pace of 12.2% to reached BHD1.76bn.

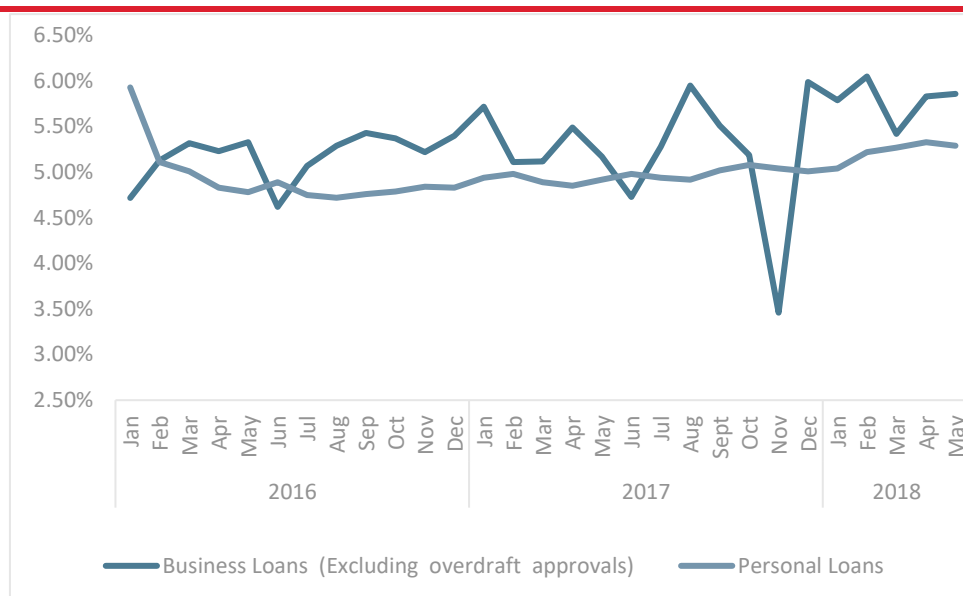
Deposit liabilities to non-banks, BHD mn



Source: Central Bank of Bahrain

The fast lending growth is doubtless in part reflective of a rapid acceleration in deposit growth over the past year. The YoY rate of increase in retail bank deposits rose from 0.1% in May 2017 to 12.8% a year later, indeed outpacing the rate of credit growth.

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



Source: Central Bank of Bahrain

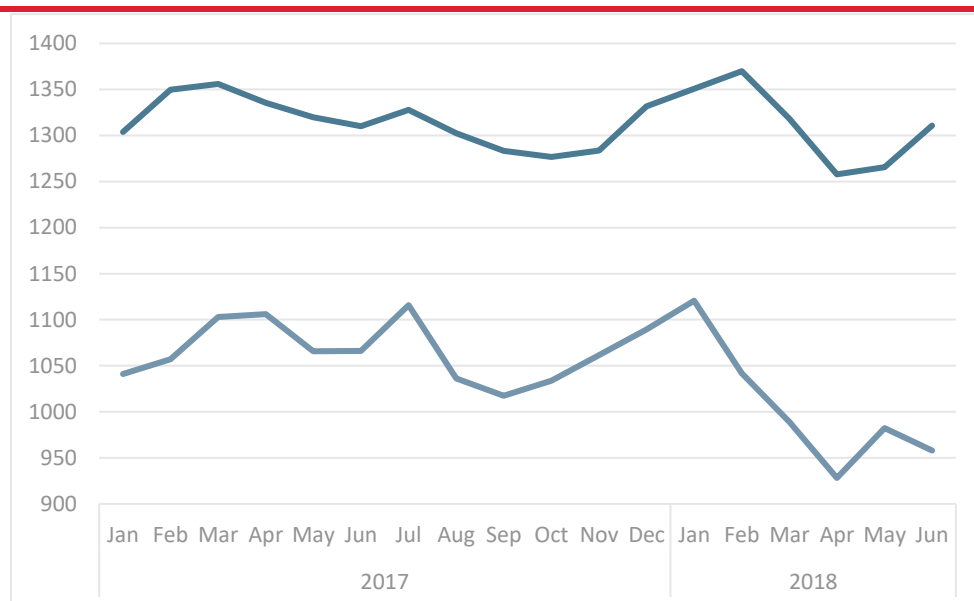
Lending costs have continued to edge up, albeit very gradually

The cost of capital has continued to edge up very gradually, to an extent in reflection of higher policy rates following the Fed hikes. The average cost of conventional business loans was 5.9% in May, as compared to 5.2% a year earlier. The monthly average during the first five months of 2018 was 5.8%, which compared to 5.3% a year earlier. The cost of personal loans averaged 5.3% in May, up on 4.3% a year earlier. The average over the first five months of 2018 was 5.2%, which compared to 4.9% for January-May 2017.

A flat Q2 for the Bourse

The equity markets in Bahrain have mirrored their regional peers. The Bahrain All Share Index (BAX) shed 1.56% during the first half of the year, even with a clear improvement in performance in May-June. The Bahrain Islamic Index, by contrast, declined by 12.05%. The market capitalization of the Bourse reached BHD8.04bn by the end of June.

Bahrain All Share Index and Bahrain Islamic Index

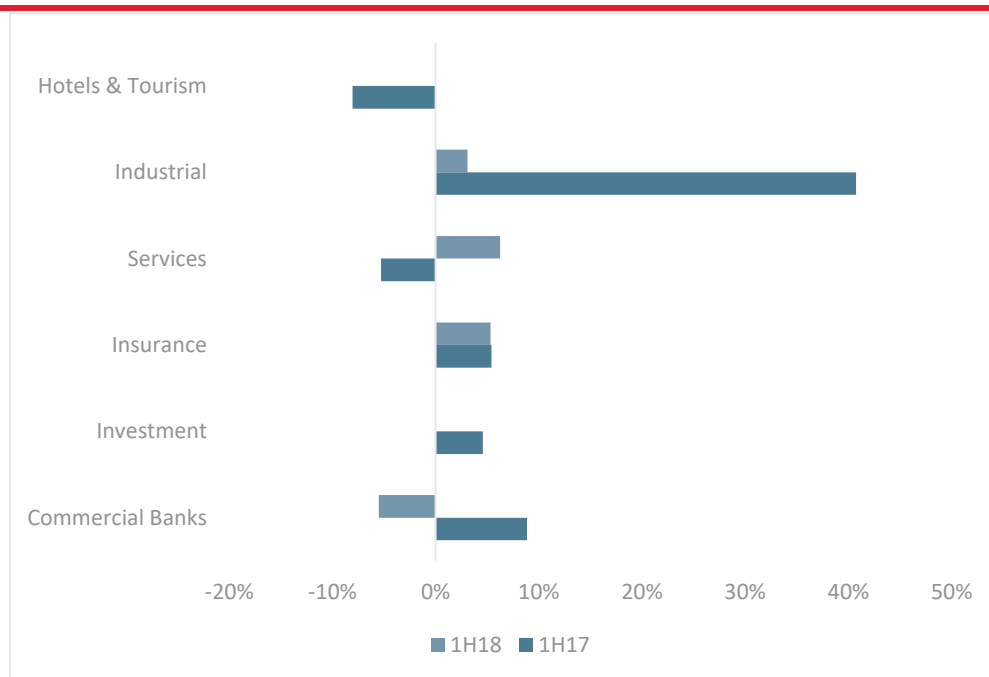


Source: Bahrain Bourse

Services was the strongest sector index during a generally flat 1H18

Among the sector indices, the Services sector was the best performer during 1H18 in a full reversal of its laggard status a year earlier. The Services index increased by 6.25% during the first six months of the year. It was followed by the Insurance sector which posted a 5.31% YTD gain. The Industrial sector advanced by 3.09%, which stood in marked contrast to a spectacular year in 2017. The Commercial Banks sector, having been among the best performers a year earlier, shed 5.51% and remains the only sector index in the red for the year to date.

YTD changes in sectoral stock market indices, 1H2017 and 1H2018



Source: Bahrain Bourse

Securities issued by the Central Bank have continued to see some upward pressure on rates

In the fixed income space, the Central Bank of Bahrain issued Government Development Bond No. 16 at the end of April. The BHD300mn issue was fully subscribed and has a maturity of two years. The bond pays an expected interest rate of 5.5%.

In addition, short-term bond and sukuk issuance by the Central Bank has continued along the regular schedule. The total outstanding value of Government Treasury Bills reached BHD2.11bn by the end of the quarter. A clear increase in the interest rates has become evident toward the end of the quarter.

Short-term bond and sukuk issues arranged by the Central Bank of Bahrain

Issue date	Issue	Value, BHD mn	Maturity, days	Average interest/profit rate, %	Average price, %	Over-subscription, %
1 Apr 2018	Treasury bill No. 1697	35	182	3.61	98.207	111
4 Apr 2018	Treasury bill No. 1698	70	91	3.33	99.166	143
11 Apr 2018	Treasury bill No. 1699	70	91	3.32	99.167	196
12 Apr 2018	Sukuk al ijarah No. 148	26	182	3.60		100
18 Apr 2018	Sukuk al salam No. 204	43	91	3.32		100
25 Apr 2018	Treasury bill No. 1700	70	91	3.33	99.166	144
26 Apr 2018	12-month Treasury bill No. 44	100	365	3.97	96.142	123
2 May 2018	Treasury bill No. 1701	70	91	3.35	99.161	101
9 May 2018	Treasury bill No. 1702	70	91	3.36	99.158	100
10 May 2018	Sukuk al ijarah No. 153	26	182	3.61		100
13 May 2018	Treasury bill No. 1703	35	182	3.65	98.190	100
16 May 2018	Treasury bill No. 1704	70	91	3.40	99.147	100
23 May 2018	Sukuk al salam No. 205	43	91	3.40		100
30 May 2018	Treasury bill No. 1705	70	91	3.55	99.110	111
31 May 2018	12-month Treasury bill No. 45	100	365	4.18	95.946	100
3 Jun 2018	Treasury bill No. 1706	35	182	3.84	98.097	102
6 Jun 2018	Treasury bill No. 1707	70	91	3.62	99.094	122
13 Jun 2018	Treasury bill No. 1708	70	91	3.75	99.061	114
14 Jun 2018	Sukuk al ijarah No. 154	26	182	3.90		100
20 Jun 2018	Sukuk al salam No. 206	43	91	3.75		100
27 Jun 2018	Treasury bill No. 1709	70	91	3.95	99.011	100
28 June 2018	12-month Treasury bill No. 46	100	365	4.39	95.753	100
1 Jul 2018	Treasury bill No. 1710	35	182	4.17	97.936	129
4 Jul 2018	Treasury bill No. 1711	70	91	3.93	99.017	127
11 Jul 2018	Treasury bill No. 1712	70	91	3.94	99.013	123
12 Jul 2018	Sukuk al ijarah No. 155	26	182	4.14		100
18 Jul 2018	Sukuk al salam No. 207	43	91	3.94		100

Source: Central Bank of Bahrain

In an important new development for the Bahraini financial sector, two pioneering funds were announced during Q2:

- ✦ Bahrain Development Bank announced a USD100mn venture capital fund of funds named 'Al Waha' which is designed to support innovative start-ups. The fund will work through venture capital funds with a presence in Bahrain, thereby helping to foster the expansion of the local ecosystem
- ✦ Bahrain has unveiled plans to set up a USD1bn private equity fund to provide financing for energy projects. The entity is being set up by the National Oil & Gas Authority, Osool, and the Securities & Investment Company (SICO). This pioneering venture represents a novel opportunity to channel private capital into a sector that has historically been entirely in the hands of the state. For the first time, investors will gain access to a diverse portfolio of highly profitable and strategic projects

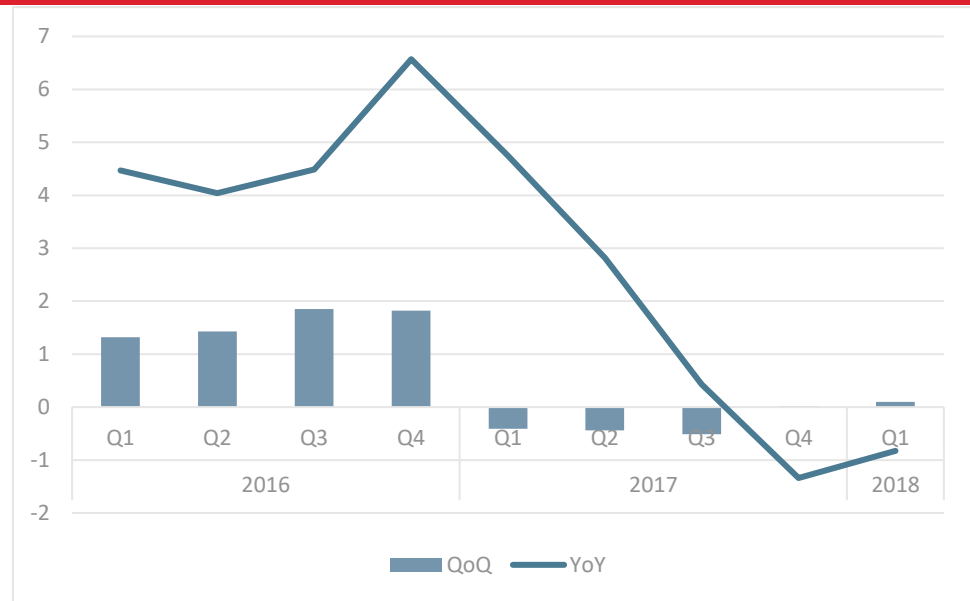
Job creation beginning to stabilize

After a year of pronounced declines in the rate of new job creation, the negative trend appears to have stalled. The YoY change in the number of Social Insurance Organisation contributors, ie registered employees, was -0.8%. This compared to -1.3% in 4Q17 and 4.8% a year earlier in 1Q17. More encouragingly, the quarter-on-quarter change in the number of employees has turned slightly positive since 4Q17 having been below zero for the preceding three quarters. The QoQ change in Q1 was 0.1%.

The total number of Bahraini contributors in Q1 was 146,632. Of this total, 63.2% worked in the private sector. Bahraini women made up 39.6% of the national labour force. Their share in the private sector was 33.8%, while they accounted for 49.1% of the public sector labour force. The total number of Bahraini contributors was 1.3% higher in Q1 than a year earlier. By contrast, the number of non-nationals registered by the SIO declined by 1.4% YoY.

The recent negative trend in job growth is showing signs of reversing

Change in Social Insurance Organisation contributors (%)



Source: Social Insurance Organisation

External assessments

Index/report	Description	Global rank	MENA rank	Key strengths highlighted
Prices and Earnings Report by UBS	Compares the cost of living in 77 cities globally on the basis of four indicators: ✦ Prices ✦ Earnings ✦ Purchasing power ✦ Working time	8	1 in GCC	Manama is the most affordable city GCC and particularly competitive in the area of housing costs
Global Startup Ecosystem Report by Startup Genome and Global Entrepreneurship Network	Evaluates start-up ecosystems globally. Evaluates different verticals with a view of identifying areas for growth			Bahrain's start-up ecosystem recognized among the top global entrepreneurial ecosystems to watch for. Particular areas of strength: ✦ Fintech ✦ Gaming
Global Location Trends 2018 by IBM	Analyses latest trends driving company decisions on locating their operations globally and seeks to identify the factors behind these choices.	13	2	The estimated number of jobs (per million inhabitants) is estimated at 1,500

KEY SECTORS

BOOSTING THE BUSINESS CLIMATE

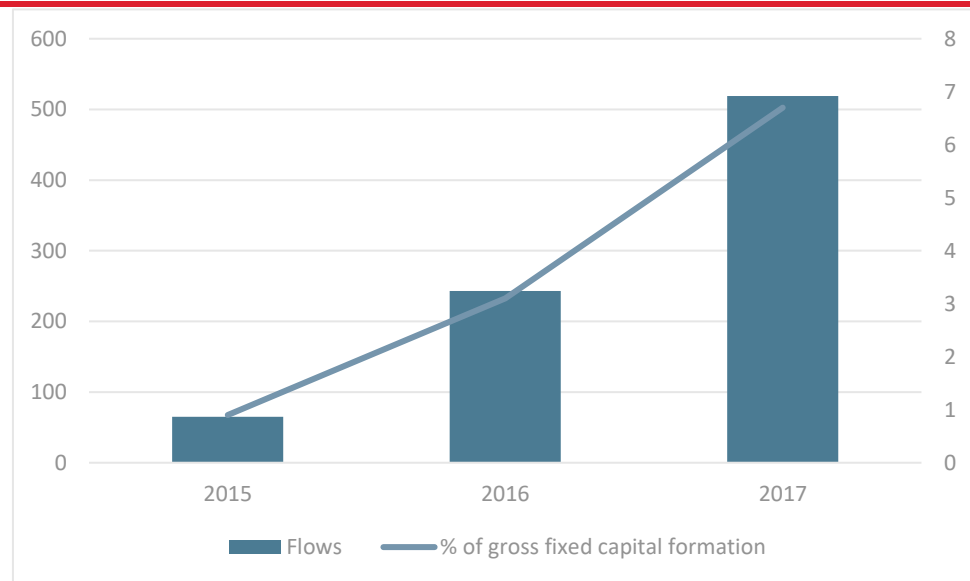
Strong momentum in FDI inflows

The 2018 edition of the *World Investment Report* (WIR) published by the United Nations Conference on Trade and Investment (UNCTAD) confirms the recent positive momentum in foreign direct investment inflows into Bahrain. According to the report, total foreign directly investment in 2017 reached USD510mn, up a remarkable 113.6% on the 2016 total of USD243mn. Inward FDI accounted for 6.3% of gross fixed capital formation in the Kingdom. This was nearly double the 3.3% for the “West Asia” (Middle East) region.

The improvement has materialized in a challenging environment where overall global FDI Flows actually contracted by 23% in the course of 2017. This was due to contracting value chains, a 22% drop in cross-border mergers and acquisitions, a 14% decline in greenfield investments, and protectionist tendencies, among other things. Even FDI inflows into the West Asia region declined from USD31bn in 2016 to USD26bn in 2017.

Total inward FDI stock in Bahrain rose from USD25.1bn in 2016 to USD26.6bn in 2017. This amounted to 77.5% of GDP. Overall, the inward FDI stock in Bahrain has hovered around 80% of GDP in recent years and is thus far higher than the 35.4% figure seen in 1995. In the West Asia region as a whole, the average inward FDI stock as a percentage of GDP stood at 28.6% in 2017.

Inward FDI flows, USD mn



Source: *World Investment Report 2018, United Nations Conference on Trade and Investment*

According to UNCTAD data, Bahrain has seen a steady increase in inward FDI in recent years

New regulations boost the business climate

A number of important laws have received approval in recent months:

- ✦ The month of May 2018 saw the approval of the Re-organization and Bankruptcy Law 22/2018. The new law updates the rules covering insolvency proceedings with a view to expediting the process and creating a more conducive climate for investment and entrepreneurship. As an important innovation, the law provides for restructuring and rehabilitation when possible. It endeavours to achieve an equitable distribution of receipts among creditors in accordance with the rule of preferential, preferred and ordinary rights
- ✦ The new Personal Data Protection Law No 30 of 2018 governs the use of personal data and its free movement. It applies to personal data which is processed electronically or obtained, collected and extracted for electronic processing, or processed through a combination of traditional and electronic methods. It grants individuals the right and control over their personal data. An individual has the right to review any of their personal data that is being stored, and to request any modifications or corrections where the information is inaccurate. Added protection is afforded to certain types of personal data, namely information relating to race, religious beliefs, children, health, relationships, and criminal records which may only be processed after obtaining formal permission from the regulator. The law further promotes the efficient and, secure and effective processing of big data for commercial use. It also provides guidelines for the transfer of data across borders. The law recognizes the strategic significance of data protection as a key enabler of the Digital Economy. The Law draws extensively on the EU Data Protection Directive of 1995 and the subsequent General Data Protection Regulation of 2018. Bahrain is the first country in the GCC to have a nationwide standalone Data Protection Law
- ✦ The Protection and Promotion of Competition Law No 31 of 2018 seeks to safeguard market competition by regulating anti-competitive conduct by companies. The law applies to commercial activities and regulates agreements, decisions, and practices that limit market competition. It regulates the abuse of monopolies and dominant market positions, as well as any other acts or actions that may result in the prevention, restriction or distortion of competition. The law assigns the responsibility for enforcement to a Competition Authority or an independent entity to be determined by decree. The overall role of this agency will be to maintain and enhance an efficient market conduct and promote overall productivity, innovation and competition of markets in Bahrain as well as to eliminate or control practices that may have an adverse effect on market competition.

Important new laws were introduced in Q2 to improve data protection, competition, and facilitate insolvency proceedings

Boosting venture capital

The Bahrain Development Bank (BDB) on 24 June announced that it had successfully closed its USD100mn fundraising for its Al Waha fund of funds. This represents an important milestone in Bahrain's ongoing efforts to position itself as an innovative startup hub characterized by a comprehensive ecosystem. The new vehicle was set up with the objective of creating a platform for investments in venture capital funds and, through them, in innovative, tech-based start-up companies. The limited partners include Mumtalakat, National Bank of Bahrain, Batelco Group, and Tamkeen with BDB as the general partner managing the fund. The new venture is not restricted to Bahrain, but will have the ability to operate the broader Middle Eastern region. The

Limited Partners Advisory Committee met in late June to also allocate \$35m into a series of venture funds.

FinTech Consortium (FinCon) – the operator of Bahrain FinTech Bay – and Washington DC-based Georgetown University's McDonough School of Business announced a partnership in late April to collaborate on Fintech innovation and education initiatives. Possible collaborations include the development of Fintech certificate and degree programmes, joint innovation labs, joint research and publication, and the exchange of Fintech ecosystem data.

The first-ever Bahrain Start-up Ecosystem Report, a data-driven initiative by Bahrain FinTech Bay (BFB) which was launched earlier this year, was released in early July. The report based on research, interviews and surveys is intended to serve as a guide for policymakers, investors and entrepreneurs. The launch event was organised by the Industry, Commerce and Tourism Ministry in an effort to familiarise businesses and companies to various services and solutions in FinTech and to benefit from what eCommerce has to offer. The discussions focused on four main areas: digital advisory, data analytics, blockchain and related legislations.

In late May the local firm Bridge Insurance and Reinsurance Brokers received regulatory approval from the Central Bank of Bahrain (CBB) to launch Bahrain's first online insurance comparison portal in the third quarter of the year. The ultimate goal is to boost overall insurance penetration in the Kingdom.

Important initiatives have been unveiled also at the level of individual companies:

- ✦ In early June, Bahrain Islamic Bank inaugurated its Innovation Lab. The bank seeks to foster innovation within the emerging Fintech industry. Efforts to this end will involve a range of new technologies such as robotics, digital banking services, instant chequebook- and card-printing services
- ✦ The CBB in June granted a regulatory sandbox license to the operator of Palmex, a Dubai-based cryptocurrency exchange
- ✦ The Information & eGovernment Authority (iGA) signed a Memorandum of Understanding (MOU) in early April with The BENEFIT Company (BENEFIT) to develop the ePayment services of government transactions and provide services that facilitate management of processes on banking and other entities. The goal is to strengthen the cooperation between iGA and BENEFIT within the IT sector, and pose a possibility of conducting more financial transactions and bill payments

*Financial sector
employment continued
to grow in 2017*

The number of employees in the Bahraini financial sector in 2017 reached a total of 14,093 employees, which marked a small increase on the 2016 total of 14,015:

- ✦ Employment in the banking sector rose to a total of 7,447, as compared to 7,402 at the end of 2016
- ✦ Employment in non-bank financial services (insurance, money changers, finance companies, investment companies, and other non-bank financial institutions) increased by 0.6%, taking the total to 6,194
- ✦ the number of employees in supporting institutions decreased from 457 employees in 2016 to 452 employees at the end of 2017.

According to the annual survey conducted by the Central Bank of Bahrain, the Bahraini national workforce employed by the financial services sector reached 9,248 in 2017, an increase of 93 jobs. Bahrain nationals represented 65.6% of total financial sector workforce. Bahraini women accounted for 38.3% of total Bahraini workforce.

ICT innovation

Bahrain Islamic Bank signed a Memorandum of Understanding (MoU) in early April with Flat 6 Labs Bahrain to bring a leading regional accelerator to Bahrain in partnership with Tamkeen. The facility was formally launched in July. The same operators currently also manage accelerators in Cairo, Jeddah and Abu Dhabi. The programme has helped develop over 75 companies backed up by more than 300 entrepreneurs. This expertise has brought forward the acceleration of more than 140 start-ups in over 20 cycles across the MENA region since 2011.

Huawei hosted a series of 4 workshops organised in partnership with local carriers and regulators in April and May by gathering a line-up of industry leaders and experts to accelerate the arrival of 5G in Bahrain. A series of keynotes and seminars were conducted by regional ICT experts to discuss challenges and opportunities in 5G wireless communication in addition to the impact 5G will have on key vertical sectors in the region.

The launch of the Batelco Gulf Network marks a milestone for boosting digital connectivity in the region

Batelco, Bahrain's leading digital provider announced the launch of Batelco Gulf Network (BGN), a new international cable system that provides the GCC region with an additional option for regional and international connectivity solutions. The initiative is part of Bahrain's plan to develop world class advanced infrastructure in line with the Kingdom's aspirations to be regional leader in ICT. Batelco also teamed up with Brinc, to officially launch a new operation in July known as the Brinc-Batelco IOT (Internet of Things) Hub, which will offer services and opportunities for IoT hardware startups and entrepreneurs. Brinc MENA provides openings for startups in the region through their program that offers access to mentorship, product design and development guidance, manufacturing, and exposure to regional and global investors and markets.

Manufacturing expansion

Mondelez International inaugurated a new USD90mn factory in Bahrain in early April. The group's second production facility in the Kingdom will manufacture renowned household snack brands to serve growing demand across the Gulf region, the Levant and Africa. The factory will create 300 new direct jobs and, in combination with Mondelez's earlier facility, will produce over 150,000 tn of food items per year.

Italy's Ariston Thermo will be opening a 7,000-sq m plant in Bahrain International Investment Park, its first Middle East facility, which will produce up to 250,000 electric water heaters for export across MENA.

Malaysia's Power Root, the manufacturer of Alicafe coffee mix and other instant hot beverages, will be investing over USD14mn in a large production facility in Bahrain International Investment Park (BIIP).

The Ministry of Industry, Commerce, and Tourism have recently reduced the timeframe for industrial land applications guaranteeing a cap of 18 days for processing all complete applications. To further improve efficiency, the Ministry has set an objective of launching an online land application service in 2018. The ability to access the land application form on the Ministry's website is designed to improve turnaround times and convenience.

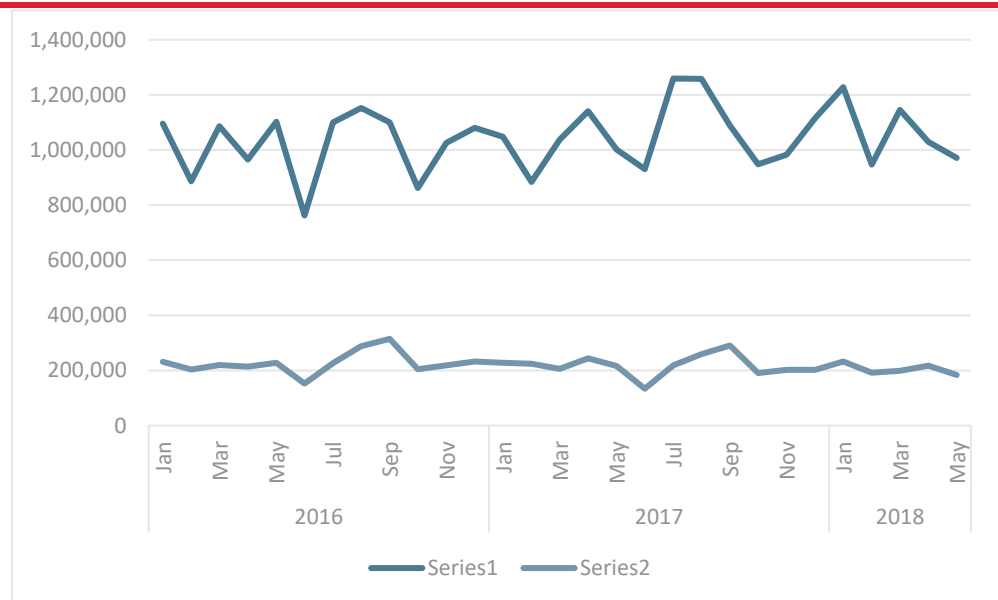
Tourism developments

A period of intensive capacity build-up is continuing to unfold in the tourism sectors:

- ✦ Bahrain Marina Development Company has signed an agreement with Shangri-La Hotels & Resorts to operate their new facility on Manama's Fateh Corniche. Located in a 310,000 sq mixed use development, the facility will have 250 rooms, 150 suites, eight chalets, and 21 waterfront villas. The first phase of the Bahrain Marina project is due for completion in 2020 and hotel is expected to open in 2022
- ✦ The southwest of Bahrain is emerging as an important focus for the future development of the tourism sector. The Al Sahel resort will be built on the coast with 1.25 km of beach. It will provide conventional hotel accommodation, villas, and a range of other facilities. The project is jointly owned by Mumtalakat Holding Co and Dubai Properties Group. The hotel and spa will be managed by Jumeirah Group. The USD250mn facility will be part of a large Bilaj al Jazayer masterplan development, which will involve two anchor resorts along with a number of private developments

Important tourism-related infrastructure developments are underway in the southwest of Bahrain

Visitor arrivals by port of entry



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

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