



Bahrain Economic Quarterly

March 2018

SUMMARY

2017 EXCEEDS EXPECTATIONS

Economic growth in Bahrain accelerated markedly in 2017. The positive momentum was due to unprecedented infrastructure spending and a range of other positive non-oil growth drivers. With the regional backdrop set to become more favourable, much of this favourable dynamic is expected to carry over to 2018.

- ✦ **Bahrain's real GDP expanded by a robust 3.9% in 2017.** This marked a clear acceleration on the 3.2% pace recorded in 2016. Growth remained strong throughout the year and reached an annual rate of 3.4% in Q4. The positive growth drivers in the area of infrastructure spending and regulatory reform can be expected to deliver growth continuity in 2018 as well
- ✦ **Growth was firmly led by a 5% expansion in the non-oil economy.** This was markedly ahead of the 4.0% pace recorded in 2016. By contrast, the oil sector recorded a small, 0.7% contraction. Non-oil growth stood at 3.8% YoY in Q4 while the oil sector expanded by 1.3%
- ✦ **The regional growth environment augurs well for 2018.** Business confidence and growth momentum are set to benefit from stronger oil prices as well as a more permissive fiscal policy stance. Ongoing fiscal consolidation efforts, notable the introduction of VAT in Saudi Arabia and the UAE, are expected to have a fairly ephemeral impact on growth dynamics
- ✦ **Global growth outlook generally positive, although market uncertainty appears to be on the rise.** Growth prospects for the global economy look generally favourable. However, a gradual tightening of monetary policy has delivered bouts of volatility in the financial markets and there is mounting concern about protectionist trends

Bahrain economic outlook

	2016	2017e	2018f	2019f
Real GDP growth, %	3.2%	3.9%	3.5%	3.1%
Non-hydrocarbons sector	4.0%	5.0%	4.4%	3.6%
Hydrocarbons sector	-0.1%	-0.7%	-0.7%	0.0%
Nominal GDP growth, %	3.4%	9.8%	7.3%	6.5%
Inflation (CPI %)	2.8%	1.4%	2.2%	3.5%
Current account (% of GDP)	-4.6%	-3.8%	-3.5%	-3.2%
Fiscal balance (% of GDP)	-13.6%	-11.0%	-9.8%	-6.4%
Crude Oil Brent (USD)	44	53	63	63

Source: Bahrain Economic Development Board

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GLOBAL ECONOMY

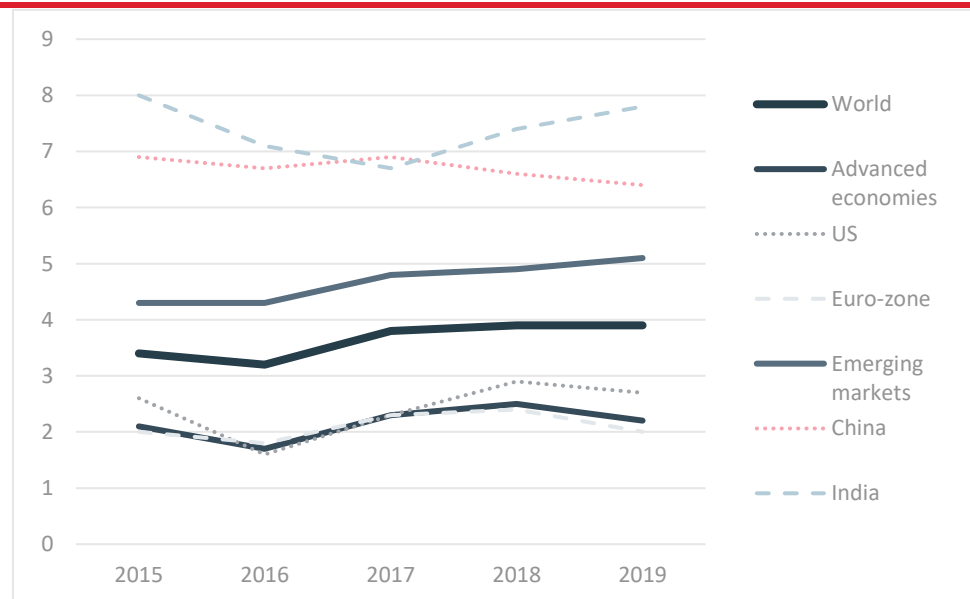
FASTER GROWTH, MARKET VOLATILITY

The global economic outlook is benefiting from stronger fundamentals but gradual monetary tightening has delivered bouts of financial market volatility

The global economy has continued to emerge from its decade of malaise with remarkable speed. This has manifested itself in a clear acceleration of global growth dynamics but has also triggered a retreat from an era of ultra-loose monetary policy. Some indications now suggest that the this process could further accelerate in the near- to medium-term. This has somewhat dented the ebullient market optimism of last year and resulted in periodic equity market corrections, some of them quite sharp by historical standards. The adoption of protectionist trade measures by the US and China has also stoked market anxiety and may well spell greater market volatility even if underlying growth dynamics are set to remain strong.

According to the latest International Monetary Fund (IMF) projections, the near-term global growth prospects remain very favourable by recent historical standards. Growth in 2017 is likely to have exceeded expectations by a fairly clear margin with global real GDP growth estimated at 3.8%. This pace is likely to be maintained in the near-term with 3.9% growth projected for this year and next alike. The advanced economies have seen a clear improvement in their growth dynamics, posting 2.3% growth in 2017 and a projected 2.9% this year before a renewed deceleration to 2.2% in 2019. Growth has been led by the US but also the Euro-zone has escaped its relative stagnation and performed much better than its recent norm. Emerging market growth is set to remain in the neighbourhood of 5% with a very gradual deceleration in China coinciding with a clear acceleration in India.

Global growth projections (%)



Source: World Economic Outlook, April 2018, International Monetary Fund

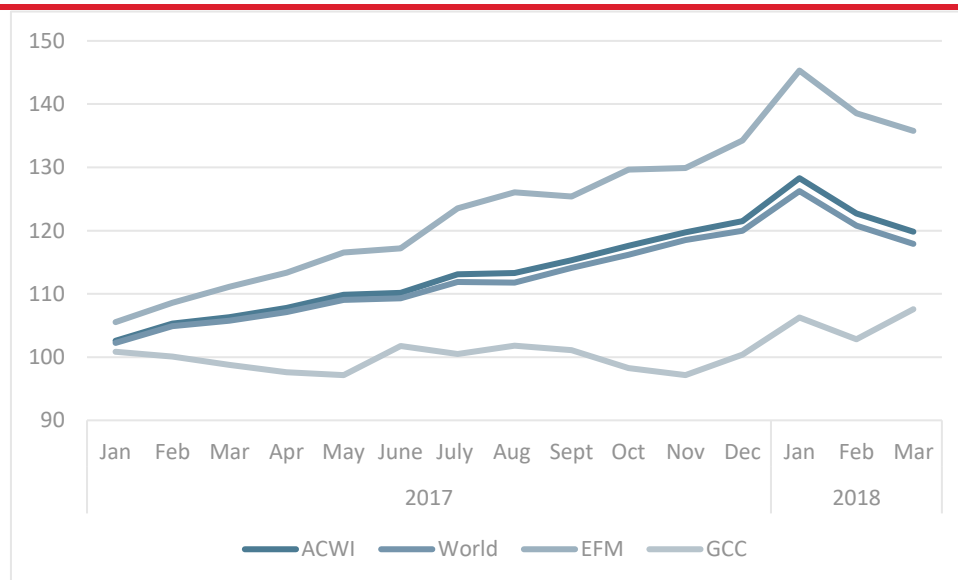
Monetary tightening set to accelerate

The first Open Market Committee (OMC) meeting of the US Federal Reserve chaired by Jerome Powell on 21 March resulted in a 25 bps increase in the Federal Fund Rate. This was the sixth raise during the current cycle and took the policy rate corridor to 1.5-1.75%. While the decision itself was in line with market expectations, it was accompanied by a palpable shift in expectation in favor of faster tightening in the months ahead. The official Fed view continues to suggest three 25 bps rate increases this year, but a growing number of OMC members, as well as external observers, now see a significant probability of four hikes during 2018. Also, projections going forward are becoming somewhat more hawkish. The expected number of rate increases in 2019 is 2-3 and in 2020, one or two.

The Fed's assessment of the US economy and near-term prospects has become more positive with the OMC noting that the outlook "has strengthened in recent months." The official growth projection for this year was revised from 2.5% to 2.7%, followed by 2.4% in 2019. The revised YoY growth figure for 4Q17 was a robust 2.9%. The positive momentum in the labor markets is expected to bring the official unemployment rate to 3.6% in 2019. In spite of this, inflation is not expected to exceed 2.1%, which is broadly in line with the Fed's target. annualized GDP growth for 4Q17 revised up to 2.9%

Monetary tightening by other central banks is likely to be more measured, although the gradual retreat from the ultra-loose monetary conditions is continuing, both in terms of policies and in rhetoric. This shift in expectations have ushered in a period of far greater financial market volatility. With central banks retreating from policies that have supported asset prices, even more favorable economic fundamentals are unlikely to suffice to maintain the positive market momentum of 2017. All major indices corrected significantly during Q1 and there have been recurrent bouts of historically elevated volatility. While this may eventually deter some of the policy hawks, it seems likely that the market environment this year will be far less predictable than in 2017.

Global equity market performance (Jan 2017 = 100)



Market expectations regarding interest rates have been moving in a hawkish direction. However, market volatility might serve as a countervailing force

Source: MSCI

Spectre of protectionism?

A broad-based commitment to free trade, reflected in sustained efforts toward further liberalization, are generally recognized as one of the main drivers of global growth in recent decades. During the era of globalization, the creation of international value chains has permitted significant efficiency chains through specialization and scale economies. However, the continuity of these trends has been in some doubt since the onset of the global financial crisis a decade ago. Many economies reacted to major dislocations through protectionism. At the same time, the impetus toward further integration has generally weakened as the benefits of free trade have come to be seen as unevenly shared.

Concern over further protectionist tendencies has generally grown in response to President Donald Trump's determination to shape external commercial relation in ways that "put America first." The US trade deficit with China is estimated at USD504bn. This year has seen concrete steps toward protecting certain American industries and intellectual property rights. In early March, the president approved 10% duties on aluminium and 25% on steel imports, although a number of exemptions were approved subsequently.

China in response imposed tariffs of up to 25% on USD3bn worth of US products, such as food and steel pipes. This quickly resulted in an escalation of tit-for-tat retaliatory measures. A report by the US Trade Representative's Office found that Chinese policies harm the US economy by at least USD50bn a year. This was used to justify further tariffs of some USD60bn along with investment restrictions in high tech activities. A 25% tariff will be applied in sectors such as aerospace, ICT, and machinery, with a clear focus on high technology. China has responded in kind and even intimated that the country might scale back its purchases of US Treasuries. Also, additional taxes on US companies have been mooted as a possibility. The latest Chinese package targeted the main categories of US exports. Soybeans, aircraft, and motor vehicles make up just under 30% of US exports to China. In all cases, the US is a major supplier, making up some 40%, 63%, and 30%, respectively of Chinese imports. Also fuels and plastics are heavily affected. The near-term outlooks remains one of further tensions.

The immediate impact of these announcements has been an increase in market volatility in response to a perceived increase in uncertainty. The longer-term implications, by contrast, are more difficult to discern. While protectionism may hold political appeal, it is not easy to implement, and concrete policies come at a cost given the high degree of global integration in many sectors. However, a protracted stand-off would test market sentiment and likely curb the growth of international trade. There is concern that potential trade wars would be more negative for emerging markets than for advanced economies.

A generally benign outlook for oil

After a major rally in oil prices during the second half of 2017, the increased market uncertainty in Q1 resulted in bouts of volatility. However, a firmer floor seems to be forming to support a price

Protectionist measures and posturing have emerged as a major source of market uncertainty, although their practical impact is likely to remain limited, at least for now

range in the 60s. Brent prices averaged USD66.81 per barrel in Q1. This was up 8.6% on the 4Q17 average and represented a robust 24.5% YoY increase.

The more upbeat price dynamic was due above all to brisk demand growth and renewed uncertainty on the supply side:

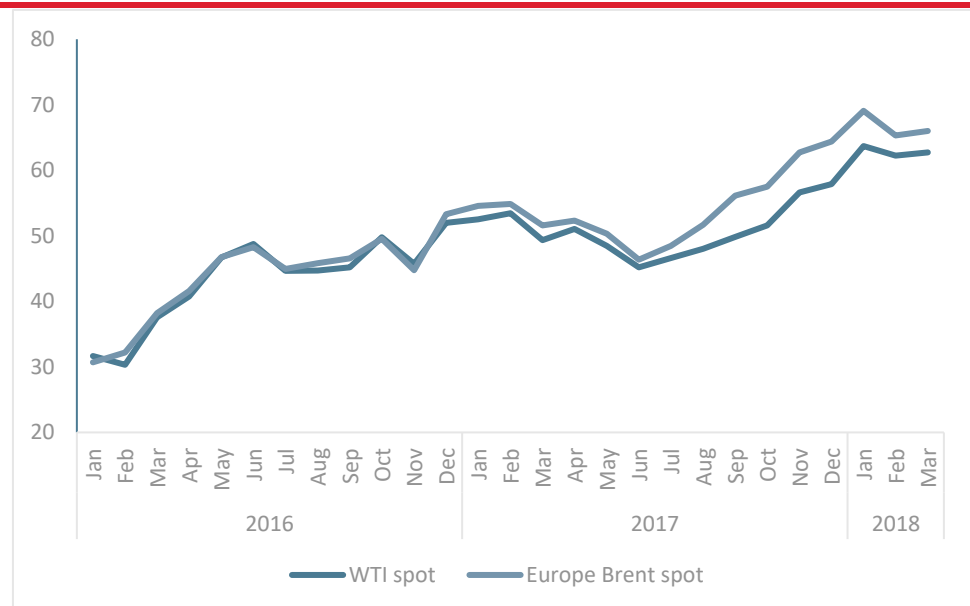
- ✦ With global economic growth continuing to rebound, the demand for oil remains on an upward trajectory. The International Energy Agency recently raised its global oil demand growth forecast for 2018 by 90,000 b/d to 1.5 mbd
- ✦ Even with US production growing at a record pace, new risks and uncertainties are raising concerns about global oil supplies. In particular, there is mounting alarm about Venezuela's plummeting production levels. Growing uncertainty around the Iranian nuclear deal has raised the prospect of renewed sanctions. In 2012, the imposition of sanctions cut Iranian exports by 1 mbd
- ✦ OPEC discipline has held firm on the output cuts. Compliance in February was estimated at a remarkable 138%

Financial market volatility has manifested itself in oil prices as well. However, stronger fundamentals have translated into an underlying positive trend

Even with the price outlook improving, the market rebalancing is proving a drawn-out process. For instance, inventories still remain above their five-year average which OPEC had previously identified as a key target to reach. Similarly, US production is increasing and the rig count has continued to edge up to 800. US oil production expected to increase by 1.3 mbd this year, some two-thirds of the projected non-OPEC increment.

Under the circumstances, members of the organization, as well as Russia, have suggested that production cuts might be extended into 2019. Perhaps even more importantly, Russia and Saudi Arabia have signalled their willingness to pursue longer-term oil market cooperation which could extend far beyond the expiry of the current round of output cuts.

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 Recent global developments have mixed implications for Bahrain:

- ✦ The improved growth prospects should be supportive of trade and export prices, although protectionism is a threat and may test market confidence
- ✦ Oil prices looks likely to remain more comfortable this year, which should make the necessary fiscal reform measures easier to implement
- ✦ Higher interest rates in the US will put upward pressure on the cost of capital and underscore the importance of the fiscal consolidation program. Bouts of market volatility would further amplify these trends

THE GCC REGION

ADAPTING TO NEW REALITIES

2018 is likely to deliver significantly higher growth than last year, with non-oil expansion accelerating and the oil sector no longer exerting a negative influence

The GCC region has embarked on 2018 with a significantly brighter growth outlook than last year. However, the regional non-oil sector is having to adapt to a new wave of fiscal consolidation measures, which is resulting in some short-term volatility in the growth dynamics. In particular, the introduction of VAT in Saudi Arabia and the UAE has clearly had an impact on the timing of key purchases, as well as on broader business confidence. On the other hand, business confidence can be expected to benefit from a more benign oil price environment.

The oil sector, which was a major drag of growth in 2017 because of the OPEC-led output cuts, should have a neutral or even mildly positive contribution to GDP growth this year. The combined effect of these developments points to stronger growth dynamics this year as compared to 2017.

Overall, GCC growth is expected to revert to its recent trend after an unusually sluggish 2017.

Real growth in the GCC, 2017 (%)

Country	Headline GDP	Non-oil sector	Oil sector
Bahrain	3.9	5.0	-0.7
Kuwait	-2.9	4.6	-8.0
Oman	0.0	2.5	-2.8
Qatar	1.6	4.2	-1.1
Saudi Arabia	-1.1	1.3	-4.3
United Arab Emirates	1.5	2.9	-1.4

N.B. All figures are provisional. The Omani estimates are by the International Monetary Fund and the UAE estimates by the Central Bank.

Source: Bahrain Information & Government Authority, Kuwait Central Statistical Bureau, International Monetary Fund, Qatar Ministry of Development Planning and Statistics, Saudi Arabian General Authority for Statistics, Central Bank of the UAE

Rebalancing growth

Three regional economies (in addition to Bahrain) have now published preliminary full-year national accounts statistics for 2017. The data paints a fairly consistent picture of economic dynamics across the region. Headline growth was historically low, albeit primarily because of the

Growth will likely benefit from more benign oil prices and less aggressive fiscal consolidation

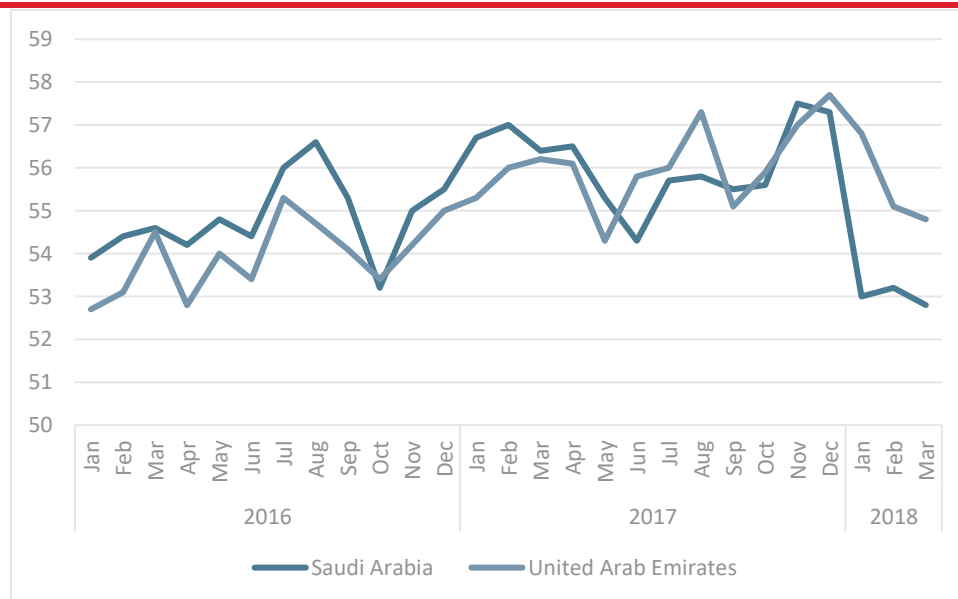
negative growth contribution of the oil sector, which contracted as a result of the OPEC-led output cuts. Non-oil growth, by contrast, was generally stronger than in 2016 in spite of ongoing fiscal consolidation efforts. All regional economies recorded negative oil sector growth, whereas all, bar Saudi Arabia and Kuwait, saw positive headline growth. Non-oil growth in the region ranged between 1.3% (Saudi Arabia) and 5.0% (Bahrain), but was generally not far out of line with recent trends. By and large, the more diversified economies tended to achieve faster growth.

Even with these signs of non-oil continuity, the region is well positioned for a pronounced pick-up in growth this year:

- ✦ The oil sector, which made a negative contribution to growth in 2017, is set to play a neutral or even a mildly positive role this year. Even if the OPEC cuts remain in place, the region is benefiting from increased downstream activity and new gas discoveries
- ✦ The more benign oil price outlook augurs well for liquidity and market sentiment
- ✦ Even with fiscal consolidation continuing, non-oil activity should benefit from the global outlook and a somewhat more permissive fiscal stance in parts of the region. Most recently, Kuwait's FY2018/19 budget increased project spending by 14.7%, although overall spending increased only marginally to KWD20bn
- ✦ The structural real estate market correction seems to be largely over, which should protect asset values and encourage continuity in project activity

In spite of the generally benign outlook, 2018 is likely to mark an important milestone for the region's economic paradigm shift. In particular, the fiscal consolidation efforts are transitioning to their next phase which will create a broad revenue base across the non-oil economy. For most consumers and companies, the introduction of the VAT marks a significant change from a long history of minimal or no taxation.

Emirates NBD Purchasing Managers' Index



Source: Emirates NBD, Markit

The regional Purchasing Managers' Indices suggest that VAT introduction in Saudi Arabia and the UAE at the beginning of the year has dented sentiment, although the impact is likely to be relatively short-lived. Encouragingly, however, the January and February Emirates NBD PMI readings for the two countries remained above 50 and are thus indicative of continued economic expansion. Nonetheless, the Saudi average for the first two months – 53 – was unusually low by recent standards, akin to the opening months of 2016. The UAE readings were more resilient. At just below 55, they were not significantly out of line with recent readings.

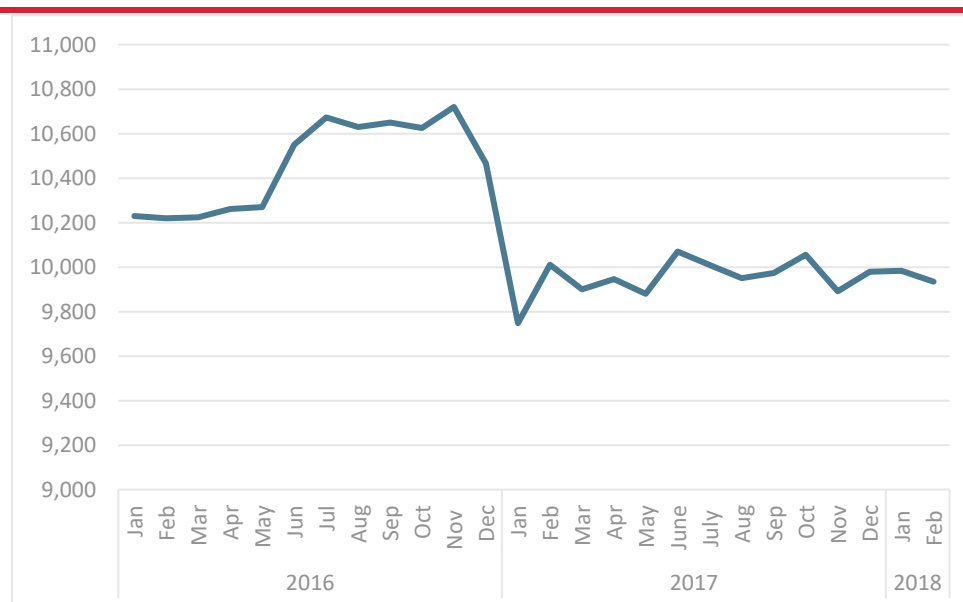
In spite of the less upbeat sentiment, the adverse VAT effect is likely to prove fairly ephemeral. Both economies are pursuing more permissive fiscal policies and have benefits from more favourable oil price dynamics. Moreover, PMI readings since late last year are likely to have been influenced by tactical buying. Indeed, late 2017 saw a burst of activity as consumers brought forward spending ahead of the introduction of VAT.

The oil sector focuses on downstream

The regional oil production numbers have reflected a high degree of compliance with the output cuts agreed by OPEC and its partners. Thus, for instance Saudi Arabian production in 2017 averaged some 9.95 mbd, according to the official data submissions. This represented an approximately 4.9% drop on the 2016 average. The UAE averaged 2.91 mbd, which translated into a 9.7% YoY drop. Kuwait saw a 6.7% drop to 2.7 mbd. Production levels in early 2018 were in line with those seen in the closing months of 2017.

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

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

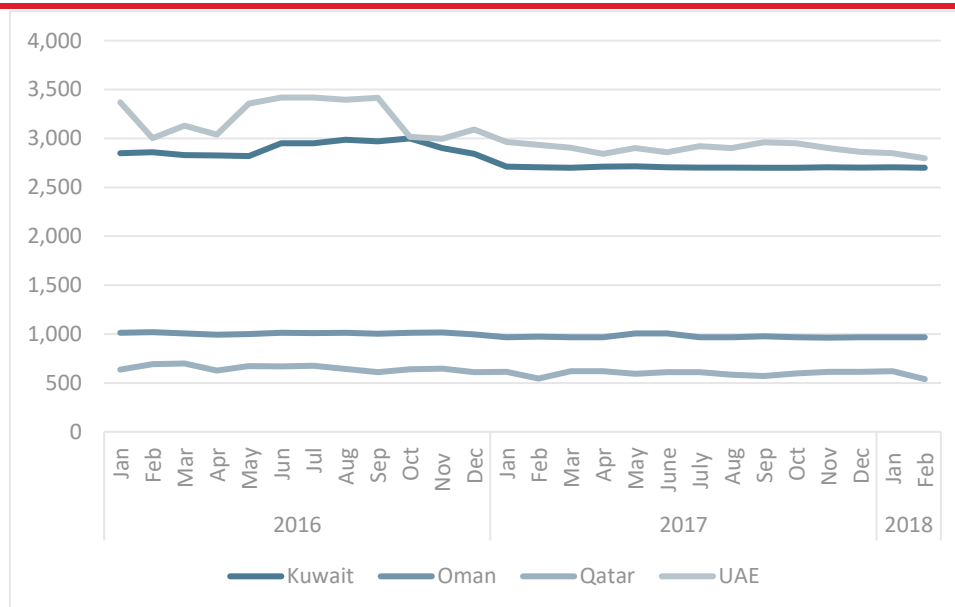


Source: Joint Organisations Data Initiative, OPEC

But even as the regional producers have cut their crude output, they have also been able to diversify their hydrocarbons exports. Investments in additional downstream capacity over the past several years have been particularly instrumental in this regard. For instance, Saudi Arabia has seen a rapid increase in its downstream export capacity since 2014. More recently, domestic consumption has been curbed by the gradual elimination of energy subsidies. Two rounds of fuel

price increases in 2016 and 2018 helped curb domestic demand growth with a 5% drop in 2016, followed by a 1% decline in 2017. Increased natural gas extraction is another factor limiting domestic oil consumption. Saudi natural gas output is expected to increase from 11.6bn cu ft/day in 2015 to 17.8 bcf/d by 2020. Also, renewables and nuclear power are set to become a more important element of the energy mix.

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



Source: Joint Organisations Data Initiative, OPEC, Bloomberg

Saudi Arabian refined product exports jumped by 30% in 2016 alone. The Kingdom exported some 1.9 mbd of oil distillates in January, a figure that equated to roughly a fifth of its total crude extraction. Moreover, following the launch of a 400,000 b/d Aramco-Total joint venture in Jubail, the mix of refined products has begun to change in favour of more complex and higher value-added products. Exports will benefit further from the opening of a 400 b/d Jizan refinery this year. Similar developments are underway region-wide and reflect a strategic commitment in favour of greater value creation from the region's main natural resource.

VAT drives inflationary divergence

After a year of historically subdued inflation readings in most of the region, the opening months of 2018 have seen a clear divergence in price dynamics across the region. Saudi Arabia and the UAE this year became the first regional economies to implement the GCC VAT agreement. This seems to have had a clear impact on driving tactical shopping decisions around the end of last year. But it has also pushed up the annual pace of inflation, albeit from a low base, in these two economies.

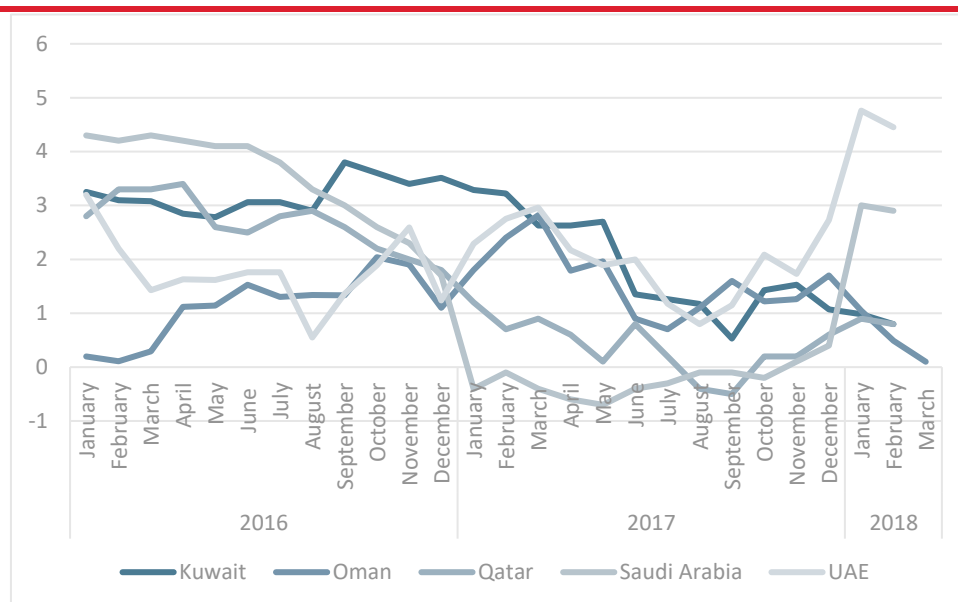
In Saudi Arabia, following a year characterized by persistent deflation, January saw the first YoY price increase in 13 months. Saudi inflation in January attained an annual pace of 3% in the wake of 3.9% month-on-month increase. A reform of utilities tariffs and fuel prices served as a further source of price pressures. The UAE reading – admittedly from a higher base – was 4.7%. Some of the inflation spike was due to the more or less simultaneous introduction of the so-called special

The introduction of VAT pushed up headline inflation in Saudi Arabia and the UAE

taxes, excise duties, on products such as tobacco. Subsidy cuts of fuel helped drive up transport prices. The UAE indicated that Government fees would be frozen for three years in the wake of the VAT introduction. In the rest of the region, CPI readings remained in line with the low levels observed in the second half of last year.

In spite of the ongoing fiscal reforms, as well as the relative weakness of the US Dollar, underlying price pressures in the region are contained by relatively subdued real estate price dynamics. Even as most regional markets are showing signs of stabilizing, housing inflation is curbed by historically subdued demand growth against the backdrop of large supply increments. For instance, in Dubai residential real estate prices in 2017 fell by a further 4.6%, according to the 9/5 House Price Index compiled by Phidar Advisory. This took the aggregate decline since the 2014 market peak to 23.4%. Apartment prices have tended to be more resilient and declined by just 2.8% in 2017.

Consumer price inflation, %



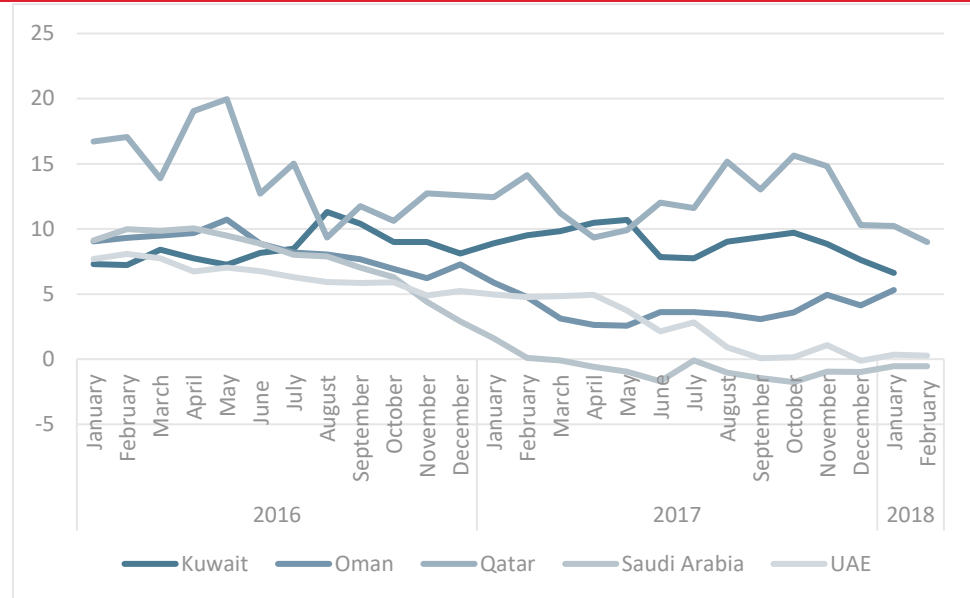
Source: National statistical agencies

Tighter bank liquidity but increased capital market activity

Liquidity conditions have continued to deteriorate virtually across the region

In the regional banking sector, liquidity conditions continued to tighten gradually in the course of 2017. New lending growth in Saudi Arabia and the UAE has virtually stalled in recent months. In the rest of the region, lending growth rates have been higher (currently 5-10%) but remain somewhat volatile. While lending growth is lower, the health of the banking sector across the region remain robust with for instance Saudi non-performing loans totalling only 1.6% in 2017. In an important step toward regional financial market integration, the GCC has announced plans to set up a company to facilitate direct money transfers within the region.

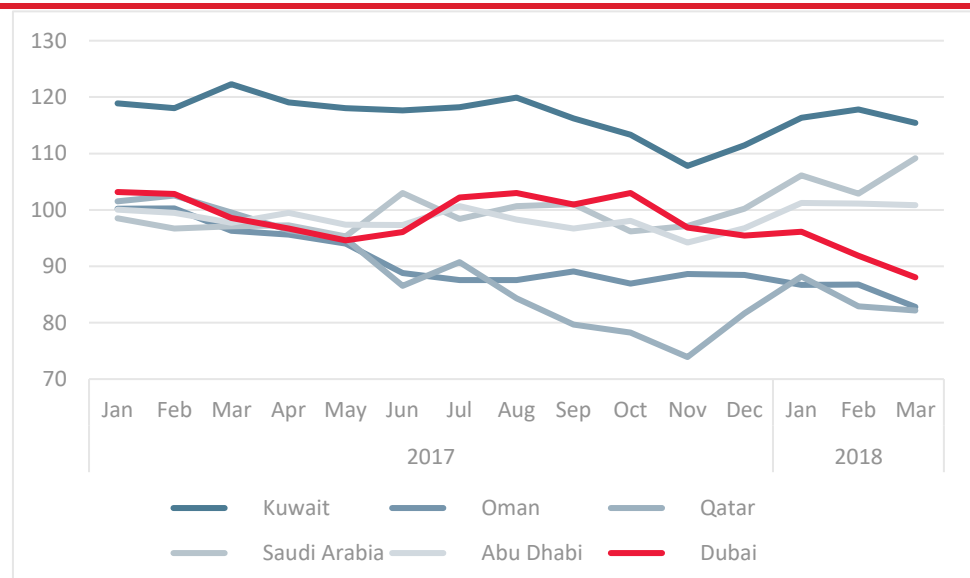
At the same time, the cost of capital has begun to edge up somewhat in response to the US interest rates increases which the local central banks have reflected. Indeed, Saudi Arabia implemented a rate increase a week ahead of the latest Fed decision, probably in response to US rates climbing above Saudi domestic rates. The repo and reverse repo rates rose to 2.25% and 1.75%, respectively.

Bank credit growth, %

Source: Regional central banks

Regional exchanges
generally stagnated
during Q1

The GCC stocks displayed mixed fortunes during Q1. Saudi Arabia led the way in terms of gains and advanced by 9.4%. The Abu Dhabi securities market posted a 4.9% gain and Boursa Kuwait rose by 3.5%. Dubai and Muscat both retreated by 7.8% and 6.1%, respectively.

GCC equity market indices (December 2016=100)

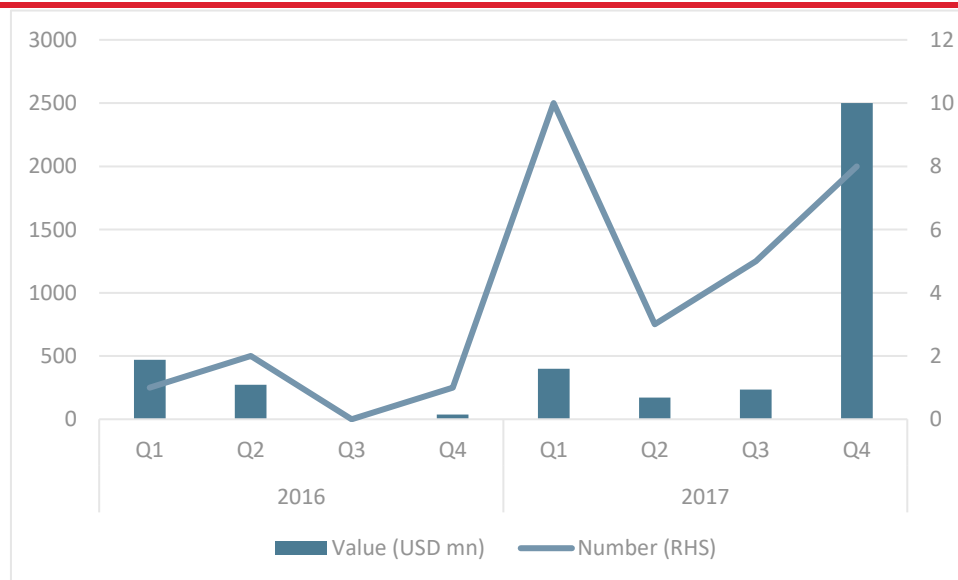
Source: Regional stock exchanges

Both Saudi Arabia and Kuwait have benefited from growing foreign investor interest. FTSE Russell this year announced the inclusion of Saudi into its emerging market index as of 2019. The Saudi market is expected to account for 2.7% of the index. Tadawul is further expected to be upgraded to MSCI's emerging market index in June 2018. These developments and the expected Aramco IPO are expected to bring foreign inflows of as much as USD30bn in the medium term. FTSE Russell is

implementing the inclusion of Kuwaiti stocks in its emerging markets index in two tranches in the second half of this year. Kuwait is expected to have a weight of 0.4%, which could bring in inflows of USD800mn. Boursa Kuwait is currently going through a restructuring to attract investors and prepare for its IPO. The exchange is planning a sale with up to 44% offered to a foreign operator and another up to 50% to the public. The state is willing to retain up to 24%.

Last year saw a brisk revival of primary market activity in the region, capped by a highly successful Q4. There was a total of eight GCC IPOs during the final quarter of the year. This took the annual total to 28 in a sharp increase from just four in 2016. Total IPO proceeds in Q4 reached USD2.5bn, which left the annual aggregate at USD3.3bn. This marked a more than four-fold increase on USD782mn. Q4 was by far the best quarter of the year, led by the IPOs of Emaar Development (USD1.3bn) at the Dubai Financial Market and Abu Dhabi National Oil Company (USD850mn) at the Abu Dhabi Securities Exchange.

GCC quarterly IPO activity



Source: PricewaterhouseCoopers, Regional exchanges

Fixed income issuance continues to dominate regional capital market activity

Financial market activity in the region has continued to be heavily dominated by fixed income issuance. GCC bond issuance in 2017 reached USD81.2bn, a 11.6% increase on 2016. UAE issuers raised USD33.3bn, up sharply from USD19.1bn the year before. By contrast, Saudi Arabian issuance dropped to USD12.5bn down from USD18bn. However, Saudi sukuk issuance rose sharply from USD1.7bn in 2016 to 28.1bn. Kuwaiti names issued USD16.8bn worth of bonds, up from USD7.2bn. Qatar saw a sharp decline to USD6.8bn from USD18.7bn. Much of issuance has capitalized on international appetite for the region. 2017 saw a total of USD49.3bn in international bonds and sukuk from the GCC. Saudi Arabia made up 44% of the total. Global sukuk issuance rose by 45.3% to USD97.9bn in 2017.

Borrowing by regional names is set to continue on a historically high level this year. In spite of a more comfortable oil price environment, the fiscal overhaul by the regional government is yet to deliver a sustainable budget balance. At the same time, especially corporate names will seek to capitalize on favourable terms ahead of expected US tightening. Nonetheless, the capital raising

needs this year look less extensive than in 2017. S&P expected Middle Eastern and North African borrowing to fall 6% to USD181bn.

Key sovereign issuance in Q1 included Oman's largest ever USD6.5bn bond in January. Sharjah raised RMB2bn (USD316mn) through a three-year Panda bond in February, followed by a USD1bn 10-year sukuk in March. Subscriptions exceeded USD2.4bn. Since 2016, the Kingdom has issued USD39bn worth of international bonds. Domestic sukuk issuance since last July exceeds SAR70bn. Saudi Arabia this year refinanced a 2016 USD10bn loan and increased it to USD16bn. In a bid to develop the market, the Ministry of Finance is listing more than SAR200bn worth of domestic bonds and sukuk on Tadawul. 45 offerings with maturities of 5-10 year were outstanding as of early April.

Saudi Arabia is also planning to use sukuk issuance to develop its mortgage market with intentions to spend SAR120bn on subsidized home loans under its new housing program. Bidaya Home Finance, which is partly owned by the Public Investment Fund, launched its debut SAR500mn sukuk program in March. The company expected the Saudi mortgage market to grow from SAE290bn now to SAR502bn by 2020. The government is committed to achieving 70% home ownership by 2030.

Corporate issuance has been dominated by regional banks with benchmark issues by Union National Bank of Abu Dhabi, Bank Muscat, First Abu Dhabi Bank, and Dubai Islamic Bank. Qatari banks have raised substantial sums through private placements and targeted foreign offerings. Q1 saw significant interest in Formosa bonds.

Implications for Bahrain

Whilst still marked by a structural transition, the regional economic backdrop looks generally favourable for Bahrain:

- ✚ Regional growth is likely to be stronger thanks to more permissive fiscal policies and a rebound from last year's lacklustre performance
- ✚ While companies adjust to VAT and other fiscal consolidation measures, purchasing and investment decisions may be more tactical

2018 is likely to see somewhat less bond and sukuk issuance than 2017

BAHRAIN

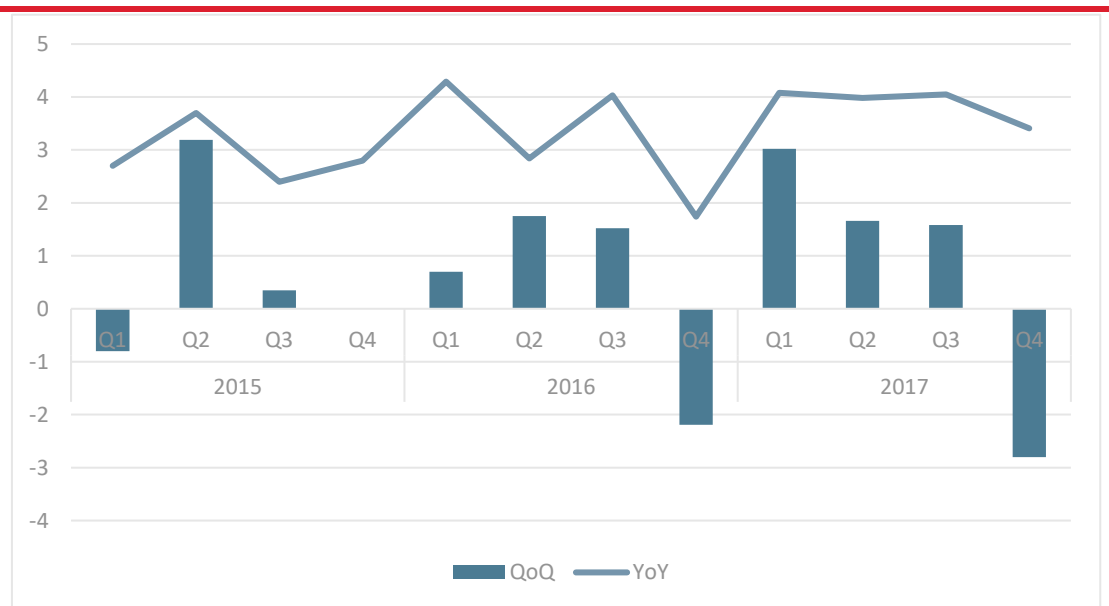
2017 EXCEEDS EXPECTATIONS

Economic growth during 2017 exceeded expectations with 3.9% headline expansion

The year 2017 proved a bumper year for the Bahraini economy in terms of GDP growth, although the pace of expansion decelerated somewhat in Q4. According to the preliminary national accounts data, headline GDP growth in 2017 reached 3.9% in a strong improvement over the 3.2% pace recorded the year before. Growth was driven by an ebullient non-oil sector which posted a 5% YoY gain in a clear positive departure from the 4.0% pace achieved in 2017. The strong momentum of the economy was reflective both of an unprecedented infrastructure investment pipeline as well as sustained efforts to improve the business environment. Bahrain's growth performance in 2017 put it ahead of all of its regional peers.

As in 2017, the growth momentum cooled somewhat toward the end of the year, probably partly due to seasonal factors. The economy expanded by 3.4% in Q4, which was clearly below the 4% pace seen during the preceding three quarters. The QoQ change in real GDP was -2.8%, the first negative reading since 4Q17. The non-oil economy expanded by an annual 3.8% in Q4, while the oil sector added 1.3%, albeit from an unusually low base the year before.

Real GDP growth



Source: Information & e-Government Authority

Forecast: Evolving growth drivers

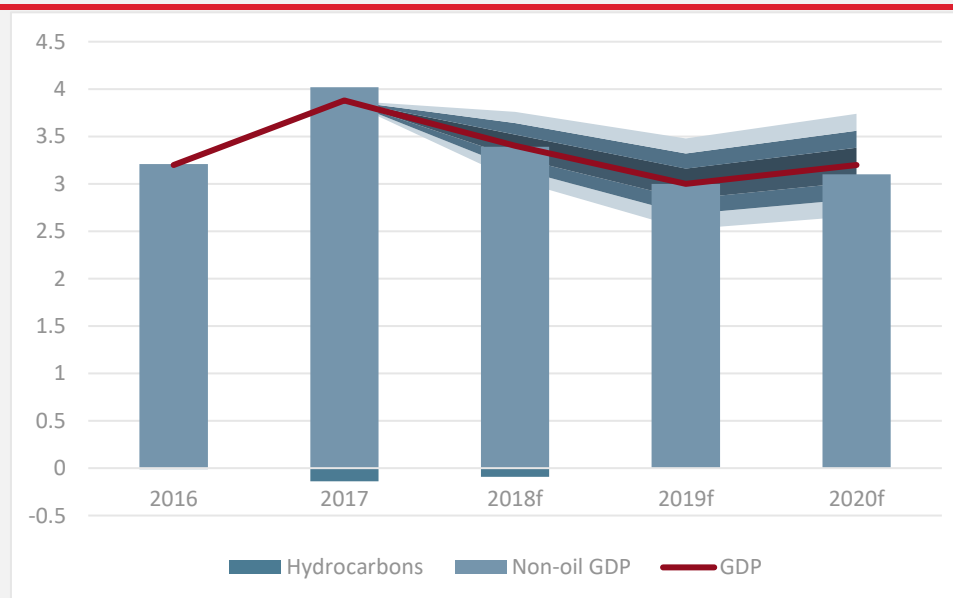
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Inflation (CPI %)	2.8%	1.4%	2.2%	3.5%
Current account (% of GDP)	-4.6%	-3.8%	-3.5%	-3.2%
Fiscal balance (% of GDP)	-13.6%	-11.0%	-9.8%	-6.4%
Crude Oil Brent (USD)	44	53	63	63

Source: Bahrain Economic Development Board

The strong economic growth momentum seen in 2017 is likely to carry over to 2018. The underlying impetus from the infrastructure pipeline is set to remain strong with increasing cash flows. Bahrain should also benefit from the more benign regional environment. On the negative side, economic activity will be affected by a gradual increase in the cost of capital as well as the ongoing fiscal reform program. With the base effect of very high headline growth in 2017, growth this year is almost certainly going to prove somewhat weaker, although the lumpy project pipeline does present some upside risks. On balance, we expect to see some moderation in headline growth in 2019. By the 2020, the scaling up of Alba Line 6 to full capacity along with a number of new manufacturing and infrastructure projects can be expected to somewhat strengthen non-oil growth again.

Real GDP growth composition



Source: Bahrain Economic Development Board, Information & eGovernment Authority

Non-oil activity remains robust

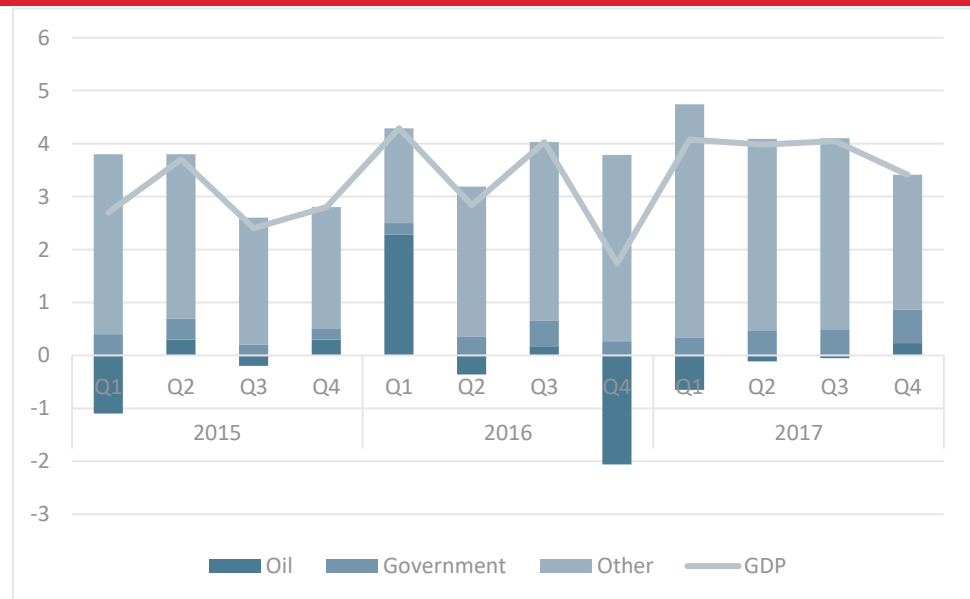
Non-oil growth reached an impressive 5% YoY in 2017. Private sector growth was 5.2%

Economic growth in Bahrain has remained almost entirely reliant on the non-oil private sector. Even though the net contribution of oil and Government Services was somewhat larger in Q4 than earlier in the year, the basic norm of private-sector led growth held throughout 2017 with the non-oil private sector expanding by an annual 5.2%. With overall non-oil growth coming in at just under 5% during 2017, all sectors of the non-oil economy posted positive real growth.

Growth has remained broad-based. The fastest growing sector during 2017 as a whole was Hotels & Restaurants which expanded by 9.5%. Social & Personal Services, a sector dominated by private education and healthcare, also performed very strongly. In line with an established pattern, it expanded by a robust 9.4%. The trade sector grew by 8.5%, partly thanks to significant new capacity additions but also due to the trickle-down effects from project spending. In the same vein, the Real Estate & Professional Services sector posted 5.5% growth. Financial Services had a strong year and expanded by 5.0%, more or less exactly in line with the non-oil sector average.

The growth pattern observed during Q4 deviated somewhat from the preceding quarters. Non-oil growth was markedly slower at 3.8% as a combination of lumpy project cash flows and seasonal factors exerted their effect, much as they had a year earlier in 4Q17. Social & Personal Services was the fastest growing sector in Q4, posting 8.8% YoY expansion. The Trade sector grew by 7.9% and the Real Estate & Business Services sector by 7.6%. Transportation & Communications was the only sector to post a small YoY contraction during Q4 in a marked departure from its solid growth during the first three quarters of the year. In contrast to the first three quarters of the year, the contribution of Government Services as well as the oil and gas sector was somewhat larger.

Real GDP growth composition



Source: Information & eGovernment Authority

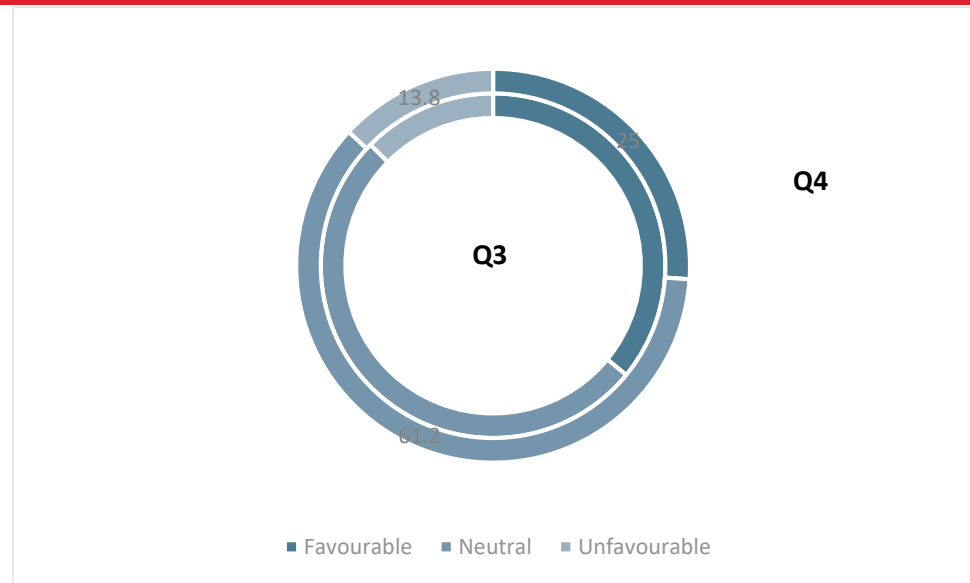
Sector-specific real growth rates, YoY (%)

	2016	2017				
YoY growth, %	Annual	Annual	Q1	Q2	Q3	Q4
Crude Pet. & Nat. Gas	-0.1	-0.7	-3.3	-0.5	-0.3	1.3
Manufacturing	1.3	1.0	0.5	-1.0	3.7	1.1
Construction	5.7	1.7	4.6	0.0	0.8	1.9
Trade	3.0	8.5	9.3	9.3	7.7	7.9
Hotels & Restaurants	2.0	9.5	12.3	13.4	8.6	3.7
Transp. & Comm's	3.2	4.6	7.3	5.9	5.8	-0.3
Social & Pers. Serv.	9.1	9.4	10.0	9.7	9.1	8.8
Real Est. & Bus. Act.	2.8	5.5	4.5	5.3	4.6	7.6
Finance	5.2	5.0	8.3	7.5	3.5	1.0
Government	2.5	3.7	3.6	3.6	3.8	5.0
Other	3.6	16.2	16.1	14.6	17.9	16.3
GDP	3.2	3.9	4.1	4.0	4.1	3.4

Source: Information & e-Government Authority

The slightly more subdued growth dynamics in Q4 were mirrored by the results of the Quarterly Business Perceptions Survey conducted by the Information & eGovernment Authority. A clear majority of corporate respondents during Q4 had a neutral opinion of the economic situation, seeing neither an improvement nor a deterioration. The proportion of respondents with an optimistic view of the situation held fairly steady between Q3 and Q4, declining marginally from 26.1% to 25%. By contrast, the share of neutral responses rose very slightly from 60.8% to 61.2%. Unfavourable responses made up 13.8% of the total, up from 13.1% the quarter before.

Bahrain QBPS opinions regarding current business performance, 3-4Q17

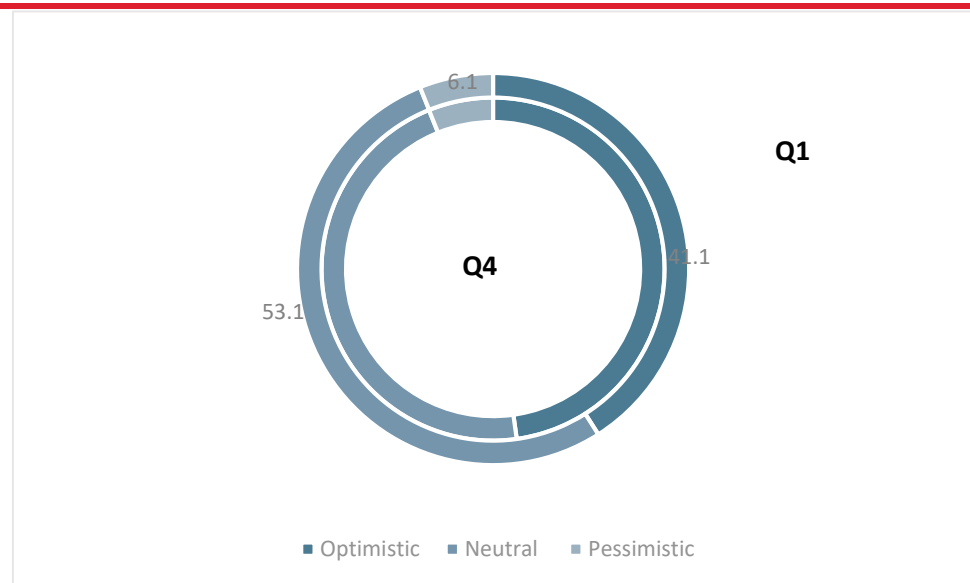


Source: Information & eGovernment Authority

The change in perceptions was somewhat more pronounced in forward-looking expectations. The proportion of respondents expecting an improvement in the economy declined from 47.8% for Q4 to 41.1% for Q1. A clear majority of businesses foresaw continuity, expressing a neutral view on the outlook. Their proportion for Q4 was 46.1%, but this rose to 53.1% for Q1. The share of pessimists held constant at 6.1% for both periods.

While the responses were somewhat less upbeat than in Q3, it is clear that an overwhelming majority of business respondents expect continuity or even some improvement in the economic prospects, whereas only a very small proportion are pessimistic.

Bahrain Business Confidence Index, 4Q17-1Q18



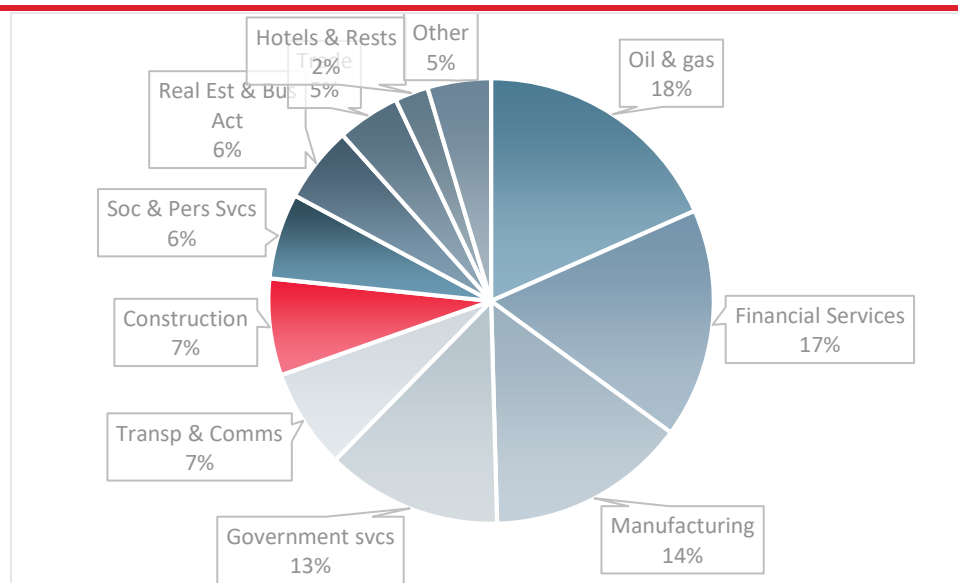
Source: Information & eGovernment Authority

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

Diversification makes headway

Bahrain enjoys widespread recognition as the regional pioneer of economic diversification. This process is continuing apace in recent years with the growth of the non-oil sector consistently faster than that of the hydrocarbons sector. According to the provision 2017 national accounts data, the oil and gas sector accounted for 18.4% of Bahrain's real GDP. This compared to 19.2% the year before and 24% a decade earlier, in 2007. At the beginning of the 21st century, in 2000, the GDP share of oil and gas still stood at 43.6%.

Composition of Bahrain's real GDP, 2017



Source: Information & eGovernment Authority

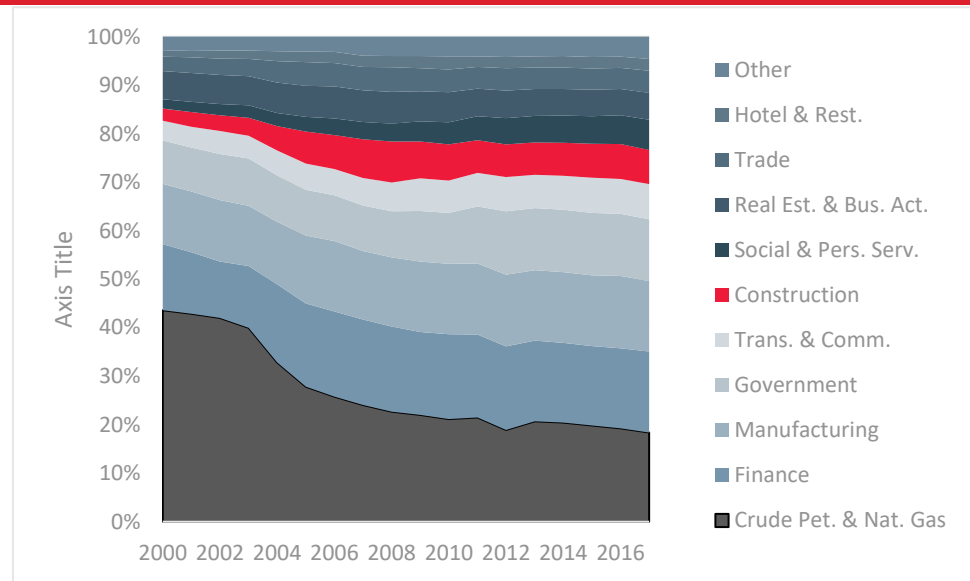
Within the non-oil economy that now makes up 81.6% of the Kingdom's real GDP, certain trends have become evident in recent years:

- ✦ The Financial Services sector remains the second largest sector of the economy. It has been seeing a renewed gradual increase in its share since 2014. In 2017, Financial Services contributed 16.7% of Bahrain's real GDP. This compared to 16.5% the year before and 17.6% a decade earlier
- ✦ Manufacturing is the second largest non-oil sector which accounted for 14.5% of the country's GDP in 2017. This was slightly down on 14.9% in 2016 but marginally up on 14.2% a decade earlier. The strong pipeline of large-scale manufacturing projects is likely to lead to significant relative growth in the coming years
- ✦ Government Services remains the fourth largest sector of the economy. However, it has seen a relatively steady decline in its contribution since 2013. Its share in 2017 was just under 12.8%. While this is down from the 13.1% peak in 2013, it is still significantly higher than the 9.4% share recorded a decade earlier. While some of this is due to demographic factors, ie the increased demand for education and health care services, it also reflects the significant countercyclical increase in government expenditure since the onset of the global economic crisis

The process of economic diversification continued its forward march in 2017. The non-oil sector now makes up 81.6% of the Kingdom's real GDP

- ✦ The single most dynamic sector of the Bahraini economy is Social and Personal Services. Its sustained rapid growth reflects the growing popularity of private health care and education and the supply response in these areas. Social and Personal Services accounted for 6.2% of Bahrain's real GDP in 2016. This was up on 5.9% the year before and compared to just 3.6% in 2007

Evolution of Bahrain's real GDP composition, 2000-2017



Source: Information & eGovernment Authority

A new oil field revives sector prospects

Oil production in Bahrain has been relatively steady in recent years, even allowing for periods of marginal declines. This reflects the full-capacity output from the off-shore Abu Sa'afah field that is equally shared with Saudi Arabia, as well as the need for further investments in the onshore Bahrain Field. Bahrain Field is the oldest active oil field in the region which has been undergoing a rehabilitation process with enhanced recovery techniques since the formation of Tatweer Petroleum in 2009. In 2017, Tatweer drilled a further 66 wells in a bid to maintain output levels, taking the total of wells drilled to 949. Total oil and condensate production reached 44,200 barrels as compared to 48,500 barrels the year before. The decline was due to a smaller number of new wells drilled as well as maintenance-related issues. Non-associated gas production continued at 1.4 mbd. Tatweer is currently exploring new collaboration agreements with foreign service companies with a view to developing heavy oil and tight reservoirs. Bahrain also has significant tight gas deposits in its onshore Khuff reservoir. Feasibility studies are currently being carried out.

Production from the Bahrain Field reached a daily average of 42,668 barrels in Q1. Also offshore production remained below capacity because of a scheduled shutdown for maintenance in December 2017-February 2018. It reached 126,463 b/d, down 4.8% on the preceding quarter and 19.5% in year-on-year terms.

In a landmark development for the oil and gas sector, Bahrain on 1 April announced its largest oil discovery since it began producing in 1932. The 2,000 sq Khalij al Bahrain field was discovered in

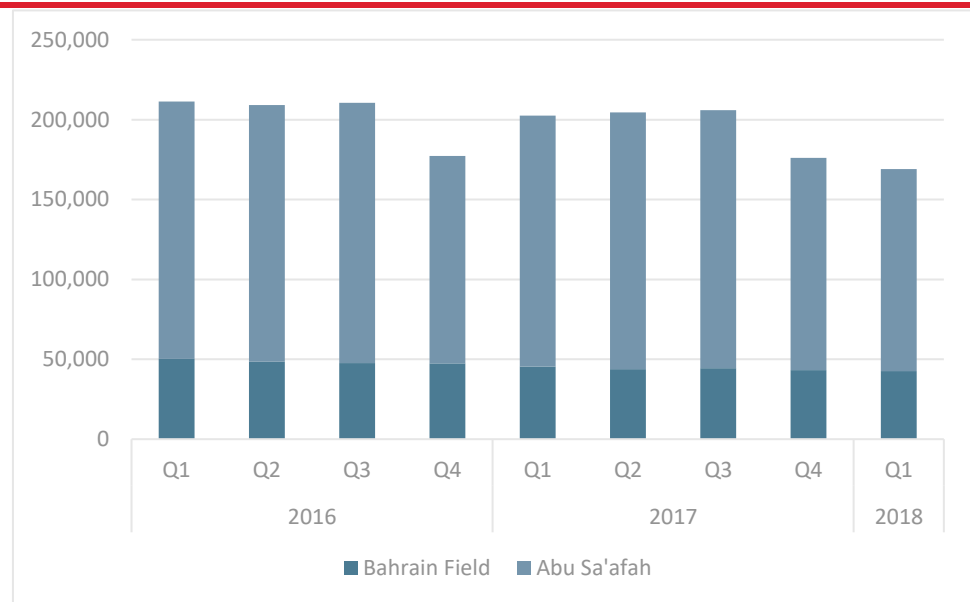
Oil production has been disrupted by seasonal maintenance during the past two quarters

Bahrain recently announced the discovery of the largest oil and gas deposits to date

4Q17 and is located in shallow waters to the west of the island. The field is mainly composed of shale oil and natural gas in quantities that far exceed Bahrain's current reserves. The deposit is estimated to contain 81.5bn barrels of oil as well as 13.7 trn cu ft of tight gas. The development of the tight gas reserves is due to start this year. A resource evaluation discovered substantial levels capable of supporting the long-term extraction of tight oil and gas.

The field is expected to start producing within the coming five years. The first well is due to come online in August and Halliburton will start work on two further appraisal wells this year. Capacity production is expected to equal 200,000 b/d, equal to Bahrain's current total production of oil. Gas production could reach 1 bn cu ft a day, enough to meet local demand.

Crude oil production, b/d



Source: National Oil and Gas Authority

Infrastructure spending continues to underpin non-oil growth

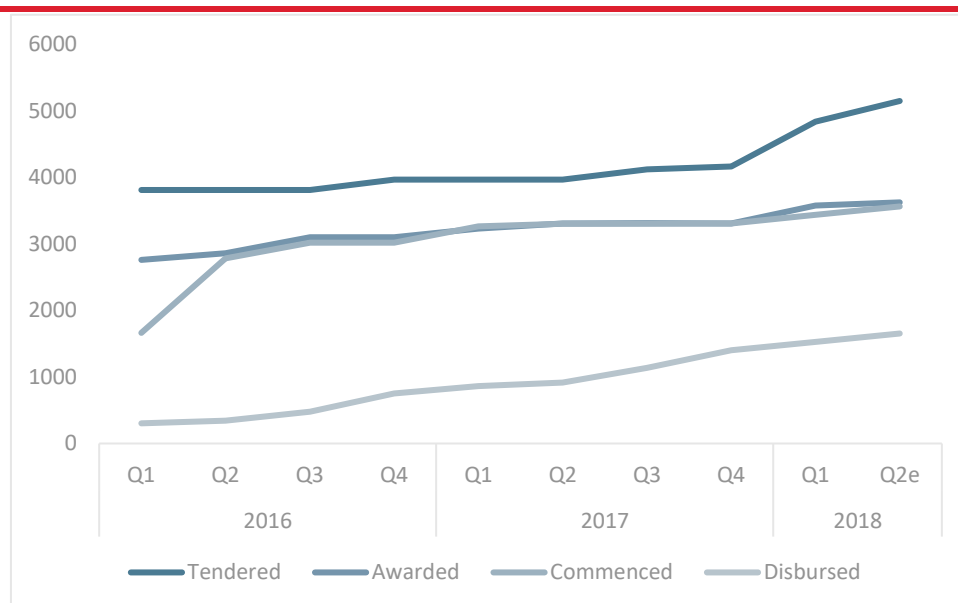
Robust infrastructure spending from the largest-ever project pipeline in Bahrain's history remains a key driver of non-oil growth and business confidence. Projects worth USD1.8bn have main contracts out to tender and are set to be awarded during 2018. A further USD6.5bn worth of projects are pending. A number of flagship developments are making good progress:

- ✦ Bahrain's ASRY (Arab Shipbuilding & Repair Yard) has completed the construction of a boat landing platform for the new LNG terminal. The facility will have a capacity of 800mn cu ft a day and a cost of USD900mn
- ✦ A consultancy study for a new national light rail network is due to be completed in May. This should trigger the preparation of a request for proportion for the transaction advisory contract for a PPP model
- ✦ The Ministry of Works has awarded the contract for the expansion of the Tubli wastewater treatment plant

Infrastructure spending remains a key countercyclical growth drivers with all landmark developments on track

- ✦ A request for proposals for the planned King Hamad Causeway is expected to be issued before the middle of the year. The 25-km causeway will connect Bahrain with Saudi Arabia and parallel the existing King Fahad Causeway. It will, among other things, provide a platform for the GCC railway
- ✦ The government has delivered 5,000 of the 40,000 housing units planned by 2022 under its social housing program. A further 8,885 units are expected to be delivered by the end of 2018. A further 4,000 units are under constructions and 7,000 in tendering
- ✦ The first phase of the USD1.1bn new passenger terminal at the Bahrain International Airport is due to be completed in 3Q19 with a soft opening expected in September. The terminal will have a capacity for 14mn passengers a year. A new cargo facility is also being developed nearby
- ✦ The Electricity and Water Authority (EWA) is inviting bids by developers for the planned Al Dur independent water and power station. The facility will have a capacity of 1,200-1,500 MW as well as 50mn imperial gallons of desalinated water per day
- ✦ Roughly half of the work on the new Saudi-Bahrain oil pipeline is complete. The work will replace an existing 70-year old pipeline and is expected to be operational by the end of the year. The 115 km pipeline will carry 350,000 b/d of oil, an increase of the 230,000 capacity of the old pipeline. The cost of the project is estimated at \$300m.

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



Source: Government sources

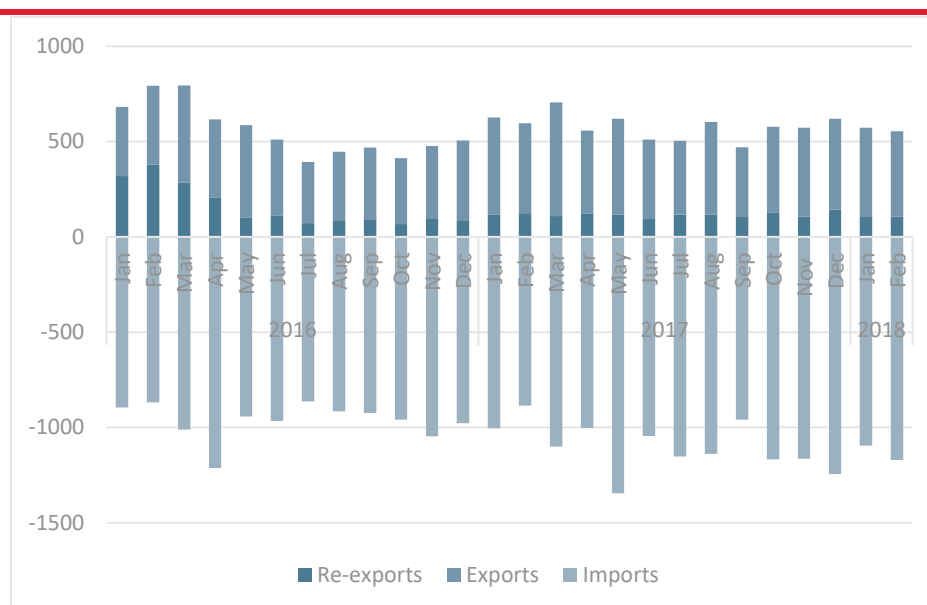
Projects funded by the GCC Development Fund remain an important component of the overall project pipeline. This segment has seen a steady escalation of activity as well as cash flows. The cumulative aggregate value of projects tendered stood at USD4.8bn in 1Q17. This was up 22% in YoY terms. The value of projects that had commenced rose by 10.7% to USD3.6bn. The aggregate cash flow increased by a remarkable 76.9% to USD1.5bn.

Trade volumes stable

The value of Bahrain's non-oil trade during the opening months of the year was marginal down on the corresponding period of 2017. Bahrain's locally produced exports totalled USD917.3mn during January-February. This compared to USD982.6mn a year earlier. Re-export trade reached USD210.5mn. This was down on USD241.3mn a year earlier.

The total value of imports in January-February reached USD2,266.1mn, up from USD1,889.7mn during the first two months of 2017.

Non-oil trade, USD mn



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

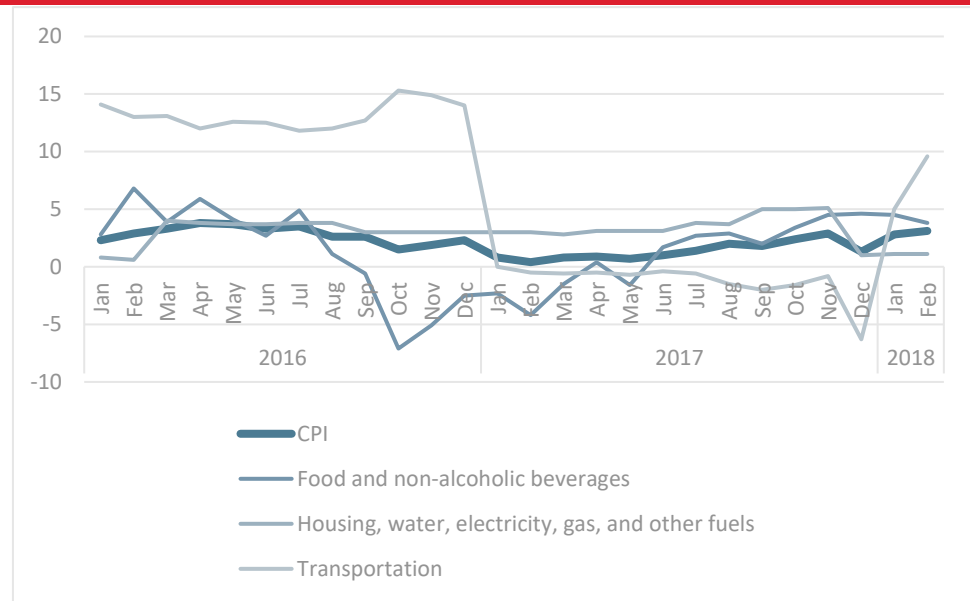
Some pick-up in inflation

Consumer price inflation in 2017 was historically subdued at 1.4%, which was a fairly low reading even by regional standards. Price pressures have become more pronounced in early 2018 as a result of new fiscal consolidation measures. These include the introduction of the Special Tax, excise duties on various goods with harmful health effects, ranging from tobacco to sugary soft drinks and power drinks. Also further steps in removing universal subsidies have pushed up energy prices.

The CPI inflation in January-February was 2.9%. The annual rate reached 3.8% in February. Prices pressures were most pronounced in the category of Alcoholic beverages and tobacco (40%) as a result of the excise duty. Higher fuel prices pushed up Transportation inflation to 9.6%. Food prices were up by 3.8%, partly as a result of relative Dollar weakness. By contrast, housing costs rose by only 1.1%, partly as a result of an evenly balanced housing market where a lot of new supply is being delivered.

Inflation has seen some renewed acceleration, albeit from a low base

Consumer price inflation, % YoY



Source: Information & e-Government Authority

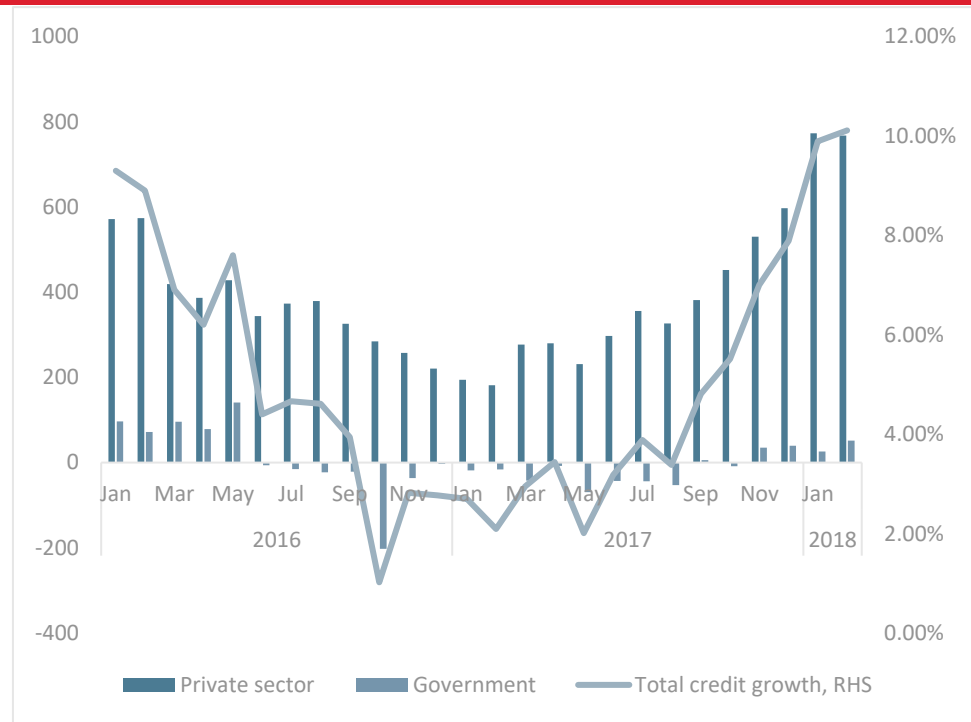
Credit growth accelerates

Bank lending has been accelerating sharply and consistently since the spring of 2017. The lending growth dynamics constitute an almost exact mirror image of the deceleration witnessed in 2015. The YoY rate of new loan growth in February narrowly exceeded 10%. This compared to a pace of just 2.1% a year earlier. The new loan growth has been primarily to the private sector, but recent months have seen some renewed growth in lending to Government entities as well.

The grand total of loans outstanding to Bahraini retail banks in February was BHD8,911.8mn. 52.4% of this total were business loans. Lending to the personal sector made up 44%. The corresponding percentages a year earlier stood at, respectively, 51.5% and 45.2%, respectively.

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

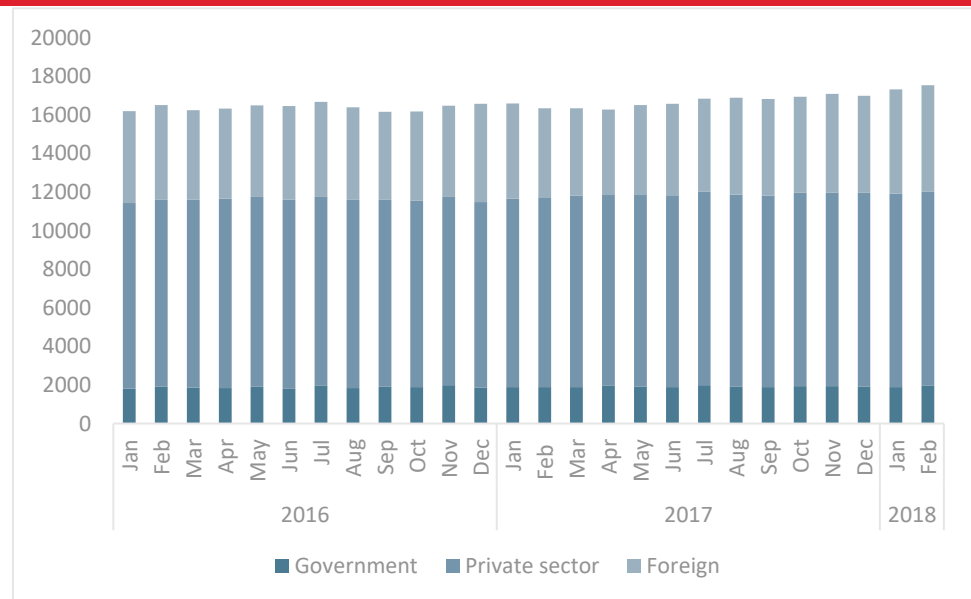
YoY growth in credit issued by retail banks, BHD mn



Source: Central Bank of Bahrain

Deposit growth in Bahrain has continued at a fairly brisk pace. The annual pace of increase accelerated to 7.3% in February in a marked improvement on the preceding couple of years. The rate of deposit growth compares favourably also in the regional context.

Deposit liabilities to non-banks, BHD mn



Source: Central Bank of Bahrain

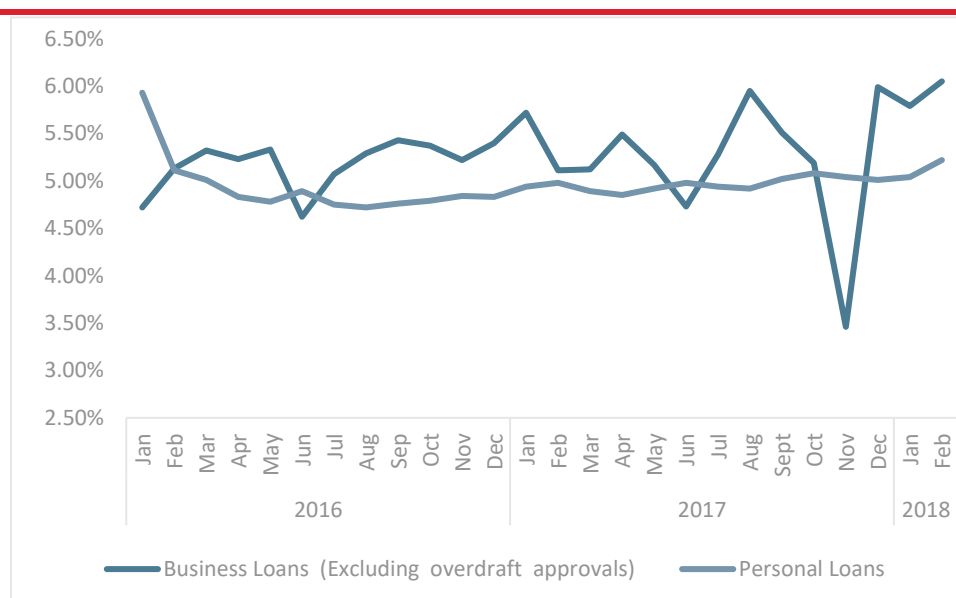
The Central Bank of Bahrain has closely followed the interest rate increases by the US Federal Reserve. Immediately following the latest Fed decision in March, the CBB adjusted its rates. The rate of the one-week deposit facility rose from 1.75% to 2%. The overnight deposit rate was

Upward pressure on lending costs has remained minimal in spite of higher policy rates

increased from 1.5% to 1.75%. The one-month deposit rate was adjusted from 2.4% to 2.65% and the lending rate from 3.5% to 3.75%.

In spite of the higher policy rates, the cost of capital in the Bahraini market has held relatively steady. The average cost of credit charged by conventional retail banks to their business clients averaged 5.9% during the first two months of 2018. This compared to an all-year average of 5.2% during 2017 but was still within the range of variation observed in recent years. More continuity was observed in the cost of personal credit which averaged 5.1% in January-February and compared to an average of 5% during 2017 as a whole.

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

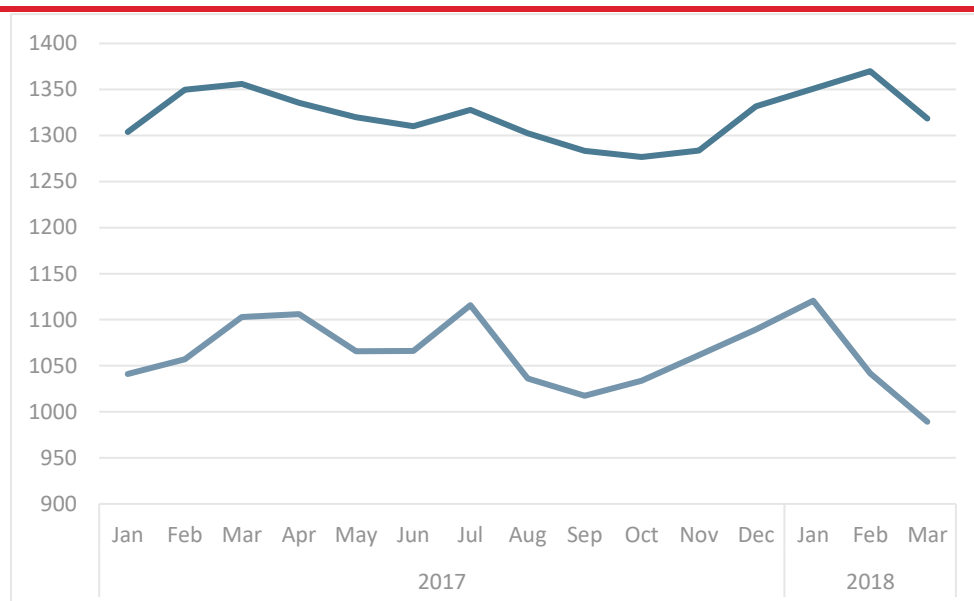


Source: Central Bank of Bahrain

Capital markets stable in Q1

After a successful 2017, Bahrain Bourse made little headway during the first quarter of 2018. The Bahrain All-Share Index posted a year-to-date loss of 1% during Q1. The Bahrain Islamic Index shed 9.2%. A generally positive start to the year was reversed in March when the BAX declined by 3.8% and the BII by just over 5%. The capitalization of the bourse as of the end of March was BHD8.1bn.

Bahrain All Share Index and Bahrain Islamic Index

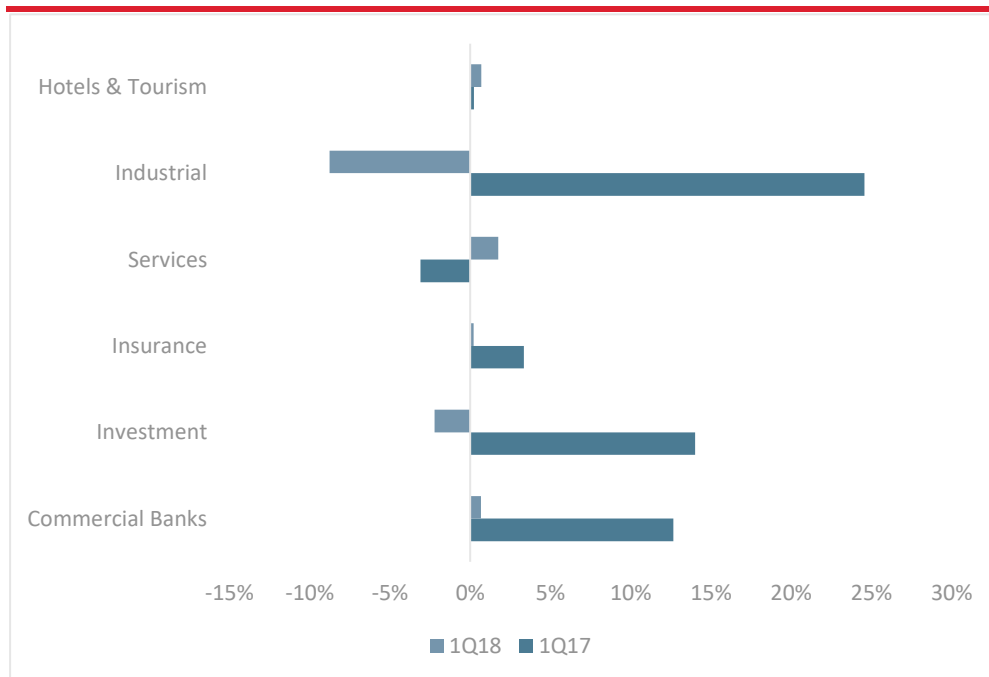


Source: Bahrain Bourse

Changes in most indices were fairly minimal during Q1

The performance of the sectoral indices was muted as compared to the strong Q1 seen in 2017. The best performing index in 1Q18 was Services which posted a 1.8% YTD gain. Commercial Banks advanced by 0.7% and Insurance by 0.2%. All other indices lost ground, led by last year's star performer, the Industrial index which shed 8.8.

YTD changes in sectoral stock market indices, Q1 2017-2018



Source: Bahrain Bourse

In a welcome development for the primary equity markets, the operator of the Khalifa bin Salman Port, APM Terminals, announced plans to list a 20% stake in April. The decision is based on the terms of the 25-year concession agreement signed between the Government and APM in 2009. A

listing was first announced in 2014 but deferred due to uncertain market conditions. The operator is currently 80% owned by APM Terminals and 20% by Bahrain-based YBA Kanoo.

The Khalifa bin Salman Port opened in 2009 and has an annual capacity of 1.1mn TEUs. Cargo volumes at the port rose by 21% in 2017 while contained traffic increased by 7%.

In the fixed income space, the CBB in early January placed a three-year *Sukuk al ijarah* (No. 25) on behalf of the Government. The BHD100mn issue was 194% oversubscribed. The expected rate of return is 4.8%.

In late March, the Government of Bahrain placed a USD1bn international (Rule 144ARegS) 7.5-year sukuk. The sukuk was priced at 6.875% after initial guidance of around 7%. The offering was rated as B+ by Standard & Poor's and BB- by Fitch. The order book was reported around USD2.1bn. 59% of the notes were taken by Middle Eastern and North African investors, 16% by Europeans, and 14% by UK-based investors. 9% was sold to the US and 2% Asia. The joint lead-managers and bookrunners were BNP Paribas, Citi, Gulf International Bank, National Bank of Bahrain, and Standard Chartered Bank.

Short-term issuance by the Central Bank continued on the regular schedule. The total value of outstanding Government Treasury Bills stood at BHD2.135bn in early April.

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

Issue date	Issue	Value, BHD mn	Maturity, days	Average interest/ profit rate, %	Average price, %	Over- subscript ion, %
3 Jan 2018	Treasury bill No. 1685	70	91	3.09	99.225	100
10 Jan 2018	Treasury bill No. 1686	70	91	3.09	99.225	176
11 Jan 2018	Sukuk al ijarah No. 149	26	182	3.15		100
17 Jan 2018	Sukuk al salam No. 201	43	91	3.08		100
24 Jan 2018	Treasury bill No. 1687	70	91	3.09	99.226	121
25 Jan 2018	12-month Treasury bill No. 41	100	365	3.71	96.382	146
31 Jan 2018	Treasury bill No. 1688	70	91	3.11	99.220	119
4 Feb 2018	Treasury bill No. 1689	35	182	3.27	98.373	170
8 Feb 2018	Sukuk al ijarah No. 150	26	182	3.27		100
14 Feb 2018	Treasury bill No. 1691	70	91	3.31	99.215	144
21 Feb 2018	Sukuk al salam No. 202	43	91	3.13		100
28 Feb 2018	Treasury bill No. 1692	70	91	3.18	99.202	124
1 Mar 2018	12-month Treasury bill No. 42	100	365	3.74	96.324	151
4 Mar 2018	Treasury bill No. 1693	35	182	3.39	98.317	126
7 Mar 2018	Treasury bill No. 1694	70	91	3.19	99.201	151
14 Mar 2018	Treasury bill No. 1695	70	91	3.17	99.205	189
15 Mar 2018	Sukuk al ijarah No. 151	26	182	3.39		100
21 Mar 2018	Sukuk al salam No. 203	43	91	3.17		100
28 Mar 2018	Treasury bill No. 1696	70	91	3.30	99.173	100
29 Mar 2018	12-month Treasury bill No. 43	100	365	3.91	96.200	122
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

Source: Central Bank of Bahrain

Job creation remains subdued in Q4

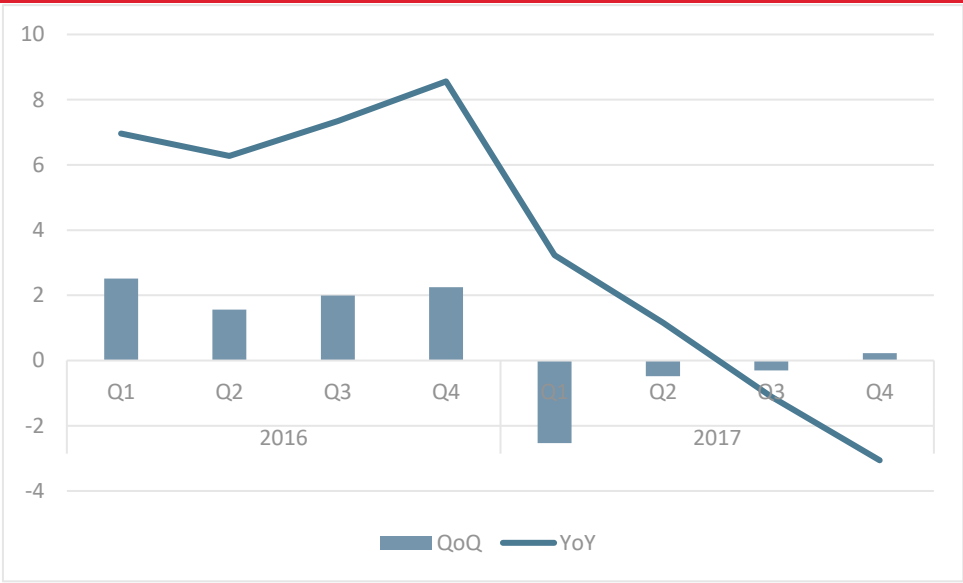
Job creation turned negative in 2H17 but Bahraini employment posted a small gain

After a rapid build-up in 2015-2016, new job creation virtually stalled by the second half of 2017. Total employment reached 763,112 at the end of 4Q17 after two consecutive quarters of negative YoY growth. The Q4 total was 3.1% lower than a year earlier.

The number of non-Bahraini employees stood at 604,697 at the end of 2017, 4% lower than a year earlier. By contrast, Bahraini employment rose by 0.8% in the course of 2017 to reach a total of 158,415 at the end of Q4.

The drop in new job creation is likely primarily reflective of the fact that the most labour-intensive sectors successfully built up capacity over the past year or two to meet their near-term operational needs. However, the large scale of the active infrastructure pipeline is likely to deliver renewed growth in the employment numbers in the near- to medium-term.

Change in employment (%)



Source: Labour Market Regulatory Authority

External assessments

Index/report	Description	Global rank	MENA rank	Key strengths highlighted
<i>Index of Economic Freedom</i> by The Heritage Foundation	<p>Analyses economic policy developments in 186 countries based on 12 measures of economic freedom grouped into four pillars:</p> <ul style="list-style-type: none"> ✦ Rule of law: property rights, government integrity, judicial effectiveness ✦ Government size: government spending, tax burden, fiscal health ✦ Regulatory efficiency: business, labour, monetary freedom ✦ Open markets: trade, investment, financial freedom 	50 (out of 186)	3	<p>Bahrain's key strengths include:</p> <ul style="list-style-type: none"> ✦ Tax policy ✦ Trade freedom ✦ Monetary stability ✦ Banking efficiency and independence from government control
<i>Emerging Markets Logistics Index</i> by Agility	<p>Ranks emerging economies on the basis of:</p> <ul style="list-style-type: none"> ✦ Market size and growth attractiveness: population, economic growth, financial stability ✦ Market compatibility: accessibility and ease of doing business ✦ Market connectedness: transport infrastructure and connections 	22 (out of 50)	7	<p>Bahrain's key strengths include:</p> <ul style="list-style-type: none"> ✦ Quality of overall infrastructure and roads ✦ Quality of port and air transport infrastructure ✦ Efficiency of customs and border controls

KEY SECTORS

DIGITIZATION DRIVES INVESTMENT

A record year for investments closes

The Bahrain Economic Development Board in 2017 posted its best year to date in terms of channelling capital into new projects. The total value of foreign direct investments (FDI) reached USD733mn, which represented an increase of 161% on 2016. The EDB helped bring a total of 71 companies to Bahrain, an increase from 40 the year before. The expected employment impact of these investments is 2,800 jobs over the coming three years.

The new projects were heavily dominated by the Information and communication technology (ICT) sector which made up a remarkable 54% of the aggregate figure. The most important single deal by far was the decision by US-domiciled Amazon Web Services (AWS) to build their first Region (including three data centres) in Bahrain. Manufacturing made up 20% of the total, led by the Mondelez expansion project. The share of transport and logistics was 10%, with Agility and Armada among others.

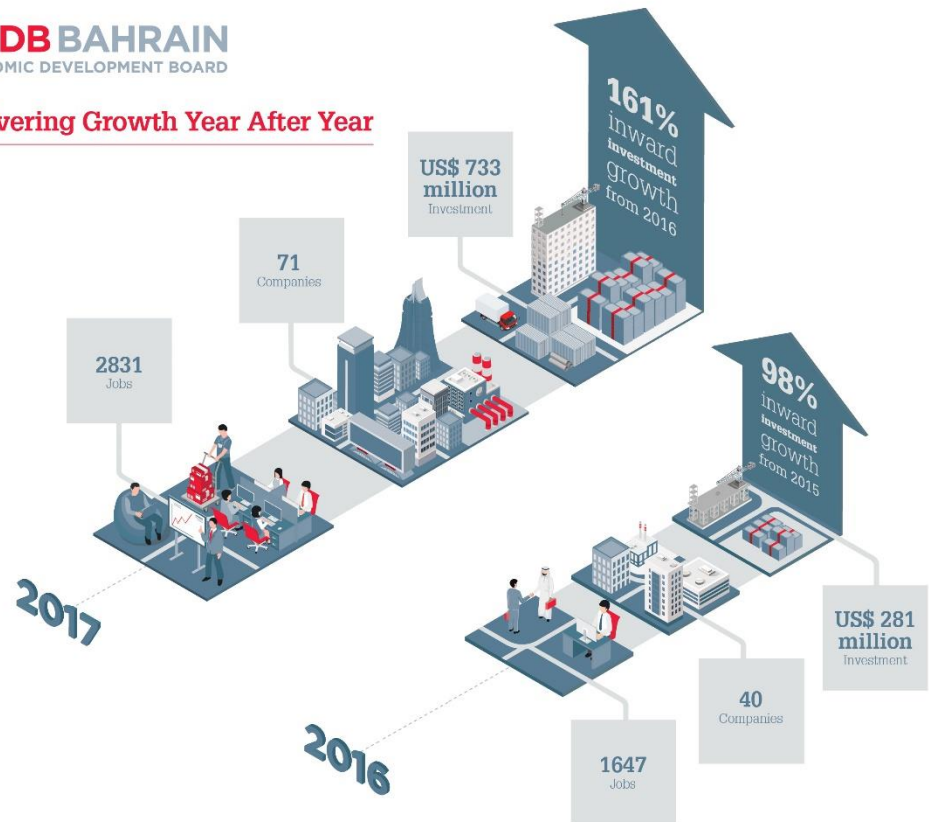
Tourism made up 10% of EDB's projects with investments by Action Hotels and the taxi services provider Careem the leading landmarks. The share of financial services was just under 5% and included investments by PayTabs, a payment solutions provider, and Invita, a business process outsourcing provider.

2017 became a record year for EDB-led foreign investments

EDB FDI projects



Delivering Growth Year After Year



Driving a financial transformation

The launch of the Bahrain FinTech Bay (BFB) in February 2018 marked an important milestone in the creation of a full financial innovation ecosystem in a country that has served as a regional financial hub for nearly half a century.

The accelerator facility achieved some 60% capacity during its first months of operation and has signed up a dozen start-ups to date. These companies are roughly equally split between local and foreign entities. Also a number of established financial institutions have taken up space in the centre in a bid to capitalize on and contribute to new trends in the industry. These include Benefit, BBK, and CBB. The CBB is further supporting the development of the sector through its dedicated unit for FinTech and innovation.

An important early product launch at BFB was the launch of the Middle East/North Africa region's first biometric payment network by the Benefit Company and Eazy Financial Services in late March. The fingerprint payment solutions will allow bank customers to perform payments without cash or cards.

Bahrain has seen a rapid increase in the number of locally financial sector-focused start-ups and new proliferation in areas such as digital wallets. The oldest local telecommunications company

Bahrain has continued to make strides in positioning itself as a hub of FinTech innovation

Batelco has partnered up with Arab Financial Services (AFS) to produce 'Bwallet', while the national switch of Bahrain, Benefit, has launched a wallet of their own 'Benefit Pay'. Bahrain is slowly catching up to the digitization of financial services in particular, with Gulf International Bank (GIB) launching the first digital bank in Bahrain and the region 'Meem.'

BFB fully recognizes the global nature of the emerging FinTech industry and has been keen to develop international partnerships. The EDB in January signed a Memorandum of Understanding with Abu Dhabi Global Market (ADGM) with the goal of information sharing and easier movement of start-ups, ideas, and people between the two jurisdictions. The agreement is designed to promote the GCC as a connected and collaborative environment for FinTech. Bahrain took a roadshow to the UK with the involvement of key players across the financial sector.

Also local events in Q1 served to generate publicity around financial innovation. The Fintastic Bahrain week was a series of events dedicated to promoting and celebrating the financial industry in Bahrain and the Gulf. Key events during the week included the GCC Euromoney Conference, as well as the official launch of BFB.

The Central Bank of Bahrain in Q1 issued a wholesale bank (branch) license to Bank of Jordan. The bank was established in 1960 and publicly listed on the Amman Stock Exchange. A representative office license was issued to Nomura International plc of the UK.

Moving toward a digital future

Bahrain has seen concerted efforts toward creating a comprehensive start-up ecosystem to promote technology-based entrepreneurship. In the opening months of 2018, the Kingdom hosted events such as Meet Bahrain, Dreamland Expo, Pitch at Palace, and most notably StartUp Bahrain Week. The StartUp Bahrain Week, held in March and sponsored by the EDB and Tamkeen, consisted of a total of five events (including the first ever GCC Game Conference) and four competitions. The largest of these was Unbound, which attracted over 1,500 visitors.

Also the local education and training sector is paying growing attention to skill development in this area. The University of Bahrain has enrolled its students in Microsoft's annual Imagine Cup competition where teams from secondary schools, vocational institutes and colleges attempt to solve software problems in certain areas. The Bahrain Institute of Banking and Finance (BIBF) has launched "Tech Talks" which consists of a series of workshops centred on IT infrastructure and technology trends.

Bahrain is well positioned to achieve further rapid growth through digitization. According to the Telecommunications Regulatory Authority (TRA), the country had some 2.37mn broadband subscriptions as of the end of 2017. Mobile broadband subscriptions represented some 93% of this total. Data traffic in the Kingdom increased from 82mn GB in 4Q16 to 122mn GB in 4Q17.

According to data released by the Information & eGovernment Authority (iGA), online transactions in Bahrain rose 55% between 2015 and 2016. BD46mn was transacted in digital payments through channels such as the national portal (Bahrain.bh), eGovernment Apps Store, and eKiosks.

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

The opening of the new Mondelez International Factory marks a major expansion for local light manufacturing

Manufacturing diversification

Apart from the high-profile heavy manufacturing expansions by Alba and Bapco, Bahrain is seeing important development also in lighter manufacturing. Highlighting Bahrain's advantages for regional for products distribution, Mondelez International in 2016 began constructing a USD90mn biscuit plant in the Bahrain International Investment Park. It began its operations in February. The annual capacity for the company's Oreo and Barni brands is 45,000 tn. This is expected to be doubled through two further lines and the masterplan envisages aggregate capacity in excess of 100,000 tn. The two Mondelez facilities in Bahrain are expected to create some 12,000 direct and indirect jobs locally and regionally. The facilities are currently exporting to 13 countries, a total that will reach 20 by the end of the year.

Renewable energy is emerging as an increasingly attractive focus area as the scaling back of energy subsidies and environmental sustainability considerations are stimulating interest. Bahrain has set a target of 10% of total energy consumption to be met through renewables by 2035. This is double the 5% target set for 2025. The Sustainable Energy Unit (SEU), established in co-operation with the United Nations Development Programme (UNDP) in 2014, is leading a number of new initiatives in the area of renewable energy and clean energy.

Several new regulations have been approved to enable the growth of alternative energy provision. The Cabinet this year approved a net metering policy which credits solar energy system owners for the electricity they add to the national grid. This terminates the long-standing status of the Electricity and Water Authority (EWA) as the sole power producer in Bahrain.

In an important milestone, this year saw the decision to build a 100MW solar power station as a public-private partnership project. The facility is set to provide 2.5% of Bahrain's electricity needs. Bahrain has also launched its first wind turbines.

Tourism with wind in the sails

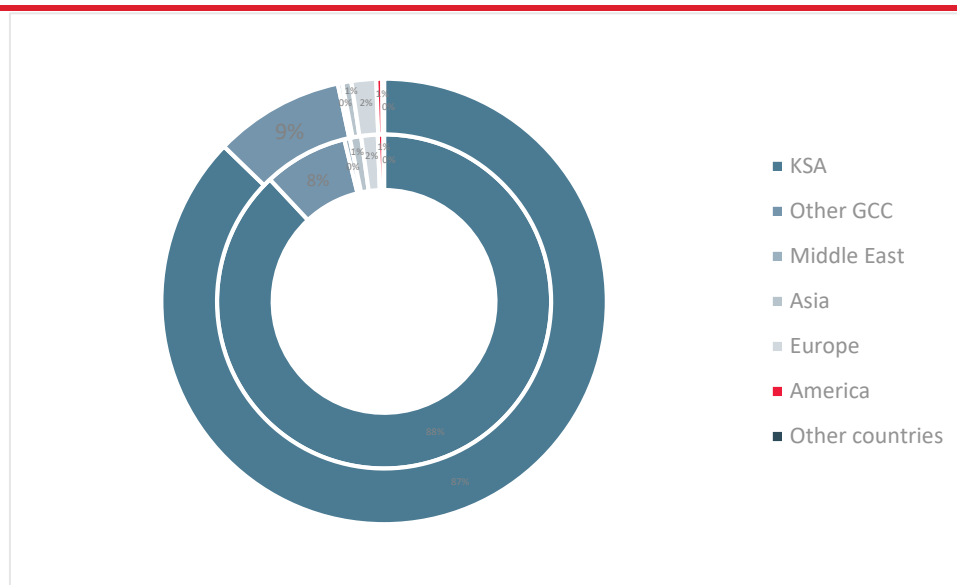
Bahrain's tourism sector experienced rapid growth in 2017. An inbound tourism flow of 11.4mn visitors marked an 11.9% increase from the previous year, according to the Bahrain Tourism & Exhibitions Authority (BTEA). Same-day trips without overnight stay made up 62% of the trips while longer stays totalled 38%. Most indicators of tourism activity point toward an improvement:

- ✦ The total number of tourist nights rose by 12.3% YoY to 12.3mn
- ✦ The average length of stay increased by 2.5% YoY to 2.82 nights
- ✦ Total tourism expenditure rose by 8.9% to BHD1.6mn, although average expenditure by visitor dropped by 3.3% to BHD85.2
- ✦ Most tourists came from Saudi Arabia and GCC countries. The number of tourists from Saudi Arabia rose by 10.9% to 9.9mn while visitors from the rest of the GCC increased by 29.5% to 1.1mn. The number of European visitors rose by 25.8% to 203,848

2017 saw rapid growth in Bahrain's tourism sector

- ✦ The number of tourist arrivals through the King Fahad Causeway increased by 11.9% to 10.1mn. Arrivals through the airport rose by 11.9% to 1.2mn. Tourist arrivals by sea saw a 23.2% increase to a total of 68,620
- ✦ The declared main purpose of tourist visits was holiday/leisure in 57% of all cases, shopping for 23%, visiting family and friends for 9%, and business and professional for 6%

Tourist visitors by region of origin, 2016-2017



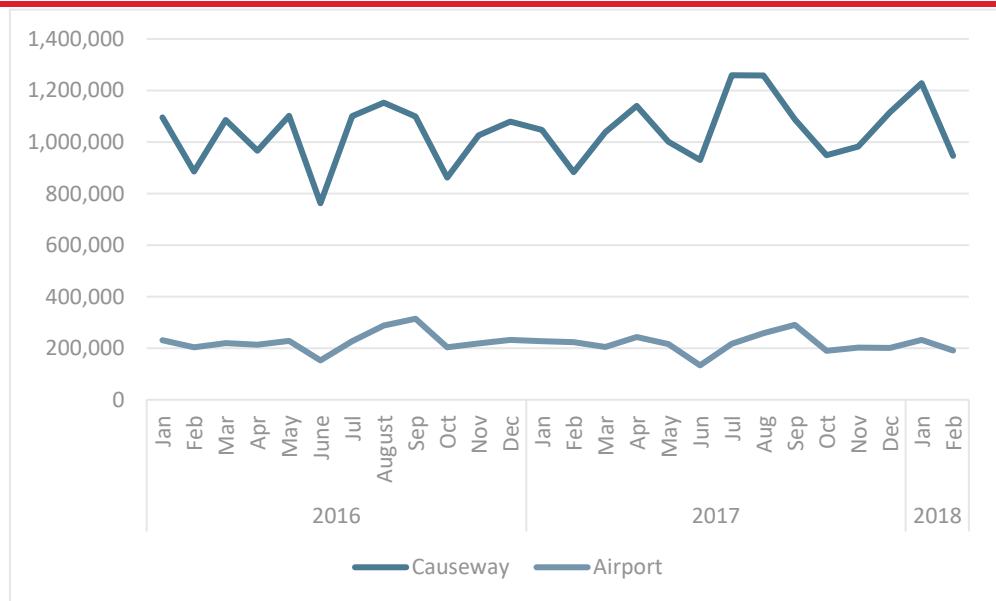
Source: Bahrain Tourism & Exhibitions Authority

The opening quarter of 2018 saw further key developments in Bahrain's tourism infrastructure and offerings:

- ✦ Three new five-star hotels opened their doors:
 - Wyndham Grand in Bahrain Bay (the largest facility of the chain anywhere, with 441 keys)
 - The Grove Hotel in Amwaj
 - Jumeirah Royal Saray in Seef
- ✦ The Hollywood-themed services apartments provider Paramount announced plans to open in Bahrain Bay in 2Q19 in partnership with the local developer Bin Faqeeh
- ✦ IKEA Bahrain is expected to open in 3Q18. One of the biggest IKEA stores in the region at approximately 255,100 sq ft, the new facility is expected to attract 1.2 mn people every year upon completion
- ✦ Bahrain has seen a growing trend in lifestyle malls which now include Zallaq Springs, Juffair Square, Liwan, Bahrain Marina, and Sa'ada West
- ✦ Bahrain Food Festival attracted more than 80,000 visitors over the span of two weeks

- ✦ The annual Spring of Culture has seen a number of event and activities, with a number of international and regional singers performing at Bahrain Bay to audiences of approximately 11,500
- ✦ The Bahrain Formula One Grand Prix took place for the 14th consecutive year in Bahrain
- ✦ The national carrier of Bahrain, Gulf Air, has received their first Boeing 787 Dreamliners, marking a start of a complete rollover for the fleet. Further new orders are expected in the near future
- ✦ The Cabinet passed law for 100% foreign ownership for operational of recreational water transportation facilities, activities of producers or promoters of sports events, arranging and assembling tours, and crop production and plant propagation
- ✦ The British College of Bahrain has made its official announcement of their partnership with The University of Salford to open up a campus in Bahrain which offers STEM (Science, Technology, Engineering and Maths) programmes.

Visitor arrivals by port of entry



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

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