



# Bahrain Economic Quarterly

September 2017

## SUMMARY

### ROBUST GROWTH MOMENTUM CONTINUES

The Bahraini economy has continued to post strong non-oil growth against the backdrop of a more benign international economic environment. At the same time, confidence across the GCC region is benefiting from stronger oil prices.

- ✦ **Headline real growth in Bahrain attained 3.3% YoY in Q2.** This was in line with the (revised) 3.5% pace posted in Q1. The annual rate of growth during the first half of the year reached 3.4%, which marked a slight improvement over the 3.2% rate seen during 2016 as a whole
- ✦ **Non-oil growth momentum has further accelerated in recent quarters.** The overall non-oil growth rate in Q2 was 4.3%. While slightly short of the 5.2% annual pace seen in Q1, this remained firmly ahead of the 3.7% rate recorded during 2006 as a whole. The non-oil economy expanded by an annual 4.7% during the first half of the year in a clear acceleration over 4.0% during 2016 as a whole
- ✦ **Oil output cuts have depressed GCC growth but momentum in the non-oil sector is accelerating.** Compliance with the OPEC-led productions cuts has led to a YoY contraction in the regional oil sector. By contrast, the non-oil economy is continuing to adapt to the new economic realities and posting stronger growth than in 2016
- ✦ **The global economy seems to be embarking on its first synchronized recovery since the onset of the financial crisis.** Growth is looking generally stronger in the advanced economies and is no longer primarily reliant on stimulus measures. Also emerging market growth is accelerating, partly thanks to stronger performance by China

#### Bahrain economic outlook

	2016	2017f	2018f	2019f
Real GDP growth, %	3.2%	3.1%	2.7%	2.2%
Non-hydrocarbons sector	4.0%	3.9%	3.3%	2.7%
Hydrocarbons sector	-0.1%	0.0%	0.0%	0.0%
Nominal GDP growth, %	3.4%	7.4%	6.4%	5.6%
Inflation (CPI %)	2.8%	1.8%	3.0%	3.5%
Current account (% of GDP)	-4.6%	-3.8%	-3.5%	-3.2%
Fiscal balance (% of GDP)	-13.6%	-11.0%	-9.8%	-6.4%
Crude Oil Arabian Medium (USD)	43	52	55	55

Source: Bahrain Economic Development Board

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

## GLOBAL ECONOMY

### ALL TOGETHER NOW

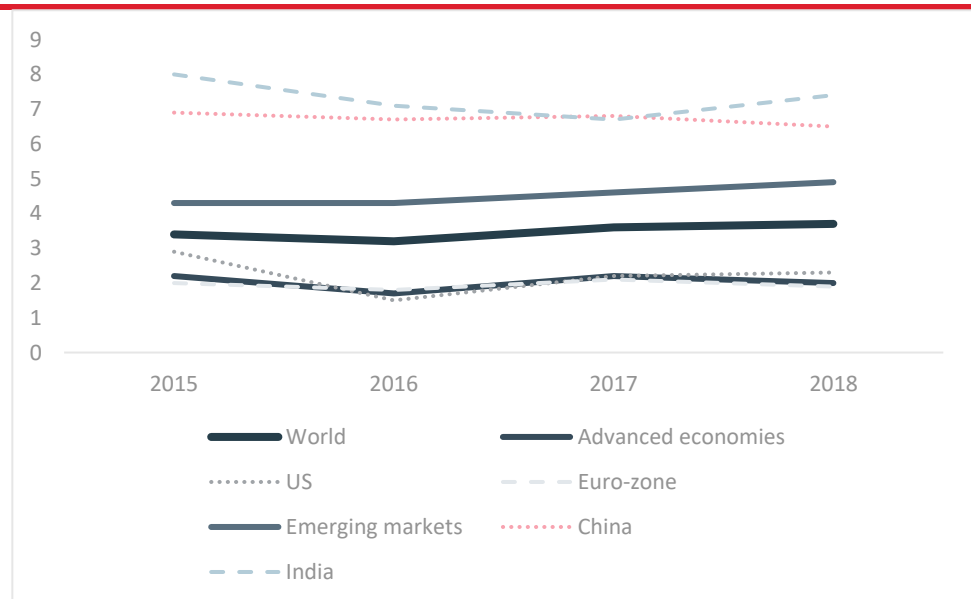
Even as the global economy remains subject to exceptional risks, the near-term outlook is increasingly turning into one of a synchronized recovery. This is the first time since the onset of the global economic crisis when the growth momentum of most major economies appears to be no longer primarily driven by stimulus measures.

The recovery is particularly evident in the US but also the Euro-zone has seen a steady improvement in its performance. Growth in Asian has proven somewhat slower, albeit possibly due to temporary factors such as the introduction of a national sales tax in India. Indian growth in Q2 slowed to 5.7%. Similarly, there is continued concern about the build-up in leverage in China, although for now, growth numbers have tended to surprise on the upside.

The International Monetary Fund now expects the global economy to expand by 3.6% this year in a clear acceleration from 3.2% in 2016. A slight further improvement to 3.7% is projected for 2018. Growth will continue to be solidly led by the emerging economies which are expected to post 4.6% expansion this year, followed by 4.9% next year. The advanced economies are on track for 2.2% growth this year and a broadly comparable 2.0% in 2018.

The stronger global growth has also translated into renewed growth in global trade flows. A downtrend in global trade was reversed last year when 1.4% expansion was achieved. This accelerated to an annual pace of 4.1% in the first half of 2017, suggesting that one of the main negative effects of the global crisis maybe passing even as worries persist about growing protectionism. Apart from greater economic dynamism, the expansion of trade has benefited from generally stronger commodity prices.

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



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

*The global economy appears to have entered its first synchronized recovery since the onset of the global economic crisis*

## Monetary normalization continues

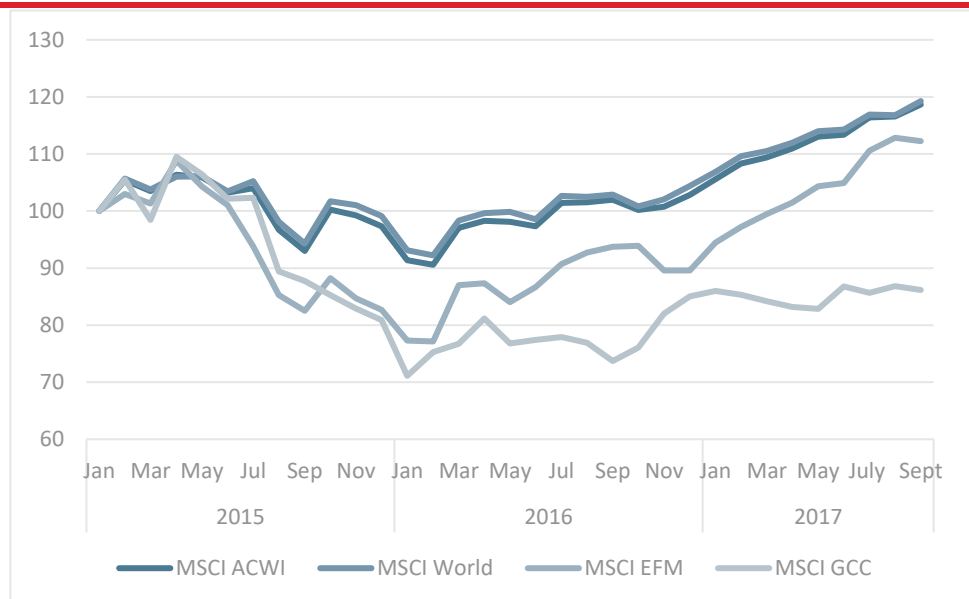
*The era of ultra-loose monetary policy appears to be drawing to a close, although questions persist as to the “new normal” for interest rates in a low inflation environment*

Perhaps the most obvious indication that the post-crisis era is finally drawing to close comes from the increased willingness of major central banks to start scaling back their extraordinary monetary stimulus measures. This process has been led by the US Federal Reserve, whose retreat from stimulus has been encouraged by a combination of strong economic data and the prospect of ambitious tax reforms by the Trump administration. Among other things, the Government is proposing a new fiscal regime with lower corporate tax rates and a personal income tax top bracket of 35%. The main counterargument against policy tightening continues to be the persistent absence of inflationary pressures even as unemployment has fallen to its lowest level since 2001. US inflation in August rose to 1.9%.

After a bout of weakness, the US Dollar has recently received renewed support from the increased willingness to normalize monetary policy. There is growing market consensus that the Fed will agree on another quarter point rate increase in December. However, Fed Chair Janet Yellen has also suggested that downward pressures on inflation may prove more persistent than expected and ultimately translate into a looser monetary policy stance. The Fed has further decided to start unwinding its quantitative easing (QE) program in October. The plan is to allow USD10bn of assets to mature each month with the ceiling being increased by a further USD10bn once a quarter until a monthly ceiling of USD50bn is reached. The Fed's balance sheet stands at USD4.5trn.

Other major central banks appear to be moving in the same direction. The Euro-zone recovery is looking increasingly strong with 2.1% YoY growth in Q2 and unemployment at its lowest in eight years. However, the outcome of the German elections along with the Catalan independence dispute has underscored the fact the political risk is by no means a thing of the past. While edging toward normalization, ECB President Mario Draghi has signaled his determination to maintain as much stimulus as needed, lest monetary policy changes jeopardize the recovery.

### Global equity market performance (Jan 2015 = 100)



Source: MSCI

## Renewed oil optimism

After a lacklustre and largely flat late spring and summer, the oil market regained some of its positive momentum in Q3. The monthly average of the Brent benchmark, having troughed at USD46.4 per barrel in June, rebounded to USD56.2 in September. Several factors account for this turnaround:

*Oil prices regained their upward momentum in Q3 against the backdrop of stronger global demand growth and OPEC determination to control output*

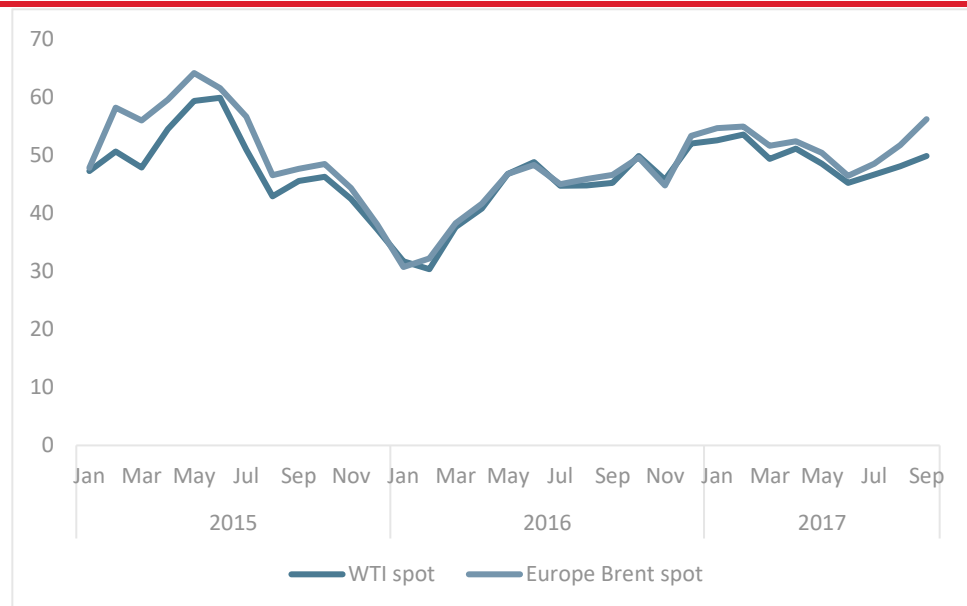
- ✦ A combination of stronger global growth and a period of lower prices has pushed up the demand for oil. A bout of relative US Dollar weakness further contributed to this. 2017 is seeing the fastest increase in global oil demand since 2015, according to the International Energy Agency (IEA), which now puts its projected demand growth this year at 1.6 mbd, the equivalent of 1.7%. This is clearly ahead of the 10-year average of some 1.2 mbd
- ✦ Even though the process of market rebalancing has persistently defied past expectations, there are growing signs of the supply overhang beginning to diminish. Advanced economy inventories have declined by some 28% since the beginning of the year. Global oil supply in August fell by 720,000 b/d while concern is mounting about the ability of several OPEC members to increase output soon. The situation is particularly acute in Venezuela where underinvestment is depressing output. But also, countries such as Nigeria, Libya, Iran, and Iraq are likely to be affected by reduced investment in exploration and field development. The rebound in US rig numbers has stalled and the shale sector is amidst a major shake-up due to high leverage levels as the cost of debt has increased
- ✦ A tighter market is in turn making oil prices more sensitive to unexpected disruptions. Recent events in Iraqi Kurdistan, which held an independence vote in September, are a case in point when it prompted Turkey to threaten to halt all oil shipments through its territory. The Kurdistan Regional Government has relied heavily on the south-eastern Turkish port of Ceyhan for its crude exports. Meanwhile, the Iraqi parliament voted to place the Kurdish fields under federal control. KRG output in 2016 was 544,600 b/d with 602,000 b/d projected for this year. The region is responsible for 12% of Iraq's output. Kurdish exports last year were estimated at 515,000 b/d. Renewed tensions around the Iranian sanctions deal is another source of market concern
- ✦ OPEC and its partners seem firm in their commitment to control their supply until the market has returned to a balance. OPEC output in August was 32.76 mbd, reflective of 98% compliance with cuts. There have been reports of discussions to extend the output cuts past March, potentially for most of 2018. Some are even suggesting a further 1% cut in production. Saudi Arabia has reiterated its determination to cut unilaterally as needed to support prices

Even as the oil market is showing signs of tightening, there are important questions as to the speed and continuity of this apparent trend:

- ✦ OPEC expects demand for its oil to increase next year and recently revised the projected demand by 400,000 b/d to 32.8 mbd. This is roughly in line with current production levels. However, OPEC expects demand for its oil to fall short of this in the first half of 2018.

- ✦ Some industry estimates suggest that US output could grow by as much as 400,000 b/d over a matter of months should prices rebound to the 60s. Similarly, compliance with the OPEC-led cuts is likely to prove more difficult to ensure in a more favourable pricing environment. US exports have risen close to 2 mbd
- ✦ A stronger Dollar, if sustained, may curb the upward momentum

#### Monthly average crude oil prices (USD/barrel)



Source: US Energy Information Administration

#### Global oil demand and supply dynamics (mbd)

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

\*Petroleum and other liquids data

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

### Implications for Bahrain

The global backdrop for Bahrain is generally benign with the main risks likely pertaining to a tighter monetary stance:

- ✦ The global economic recovery appears to be gathering steam which should support trade and investment flows
- ✦ There are renewed signs of oil market rebalancing, which should help improve the fiscal position in combination with ongoing consolidation efforts
- ✦ With monetary tightening in the US set to continue, the monetary policy environment is set to become less permissive. However, there are growing doubts about how far rates can rise in the current low inflation environment



## THE GCC REGION

### OIL-FUELLED OPTIMISM

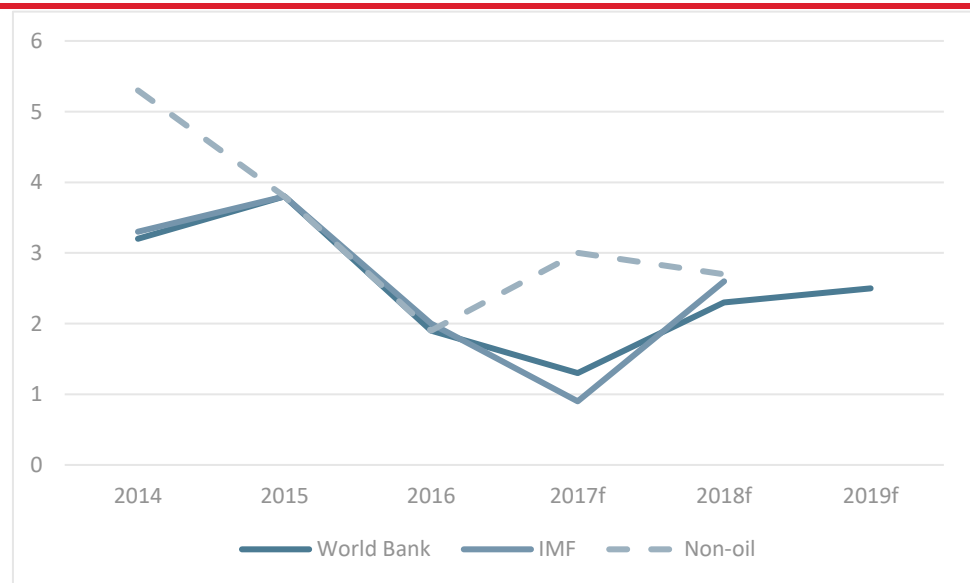
*While oil production cuts will bring down regional headline growth this year, non-oil economic activity is showing signs to accelerating from last year's lows*

The GCC economy is steadily continuing to adjust to the new oil market and fiscal realities. In this environment, the drivers of oil sector and non-oil growth are increasingly decoupling, a trend that various government policies across the region are seeking to encourage further.

Growth in the oil sector is set to fall to a multi-year low this year as a result of the OPEC-led output cuts. This in turn is likely to reduce headline growth to its cyclical trough – at most 1.5% for the GCC region as a whole. In fact, some estimates suggest growth of less than 1%.

By contrast, the growth momentum in the non-oil economy appears to be strengthening as companies adjust to the new economic realities. Further steps toward fiscal consolidation – such as the introduction of the region-wide value added tax next year – will temper this growth momentum but are unlikely to reverse it.

**GCC real GDP growth, %**



N.B. The non-oil growth projections are by the IMF.

Source: International Monetary Fund, World Bank

### Gradual strengthening in the non-oil sector

Economic activity in the non-oil sector has generally continued to strengthen across the region. Nonetheless, the first half of the year saw very subdued growth in much of the region with the more diversified economies generally performing somewhat better. GCC-wide corporate earnings disappointed as they came below expectations, reflecting tougher operating conditions. Overall, net profits were up 3% y/y in the first nine months of 2017, but the pick-up stemmed from cost cutting rather than higher revenue. Indeed, total revenue growth across Kuwait, Saudi, and the UAE was flat and up 1% as a whole for the GCC. Also, project awards have remained under



downward pressure with MEED Projects tallying regional awards of USD56.1bn during the first half of the year, down on USD69.3bn a year earlier.

Economic growth in the region's largest economy, Saudi Arabia, has remained subdued with a 1% YoY headline contraction in Q2. This was led by a 1.8% YoY drop in the oil sector as a direct result of the OPEC cuts. The non-oil sector, by contrast, expanded by an annual 0.6% with the Government sector increasing by 1% and the non-oil private sector by 0.4%. Recent data point to gradual strengthening of activity. Point of sale transactions in the summer months achieved double-digit annual growth rates while ATM withdrawals rose by 4% YoY in August. Trade data, similarly, has turned more positive with a 19% YoY increase in imports and a 25% rise in non-oil exports in July. The IMF now projects Saudi headline growth this year of just 0.1% followed by 1.1% in 2018.

*Although the overall growth dynamics are historically subdued, most indicators of non-oil activity point to gradual normalization*

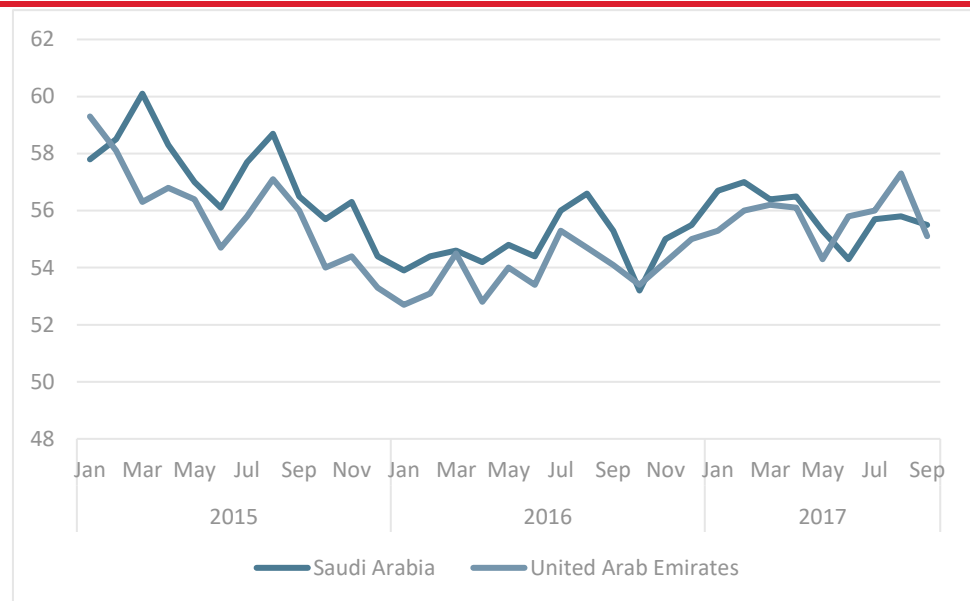
The Non-Oil Economic Composite Indicator of the UAE Central Bank suggested a non-oil growth rate of 3.1% during the first half of 2017. Nonetheless, the OPEC-led cuts have brought headline growth down from 3.3% in Q1 to 2.4% in Q2. YoY growth in the Dubai economy decelerated from 3.9% in 4Q16 to 3.2% in 1Q17. While the economy is thus continuing to expand, new job creation has been minimal. The IMF now expects UAE growth to be 1.3% this year, led by 3.3% expansion in the non-oil sector. Growth is projected to rebound to 3.4% in 2018.

In Kuwait growth in total consumer spending has also been steadily improving and reached an annual pace of just under 5% in 2Q17. Also, consumer confidence has continued its gradual rebound. In spite of the stronger performance of the economy, employment growth has been historically subdued. In particular, the public sector added 17% fewer jobs in FY2016/17 than the year before. Non-Kuwaiti job growth fell below 4% YoY in 1H17. The IMF projects a 2.1% oil-led contraction in the Kuwaiti economy this year followed by a sharp 4.1% rebound in 2018. Also, the Oman forecast sees flat GDP this year followed by 3.7% expansion in 2018.

Qatar has seen a sharp slowdown in its growth, partly as a result of a diplomatic dispute with its neighbours. Headline growth in Q2 stalled to an annual 0.6%, down from 2.4% in Q1. While the hydrocarbons sector shrank by 2.7% YoY, in line with regional trends, also non-oil growth decelerated from 5.2% in Q1 to 3.9% in Q2. Going forward, growth is likely to benefit from increased activity in the hydrocarbons sector with the launch of the Barzan gas project.

Forward-looking indicators of economic activity in the GCC suggest that the positive trend in non-oil growth is likely to continue. The Emirates NBD Purchasing Managers' index for the region's two largest economies has, in spite of some volatility, seen consistently higher readings than in 2016. The YTD average during the first three quarters of 2017 was 55.9 in Saudi Arabia, up from 54.9 a year earlier. The UAE monthly average improved from 53.8 to 55.8 over the same period. The Emirates NBD Dubai Economy Tracker saw a slight drop from 56.3 in August to 55.2 in September.

### Emirates NBD Purchasing Managers' Index



Source: Emirates NBD, Markit

Going forward, growth in the will likely benefit from potent structural drivers. The Saudi authorities have announced plans to release a revised version of the National Transformation Program (NTP) 2020 later this year. The original NTP released last year set 543 initiatives with a total cost of SAR268bn (USD71bn). Its key overarching goals were linked to employment, private sector participation, local content maximization, and digital transformation.

In another important step, the Saudi government has agreed to allow women to drive starting in June 2018. This will be instrumental for achieving the objectives of greater female labour market participation and will also reduce reliance on low-cost foreign labour. Other economies activities benefiting from the move are likely to include car sales, insurance, and consumer goods.

Kuwait is, similarly, implementing its 'New Kuwait' strategy which was launched earlier this year. The plan is aimed at diversifying the economy with key policy initiatives are clustered around seven key pillars: global standing, human capital, healthcare, living environment, infrastructure, the economy and public administration.

In an important development for a region going through a major infrastructure build-up, the real estate sector is showing signs of stabilizing. The property market has been challenged by weaker demand growth and increasing supply. For instance, the Government estimates that real estate prices in Saudi Arabia declined by 8.7% last year. The Dubai real estate sector has recorded stronger growth and especially apartment prices are showing sign stabilizing. Overall transaction volumes during the first eight months of the year were up by 9.8%, as compared to a 24.6% drop a year earlier. In Kuwait, residential real estate sales rose by 23% during the first eight months of the year. Prices are stabilizing, albeit down 5%-10% YoY.

Tourism flows have also remained generally strong. The Dubai International Airport witnessed its busiest month on record in August with 8.2mn passengers. The YTD average of 7.4mn compared to a 2016 average of 6.9mn. Hotel occupancy has remained high (83% in 1H17) in spite of new construction ahead of Expo 2020. Saudi Arabia had a successful Hajj season with a record share of

*The real estate sector is showing signs of stabilizing across the region*

foreign pilgrims at 74%. The total number of pilgrims rebounded sharply from less than 1.9mn in 2016 to some 2.4mn this year.

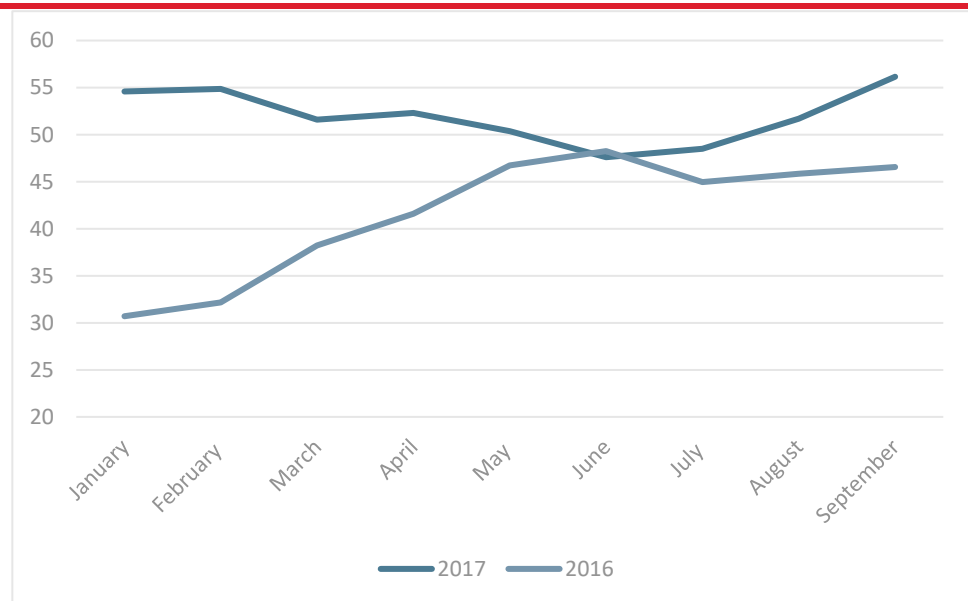
### Fiscal consolidation progresses

*Fiscal consolidation has benefited from higher oil prices but also revenue diversification is beginning to pay off. The introduction of excise and value added taxes is likely*

The fiscal reforms across the GCC region are beginning to bear fruit while the stronger oil prices are further accelerating the gradual process of fiscal rebalancing. For instance, Saudi Arabia's budget deficit during the first half of 2017 was half the level recovered a year earlier. Saudi revenues during Q2 rose by an annual 6% to SAR163.9bn, led by a 28% gain in oil revenues. Spending declined by 1.3% to SAR210.4bn. The resulting deficit of SAR46.5bn compared to a shortfall of SAR58.4bn as year earlier. Recurrent spending was 2.4% lower in 1H17. Oil made up 62% of Saudi Government income in Q2.

Oman's budget deficit in the first five months of the year was OMR2bn, as compared to just over OMR5bn in 2016. Similarly in Qatar, the fiscal shortfall contracted to 5.1% of GDP in Q1, as compared to 17.9% in 4Q16. Government revenues rose by an annual 31.0%, more than twice as fast as the 15.8% increase in expenditure.

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



Source: US Energy Information Administration

Several further steps are being taken to push fiscal consolidation forward:

- ✦ The costly regime of universal subsidies is continuing to be scaled back. Kuwait has implemented petrol subsidy cuts while Saudi Arabia is reportedly planning to raise gasoline and jet fuel prices in November
- ✦ Revenue diversification is making gradual headway. Saudi Arabia became the first regional economy to introduce excise duties in June. The UAE introduced an excise duty in October with a 100% increase on tobacco and energy drinks and 50% on fizzy drinks. The duty is expected to raise around USD2bn (some 0.5% of GDP) of revenue annually. The UAE has further reiterated its intention to implement the region-wide VAT from January. It will be

levied on companies with annual revenues greater than USD1mn. The 5% levy is projected to generate tax revenues of some USD5bn a year – or 1% of GDP. The Government expects VAT to generate AED12bn in the first year and AED20bn in the second year

- ✦ The administration of the fiscal system is strengthening, an example being the creation of the Federal Tax Authority in the UAE
- ✦ Government infrastructure spending is continuing to be reviewed in some countries and there is a growing interest in new funding models involving private capital

### Lower oil production underpins slower growth

Having been a key source of GDP growth in recent years, the oil sector across the region is pulling down headline growth because of the OPEC-led production cuts. Saudi Arabia has been leading the way and recently signalled that it would be ready to cut a further 300,000 b/d starting in November to drive the global rebalancing. Similarly, the UAE's Abu Dhabi National Oil Company (Adnoc) recently announced that it will cut crude shipments by 10% starting in October.

Overall, regional output has remained well below last year's levels. Saudi output is estimated to have averaged just over 9.95 mbd during the first eight months of the year. This is some 4.2% down on the 10.38 mbd monthly averaged recorded during the corresponding period of 2016. In Kuwait, the monthly average has declined an estimated 6.2% from a monthly average of just under 2.9 mbd during the first eight months of 2016 to just over 2.7 mbd a year later. In the UAE, the decline was just over 11.1% from some 3.27 mbd to 2.9 mbd.

Even as crude extraction is under downward pressure in the near term, the regional oil companies are developing other activities. Saudi Aramco recently announced plans to expand its trading business to buying and selling non-Saudi crude. Kuwait is pursuing ambitious plans in the downstream area. The authorities are aiming to modernize and expand the two largest refineries in the country. An entirely new refinery will be built to replace a decommissioned facility. These investments should increase the country's overall refining capacity from 0.9 to 1.4 mbd by 2020.

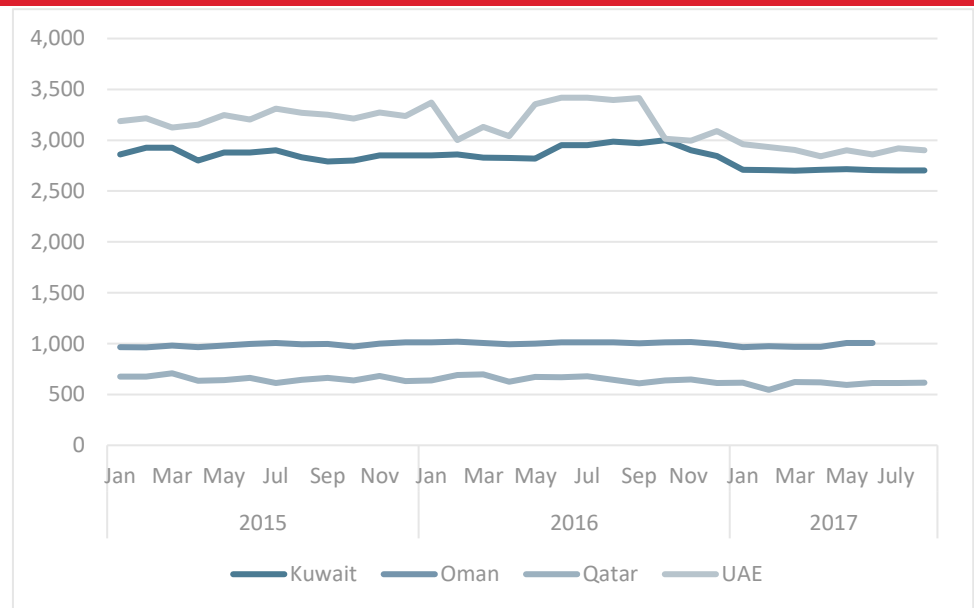
*Key producers across the GCC have cut their oil output in response to OPEC's current quota regime*

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



Source: Joint Organisations Data Initiative, OPEC

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



Source: Joint Organisations Data Initiative, OPEC, Bloomberg

### Inflationary convergence at low levels

Consumer price pressures have generally remained on a firm downtrend across the region. While some regional economies saw YoY inflation in excess of 3% as recently as the beginning of the year, the regional inflation rates had converged to a fairly narrow range of -0.4% to 1.2% by August. Both Saudi Arabia and Qatar recorded YoY declines in consumer prices. Indeed, Saudi inflation has remained consistently negative since the beginning of the year, although the August reading was barely negative at -0.1%.

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

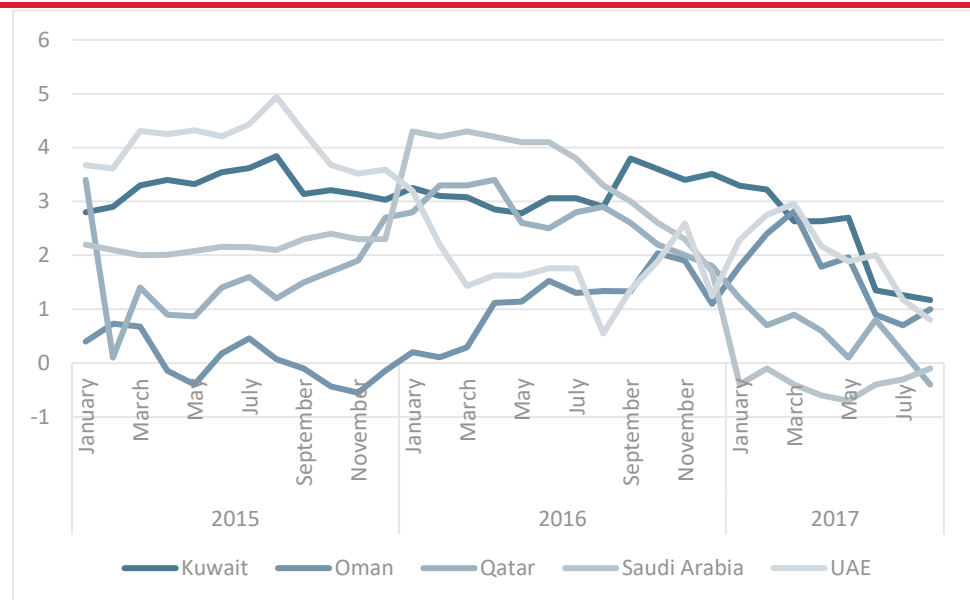
*Inflationary pressures remain subdued across the region with a clear downtrend in evidence since the summer*

The highest inflation has been recorded in Kuwait, Oman, and the UAE. However, all three countries have seen a fairly consistent deceleration this year from the neighbourhood of 3% to around 1% in August.

The slower inflation has been due to reduced import price inflation thanks to bouts of US Dollar strength as well as the inflationary impact of earlier subsidy price cuts wearing off. There have been minimal disruptions in the food market, while the ample new supply in the real estate market has curbed housing cost inflation at a time of measured demand growth.

Going forward, the introduction of the regional excise duty and VAT is likely to stoke up renewed inflationary pressure. UAE government officials have estimated the short-term inflationary impact of VAT and the excise duty at 1.4%.

#### Consumer price inflation, %



Source: National statistical agencies

#### Fixed income markets drive financial sector activity

Activity in the financial sector has been heavily dominated by continued sovereign issuance, while also corporate names, especially in banking and utilities remain active. In particular, the sukuk market has become more active in spite of some concerns over the impact of the Dana Gas dispute. GCC sukuk issuance in the first half was USD17bn, up on USD13.7bn a year earlier. Total GCC bond and sukuk issuance in 1H17 reached a record USD43, as compared to USD36bn a year earlier.

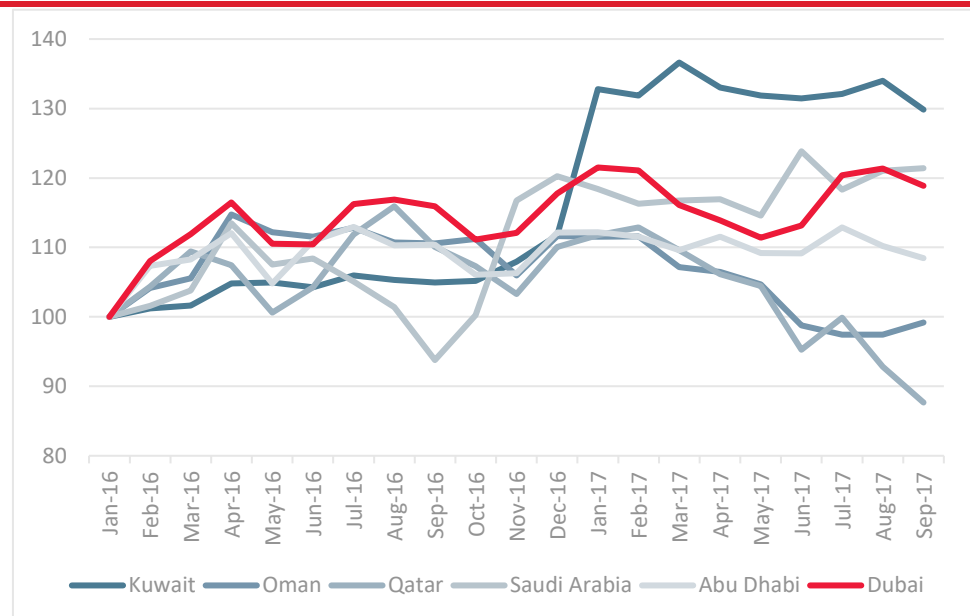
Most GCC governments have tapped the bond and sukuk markets at a time of low rates and strong international demand:

- ✦ Saudi Arabia in July launched a new domestic sukuk program following regular domestic bond issuance between 2015 and September 2016. 13 Saudi banks were qualified as participants by the Ministry of Finance. Three rounds of sales with an aggregate value of SAR37bn were conducted by the end of Q3: SAR17bn in July, SAR13bn in August, and SAR7bn in September.

The placements were approximately three times oversubscribed with the latest round in September attracting SAR24bn of subscriptions. Each round was composed of three tranches with tenors of five, seven, and ten years, respectively

- ✦ Saudi Arabia in late September issued its second international bond, a USD12.5bn offering, which was the largest emerging market bond in 2017. A USD3bn five-year tranche was priced at 110 basis points over US Treasuries. A USD5bn 10-year bond was placed at 145 bps over Treasuries, while a USD4.5bn 30-year offering had a 185 bps margin. More than three times oversubscribed, the placement attracted bids in excess of USD40bn. Saudi Arabia has raised nearly USD40bn in international markets since 2016
- ✦ The Kuwaiti Cabinet in August approved a bill that allows the Government to take loans of up to KWD25bn for a period up to 30 years. Recent issuance by the Central Bank of Kuwait took the total outstanding domestic debt to KWD4.9bn
- ✦ Oman in August announced a USD3.55bn five-year loan agreement with a number of Chinese financial institutions. The initial target for the deal had been USD2bn
- ✦ At the very beginning of October, Abu Dhabi issued a USD10bn international bond which attracted some USD30bn of subscriptions. The offering was composed of three tranches with maturities of five, 10, and 30 years, respectively. The spreads varied between 65 bps and 130 bps above Treasuries

#### GCC equity market indices (January 2016=100)



Source: Regional stock exchanges

The regional equity markets have generally lagged their international peers, reflecting the volatility of oil prices as well as the historically weaker drivers of non-oil growth at a time of tighter liquidity and reduced government spending. Most regional markets have fluctuated around a relatively flat trend this year. During Q3, Dubai and Oman were the only two regional markets to post positive growth, by 5.1% and 0.4% respectively. Apart from an 8% drop at Qatar Exchange, the other regional exchanges posted modest declines of 0.6-1.8%. During the first three quarters of the year,

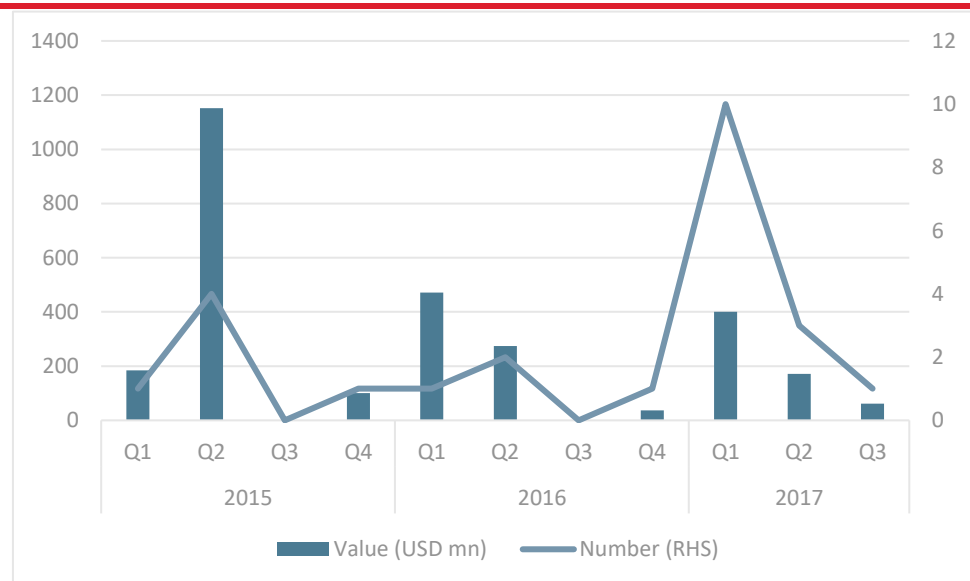


Boursa Kuwait was the strongest performer with a 16.2% gain. Saudi Arabia's TASI gained 1% and the Dubai Financial Market 0.9%. The other regional markets declined in YTD terms with Abu Dhabi shedding 3.3%, Oman 11.2%, and Qatar 20.4%.

In an important development in the ongoing internationalization of the regional equity markets, FTSE Russell included Kuwait as a "secondary emerging market" as of September 2018. The decision is likely to result in passive inflows of USD600-800mn as more international investors choose to track the Kuwaiti index. FTSE Russell did not yet include Saudi Arabia in its Emerging Markets index but is expected to consider the issue again in March.

Primary equity market activity has remained fairly subdued by historical standards. A total of 14 GCC companies listed during the first three quarters of the year. However, the amount raised – USD632mn – fell short of the corresponding figure in 2016, namely USD745mn. Outside of the GCC, Dubai-based oil and gas production services firm ADES International Holding raised USD243.5mn in a London IPO in May. Q3 saw only one IPO when Saudi Arabia's Zahrat al Waha Trading Co. sold a 30% stake in September.

#### GCC quarterly IPO activity

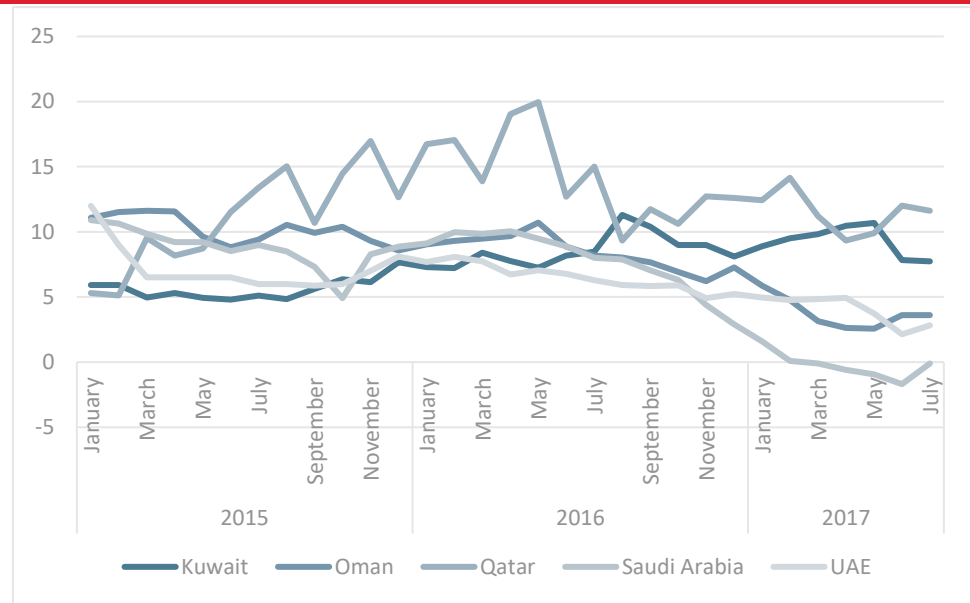


Source: PricewaterhouseCoopers, Tadawul

Reflecting the lower oil price environment, bank lending has generally continued to edge down across the region. At same time, new liquidity requirements under Basel III appear to be curbing loan growth. With the exception of Qatar and Kuwait, the YoY pace of lending growth is now below 5%. In the case of Saudi Arabia, credit growth has remained negatively, albeit on the latest data only barely so.

*Bank lending has generally tended to drift down in a tighter liquidity environment*

In the case of Qatar, renewed lending growth has been made possible by a sharp increase in public sector deposits, which were up 70% YoY as of July. A QAR95bn injection since the onset of the crisis has pushed up the share of government deposits from 26% to 37%. While primarily a response to heavy non-resident deposit outflows, the policy has also increase the annual pace of deposit growth to 20% in August.

**Bank credit growth, %**

Source: Regional central banks

**Implications for Bahrain**

The regional environment of historically subdued growth and ongoing fiscal consolidation entails mixed implications for Bahrain:

- ✦ The improved near-term prospects for the non-oil economy should support regional trade and investment. However, the ongoing steps toward government revenue diversification are likely to test to positive momentum somewhat
- ✦ More subdued disposable income growth should increase Bahrain's appeal as a regional, cost effective holiday and weekend destination, thereby supporting tourism

## BAHRAIN

## ROBUST GROWTH MOMENTUM CONTINUES

Recent revisions to the 2016 National Accounts as well as more complete data for 1Q17 indicate that the Bahraini economy is on a somewhat faster growth trajectory than previously estimated. The revised overall growth figure for 2016 was 3.2% and growth in Q1 further accelerated to 3.5%.

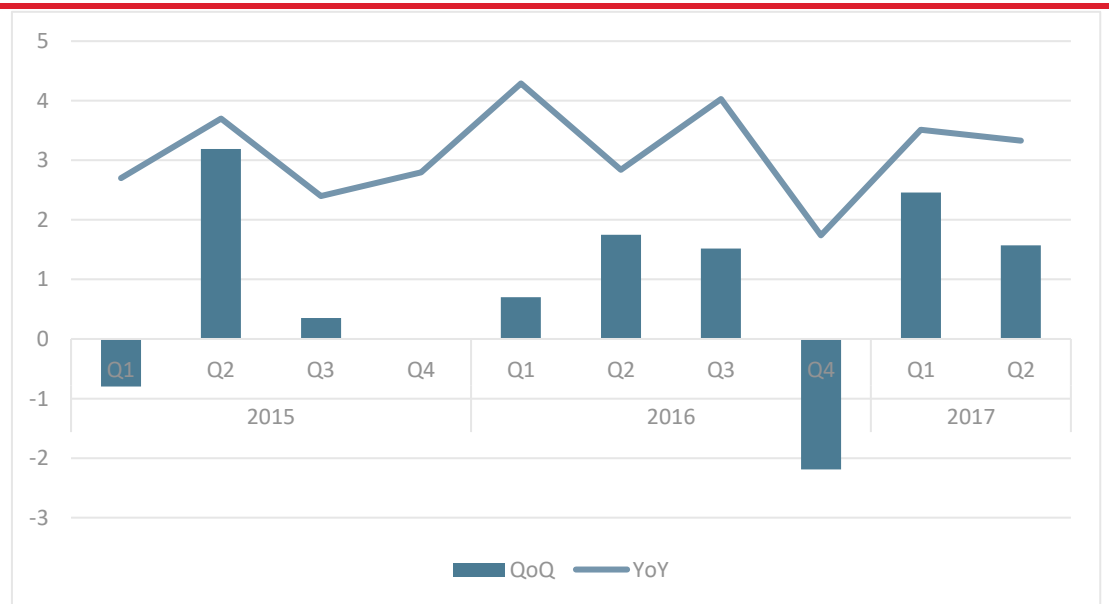
The Bahraini economy posted another quarter of strong performance during the April-June period. Headline real growth in the Kingdom attained 3.3% YoY in Q2. The annual rate of growth during the first half of the year reached 3.4%, which marked a further improvement over the rate seen during 2016 as a whole.

Non-oil growth decelerated from an annual 5.2% in Q1 to 4.3% in Q2. The non-oil economy expanded by an annual 4.7% during the first half of the year. This nonetheless remained ahead of the 4.0% pace recorded during 2006 as a whole. The continued strong growth momentum is reflective of unusually strong countercyclical drivers, most notably unprecedented infrastructure investments.

By contrast, the oil sector has remained under some continued downward pressure. It contracted by just over 0.5% YoY in Q2. The annual pace of decline during 1H17 was 1.9%. The declines are partly reflective of a base effect as especially offshore output was above historic capacity levels last year. Onshore production, similarly, remained under some downward pressure during 1H17.

*The Bahraini economy is growing slightly faster than previously projects with the YoY growth rate 3.4% during 1H17*

## Real GDP growth

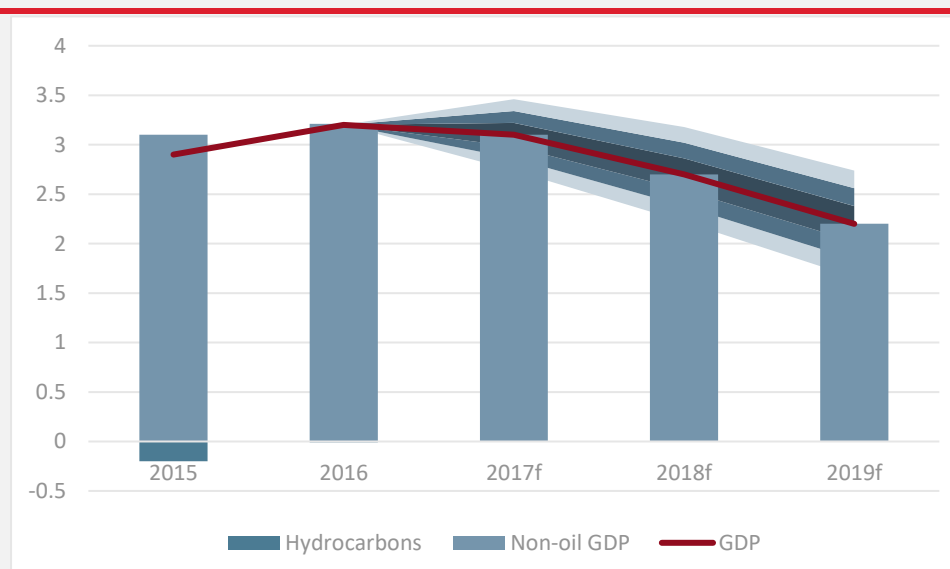


Source: Information & e-Government Authority

**Forecasts: Growth continuity in the face of conflicting pressures**

	2016	2017f	2018f	2019f
Real GDP growth, %	3.2%	3.1%	2.7%	2.2%
Non-hydrocarbons sector	4.0%	3.9%	3.3%	2.7%
Hydrocarbons sector	-0.1%	0.0%	0.0%	0.0%
Nominal GDP growth, %	3.4%	7.4%	6.4%	5.6%
Inflation (CPI %)	2.8%	1.8%	3.0%	3.5%
Current account (% of GDP)	-4.6%	-3.8%	-3.5%	-3.2%
Fiscal balance (% of GDP)	-13.6%	-11.0%	-9.8%	-6.4%
Crude Oil Arabian Medium (USD)	43	52	55	55

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

**Projected real GDP growth contribution**

Recent data revisions put the trend growth rate in Bahrain at a higher level than previously estimated. In addition, the ongoing rapid build-up in infrastructure spending along with the fiscal direction provided by the 2017-2018 suggest that growth is likely to remain around 3% in 2017 and 2018 alike. Beyond that, further steps toward fiscal consolidations (notably the full impact of VAT) along with the base effect on the infrastructure side, are likely lead to more moderate growth with a gradual deceleration toward 2-2.5% now likely by 2019.

Near-term inflationary pressures are likely to remain fairly measured with the introduction of VAT eventually resulting in one-off increases. However, inflationary expectations remain well anchored.

The fiscal and external imbalances are likely to correct gradually, with the introduction of VAT eventually accelerating the fiscal consolidation more significantly.

*Non-oil growth in 1H17 attained an annual pace of 4.7%. The momentum was led by the private sector which expanded by 5.0% YoY*

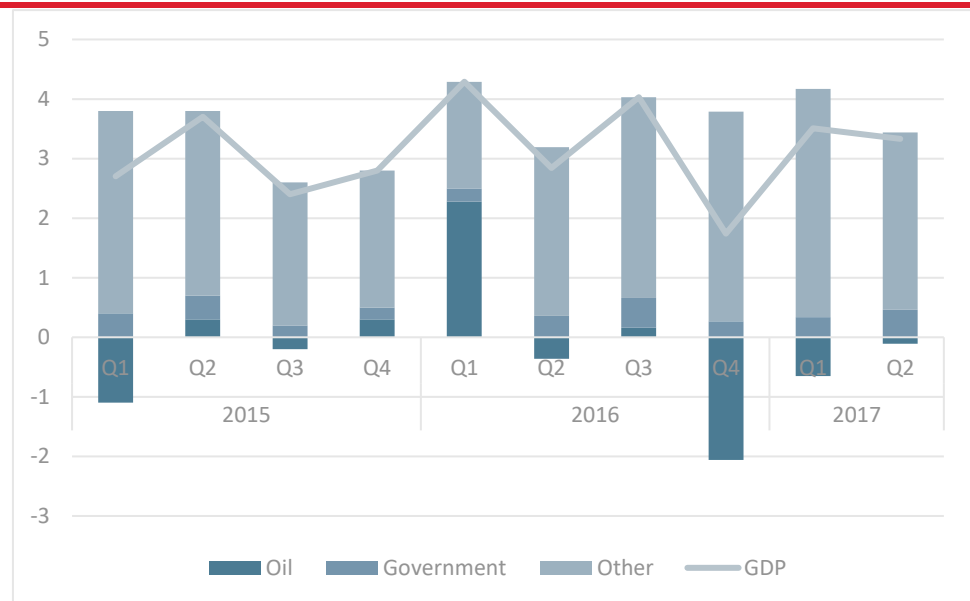
### Non-oil activity shows continued resilience

The revised national accounts data showed 5.2% YoY growth in the non-oil sector during Q1. With Government Services posting only modest growth, the non-oil private sector expanded by a remarkable 5.7%. This growth momentum moderated somewhat in Q2 and its composition changed. Nonetheless, growth remained strong by recent historical standards.

The YoY non-oil growth rate in Q2 was 4.3%. While markedly lower than the Q1 reading, this still pointed to non-oil sector momentum ahead of that seen in 2016. The non-oil private sector expanded by an annual 4.4% while Government services expanded by 3.6%.

The overall rate of non-oil growth during the first half of 2017 reached 4.7% as compared to the first half of 2016. This was clearly ahead of the 4.0% non-oil growth recorded during 2016 as a whole. The non-oil private sector expanded by just over 5% in annual terms. This compared to 3.1% YoY expansion in the Government Services sector.

### Real GDP growth composition



Source: Information & eGovernment Authority

The sectoral composition of growth in Q2 was broadly in line with the trends seen during the beginning of the year. The fastest growing sector was Hotels & Restaurants, which posted a 13.4% YoY rate of expansion in a slight acceleration from the 12.3% pace seen in Q1. Social & Personal Services adhered to its established track record as one of the most dynamic sectors of the economy – a reflection of the continued popularity of private education and health care in the Kingdom. The YoY rate of growth in Q2 was 9.8%, almost exactly in line with the 10.1% pace seen in Q1. Financial Services have continued to post robust growth, expanding by an annual 7.6% in Q2, down slightly from 8.3% in Q1. The Trade sector saw a clear pick-up in activity from 3.6% in Q1 to 5.6% in Q2.

During the first half of the year as whole, Hotels & Restaurants posted 12.9% YoY growth. Social & Personal Services expanded by 9.9%. Financial Services posted 7.9% YoY growth. Transportation & Communications grew by 7%, Real Estate & Business Activities by 4.9%, and Trade by 4.6%.

	2015	2016	2017		
YoY growth, %	Annual	Annual	Q1	Q2	H1
Crude Pet. & Nat. Gas	-0.1	-0.1	-3.3	-0.5	-1.9
Manufacturing	3.2	1.3	0.4	-1.9	-0.8
Construction	5.9	5.7	4.6	-0.1	2.2
Trade	2.1	3.0	3.6	5.6	4.6
Hotels & Restaurants	3.0	2.0	12.3	13.4	12.9
Transp. & Comm's	6.8	3.2	8.2	5.9	7.0
Social & Pers. Serv.	3.5	9.1	10.1	9.8	9.9
Real Est. & Bus. Act.	1.7	2.8	4.5	5.3	4.9
Finance	4.5	5.2	8.3	7.6	7.9
Government	2.2	2.5	2.6	3.6	3.1
Other	7.9	3.6	6.6	5.6	6.1
GDP	2.9	3.2	3.5	3.3	3.4

Source: Information & e-Government Authority

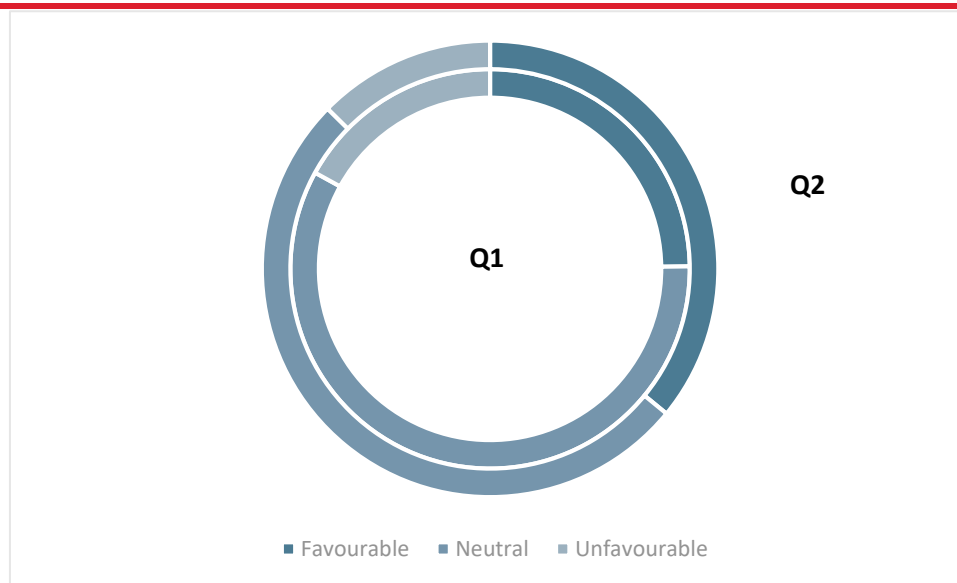
*The service sector drove growth in the Bahraini economy during 1H17*

In something of a departure from recent historical trends, the Manufacturing sector posted a 0.8% YoY decline during 1H17. This was in part due to production disruptions at the Alba aluminium smelter which have seen been rectified. Similarly, the Construction sector, which has been one of the most dynamic areas in recent year, expanded by just 2.2% in 1H17. In fact, the second quarter saw a slight 0.1% YoY contraction. While the slower momentum is partly due to a base effect after a couple of years of robust growth, some of slowdown is likely to prove temporary given the ongoing build-up of infrastructure project activity.

The outlook for the economy looks generally encouraging in view of the Quarterly Business Perceptions Survey (QBPS) undertaken by the Information & eGovernment Authority (iGA). The most recent data suggest that businesses in the Kingdom had a clearly more favourable view of

the business environment in Q2 than during the opening three months of the year. The percentage of respondents with a favourable assessment of the current situation rose from 24.8% in Q1 to 35.9% in Q2. The share of pessimistic assessments declined from 17% to 12.6% over the same period. The favourable assessments were consistently more prevalent for the larger the companies in question.

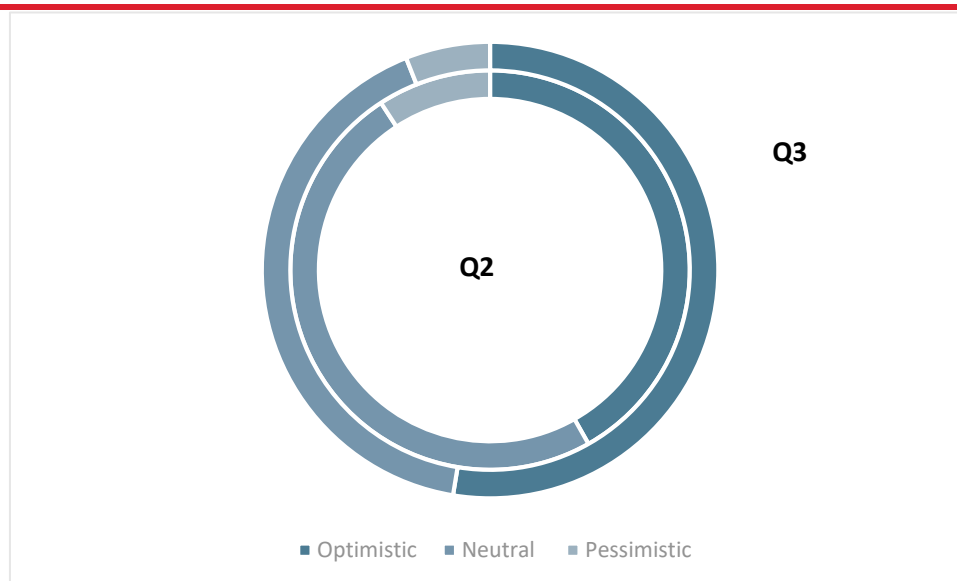
#### Bahrain QBPS opinions regarding current business performance, 1-2Q17



Source: Information & eGovernment Authority

Forward-looking indicators of business confidence in Bahrain attest to continued dynamism in the economy. According to the QBPD, the proportion of optimists among respondents has risen from 41.8% in Q2 to 52.6% in Q3. At the same time, the proportion of those subscribing to an unfavourable outlook has declined from 9.2% to 6%.

#### Bahrain Business Confidence Index, 2-3Q17



Source: Information & eGovernment Authority

*Business confidence has remained resilient and companies appear increasingly optimistic about the future*



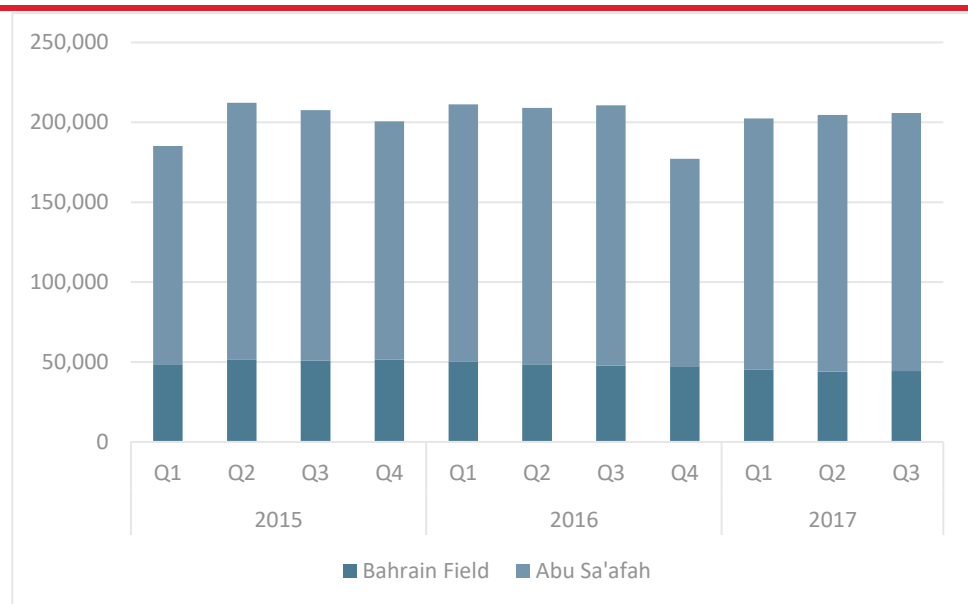
### Oil production edges up in Q3

The oil sector in Bahrain had relatively weak first half of the year, posting YoY declines in Q1 and Q2 alike. This was partly due to the base effect of historically high production in 1H16 but also reflected a gradual decline in onshore production.

Encouragingly, these trends were reversed in Q3. Off-shore output from the Abu Sa'afah field rebounded to 161,494 b/d. This marked a 0.5% increase on the previous quarter. However, it was 0.9% down in YoY terms, in reflection of the historically and seasonally high production in 3Q16. Production from the on-shore Bahrain field reached 44,400 b/d in Q3. This represented a 1.1% QoQ increase but a 12.9% YoY drop.

During the first three quarters of the year, Bahrain's total oil production averaged 204,332 b/d. This was broadly comparable to the 2016 all-year average of 202,063 b/d. Abu Sa'afah production was some 4% higher in 1-3Q17 than during 2016. Bahrain Field production, by contrast, was 8.1% lower.

#### Crude oil production, b/d



Source: National Oil and Gas Authority

### Counter-cyclical project drivers remain strong

Bahrain continues to benefit from exceptionally strong growth drivers in the infrastructure projects area. According to MEED Projects, the active pipeline of projects in Bahrain stood at USD83.6bn in October, up some 21.4% in YoY terms. According to the Ministry of Works, Municipal Affairs, and Urban Planning, 627 investment projects with a footprint of 4.9mn sq m were authorized in Bahrain in 1-3Q17. This was up from 560 projects and 2.1mn sq m a year earlier. The aggregate value of the projects increased from BHD526mn to BHD1.3bn/

A number of projects are making progress:

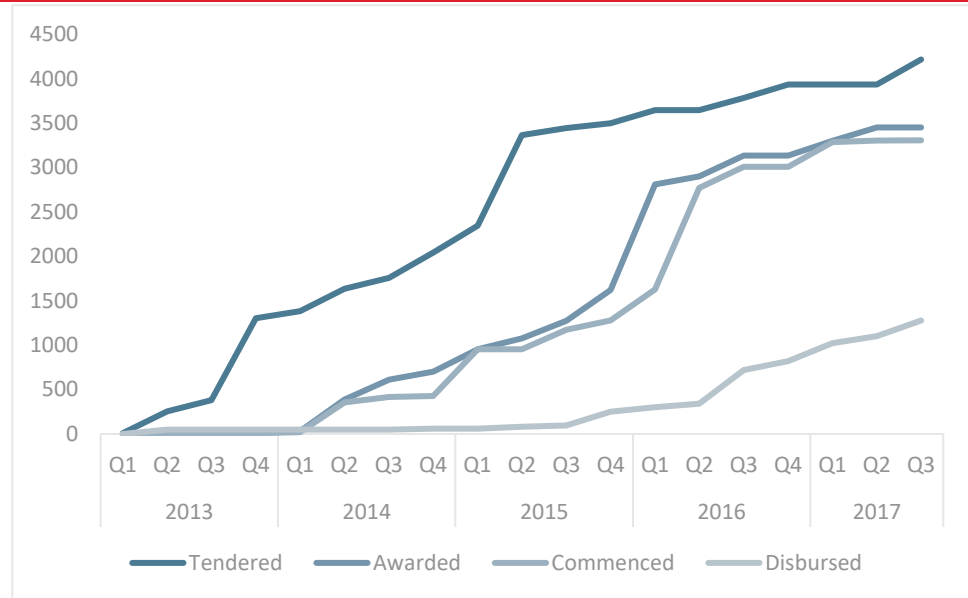
- ✦ The new 350,000 b/d oil pipeline between Saudi Arabia and Bahrain is due to be completed next year. The expanded capacity will in turn support the modernization of the Bapco refinery which is seeking to boost its capacity from 267,000 to 360,000 b/d. The estimated USD5bn project is expected to be awarded by the end of the year. Plans are reportedly under consideration also for a gas pipeline to connect the two countries
- ✦ The Bahrain LNG terminal is expected to be commissioned in 2019. The pioneering PPP project has a total estimated value of USD1bn
- ✦ The Electricity and Water Authority (EWA) has received proposals for a planned 100 MW photovoltaic solar power plant. The facility is due to be tendered in February and commissioned in 2019. The Government's National Renewable Energy Action Plan seeks to produce 5% of Bahrain's energy needs from renewables by 2025, a proportion that is due to increase further to 10% in 2035
- ✦ EWA has received prequalification bids for the planned Al Dur 2 independent water and power project. The new facility is expected to have a power generation capacity of 1,200-1,500 MW and a desalination capacity of 50mn imperial gallons a day. EWA is expected to sign a 20-year power purchase agreement as the plant becomes operational in 2020. Power demand in Bahrain grew by 3.5% and is expected to increase by an annual average of 6.4% in the medium term
- ✦ The Ministry of Works, Municipal Affairs, and Urban Planning has received bids for the expansion of the Tubli wastewater plant. The project is designed to double the capacity of the plant from 200,000 cu m a day to 400,000 cu m/d. The value of the project is expected to be close to USD400mn
- ✦ Tender documents are due to be released for a feasibility study of the King Hamad Causeway in April 2018. The project which will establish a 25km road and rail causeway between Bahrain and Saudi Arabia to parallel the current King Fahad Causeway. The rail segment is 70 km and may be structured separately
- ✦ Bids have been submitted for the North Manama Causeway and Busaiteen link road project which will create a fourth bridge between Manama and the island of Muharraq
- ✦ Eagle Hills has appointed the main contractor for a USD270mn Marassi Shores Residences project providing 287 units. Another scheme, Marassi Boulevard, will provide 240 residential units and a retail area. The Marassi al Bahrain master development is expected to house 22,000 people and provide 1,200 jobs
- ✦ In connection with ongoing efforts to revive projects that stalled during the global financial crisis, the Judicial Committee for the Settlement of Stalled Real Estate Projects is due to publicly auction the Amway Gateway mixed-used project at the end of October. The project covers an area of 33,391 sq m

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

The GCC Development Program is seeing a major scaling up of activity as the pipeline of tendered projects becomes active. As of Q3, the total value of awarded projects was just below USD3.5bn

while the aggregate value of projects that have commenced stood at USD3.3bn. The cumulative fund disbursement to date stand at less than USD1.3bn.

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



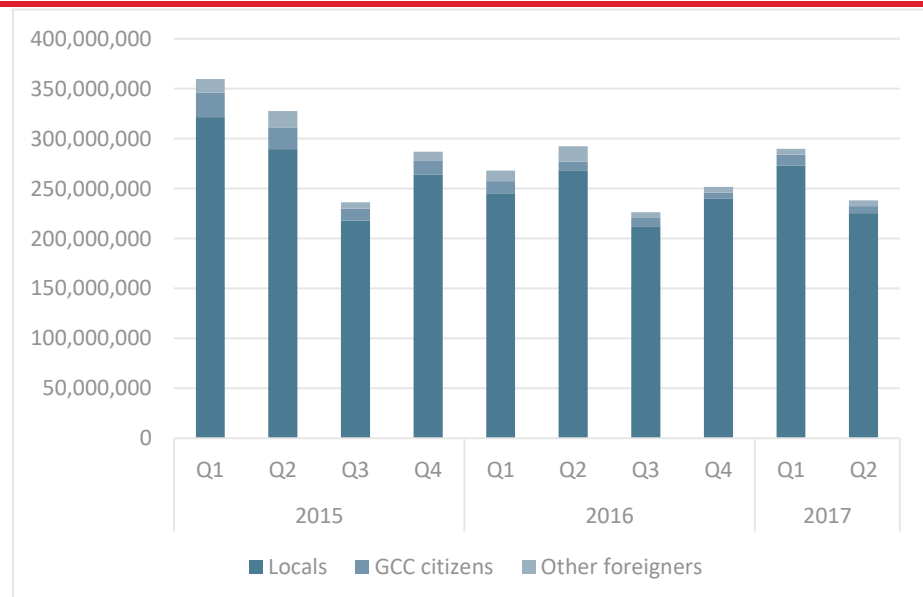
Source: Government sources

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

In general, activity in the real estate sector has been characterized by continuity. According to data collected by the Survey and Land Registration Bureau, the total value of property transactions in Q2 stood at BHD238.1mn, as compared to BHD290mn in Q1.

The aggregate value of real estate trading during the first seven months was BHD613.6mn. The monthly average of BHD87.8mn. This compared to a 2016 monthly average of BHD86.6mn. Local buyers have decisively dominated the market in 2017.

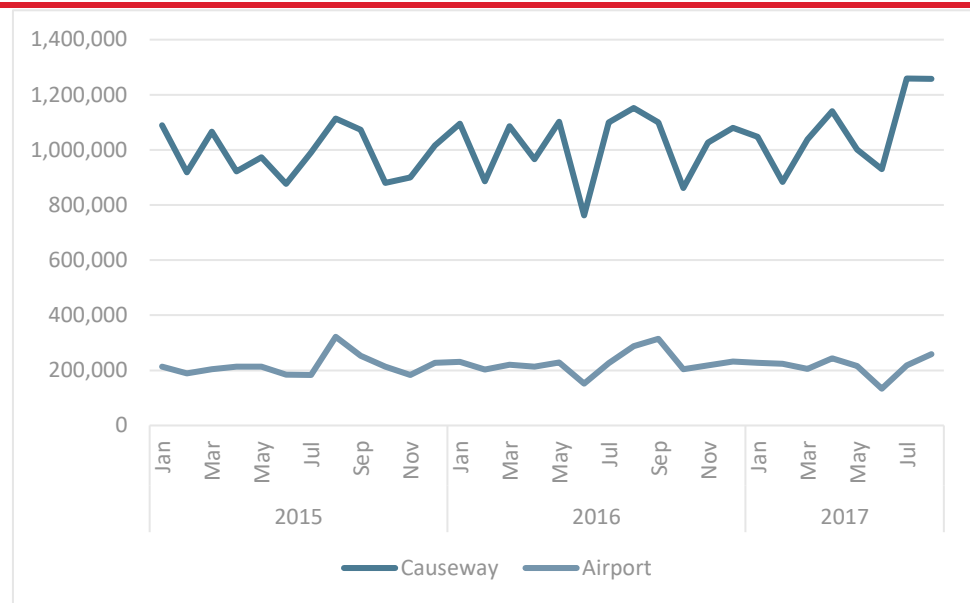
#### Aggregate value of real estate transactions, BHD



Source: Survey and Land Registration Bureau

Visitor numbers in Bahrain have continued to grow steadily. The YTD total of inbound visitors during the first eight months of the year was 10.28mn, up just over 3.7% from the I-VIII 2016 total of 9.91mn. Growth was particularly pronounced on the King Fahad Causeway where the cumulative number of inbound arrivals rose to nearly 8.6mn, up 5% on just over 8.1mn a year earlier. Airport arrivals were more or less flat and totalled just over 1.7mn during the first eight months of the year.

#### Visitor arrivals by port of entry



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

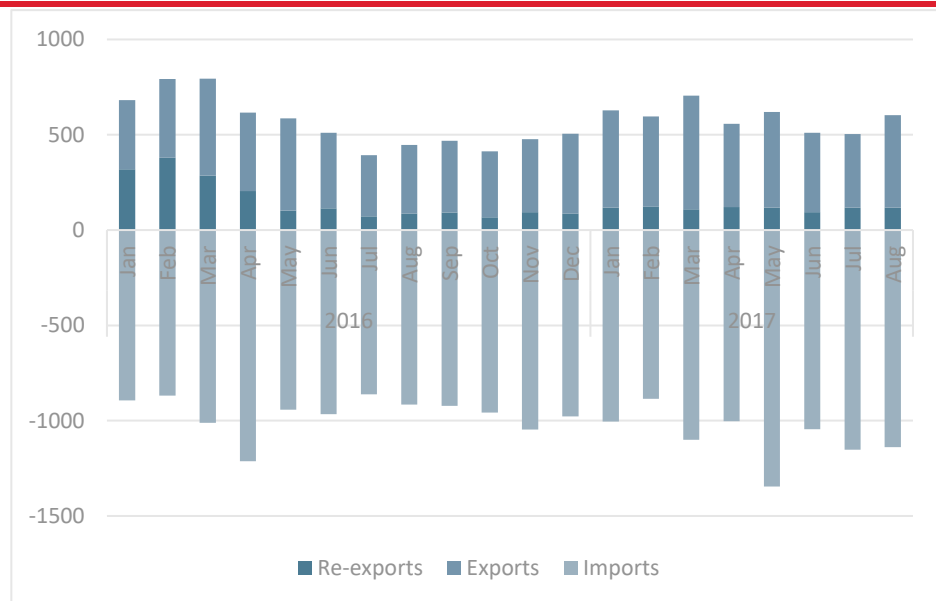
#### Trade volumes stable

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

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

According to Civil Aviation Affairs of the Ministry of Transportation and Telecommunications, the cumulative volume of airborne cargo traffic rose by an annual 10% during the first three quarters of the year to reach 174,856 tonnes.

## Non-oil trade, USD mn



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

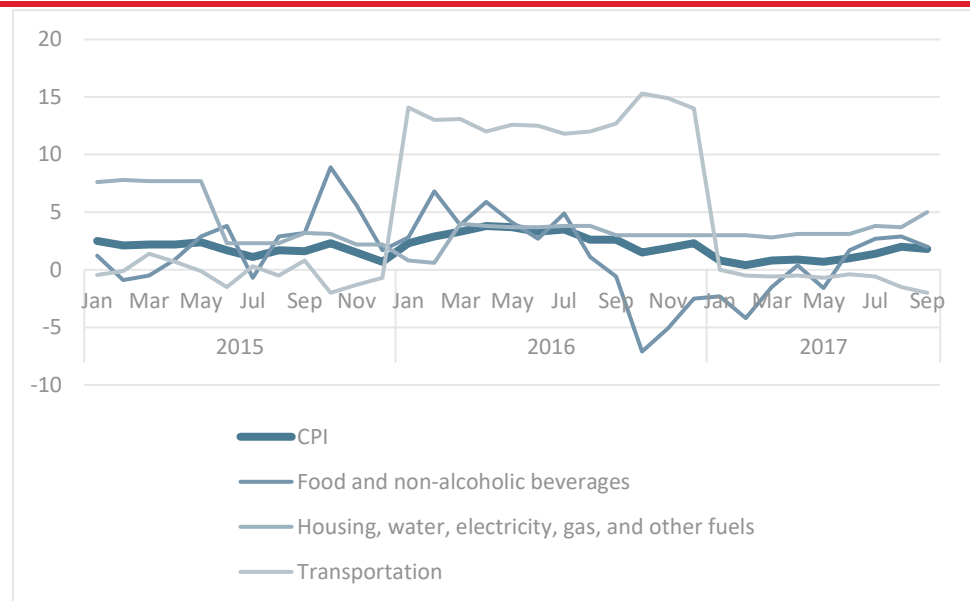
## Continued low inflation

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

Headline inflation in Bahrain has accelerated somewhat recently after several months of minimal price pressures. The YoY rate of consumer price increases in September rose to 2%, which was slightly down on 2% in August. This had been the highest reading so far during 2017. In spite of this, the average monthly rate of YoY inflation during the first nine months of 2017 was substantially lower than a year earlier: 1.1%, as compared to 3.1% during January-September 2016. The year-to-date rate of inflation was 1.1% and the Q3 reading 1.7%, up on 0.9% in Q2.

The slowdown in inflation is mainly due to the impact of the 2015 subsidy cuts wearing off, although utilities tariffs, for instance, remain subject to annual increments. At the same time, food inflation has been relatively subdued while a steady influx of new supply has checked the rise of housing costs. Price pressures in September were led by clothing and footwear (5.5% YoY inflation), housing costs (5%), recreation and culture (2.2%), and food (2%). YoY price decreases were observed in transportation (-2%), furnishings, household equipment, and maintenance (-1.2%), as well as communication (-0.2%).

### Consumer price inflation, % YoY



Source: Information & e-Government Authority

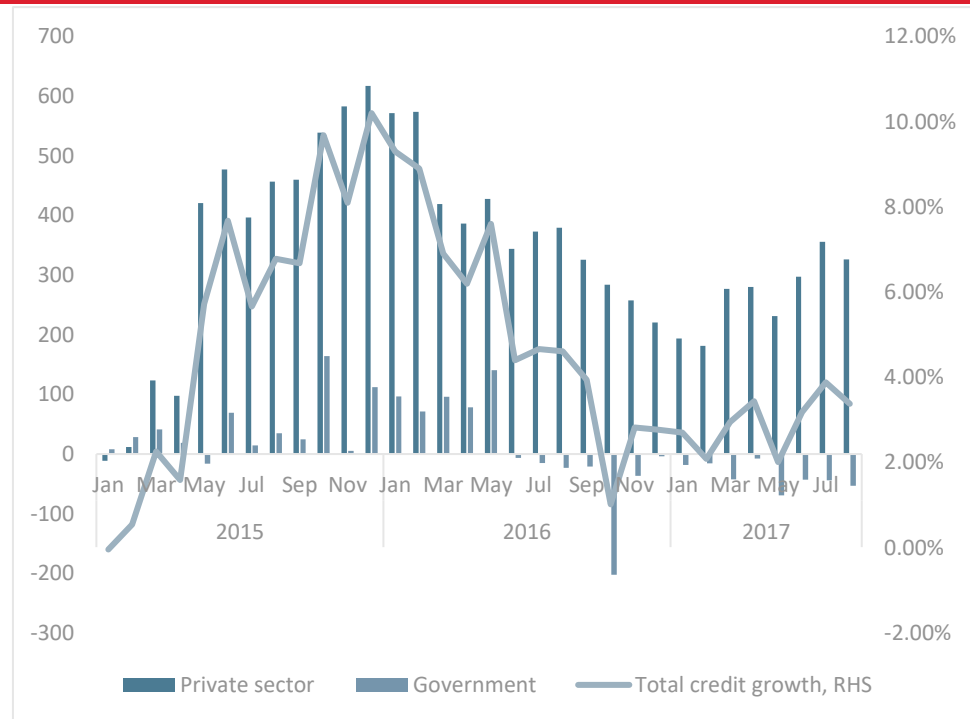
### Increased bank lending

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

Following a gradual deceleration in the annual pace of bank lending since the beginning of 2016, recent months have seen renewed growth. The overall YoY rate of credit growth peaked at 3.9% in July before decelerating slightly to 3.4% in August. As recently as May, the rate had been just narrowly above 2%. Encouragingly, the lending growth has been entirely thanks to increased credit to the private sector. Throughout the year, the YoY change in credit to the Government has been negative.

As of August, business loans made up 53.3% of the total BHD8.4bn retail bank portfolio. Loans to the personal sector accounted for 44% while the share of the government sector was 2.7%.

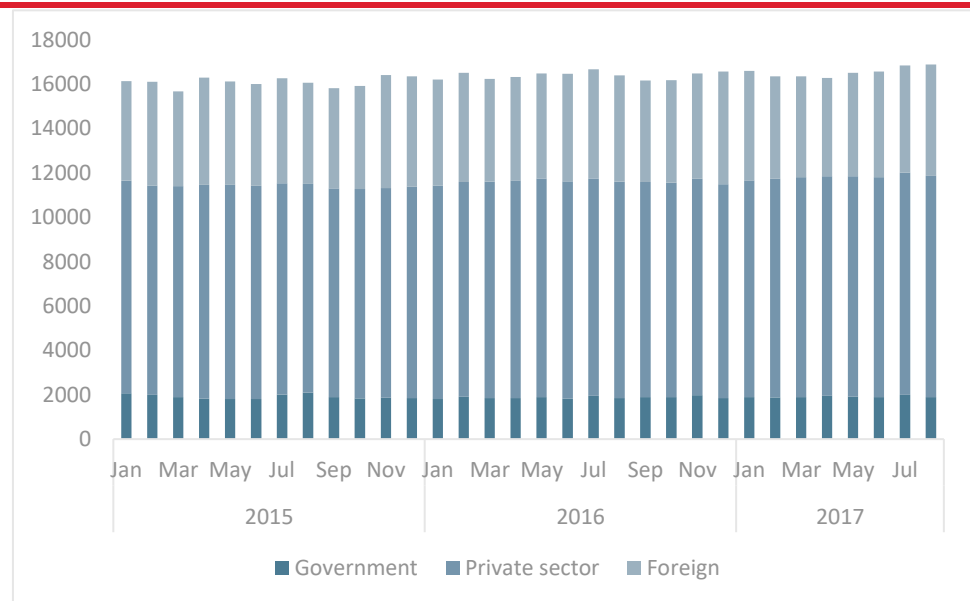
### YoY growth in credit issued by retail banks, BHD mn



Source: Central Bank of Bahrain

In spite of a generally tighter liquidity situation across the region, the deposit base of Bahraini retail banks has continued to grow. The total value of deposits in August stood at BHS16.9bn. This was up just 3% in YoY terms.

### Deposit liabilities to non-banks, BHD mn



Source: Central Bank of Bahrain

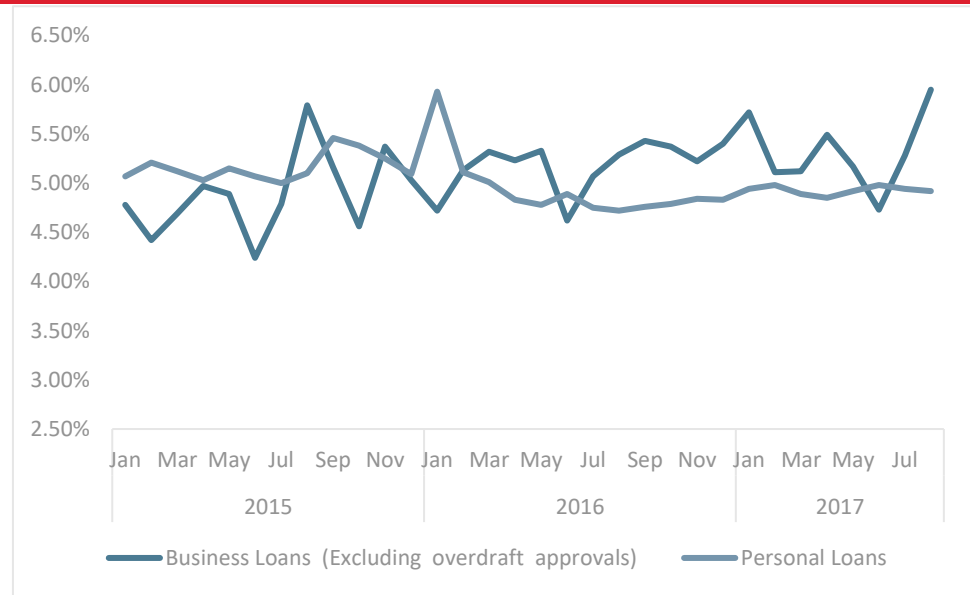
In spite of gradual policy tightening led by the US Federal Reserve, the cost of capital in Bahrain has remained more or less flat. The average interest rate charged by conventional retail banks for



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

business loans was just under 6% in August. It averaged 5.3% during the first eight months of the year. Whereas business loans have manifested a degree on month-to-month volatility, the cost of personal loans has been virtually flat. It reached 4.9% in August, which in fact also equalled the average during the year to date.

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



Source: Central Bank of Bahrain

#### Medical policies drive insurance sector growth

Growth in medical policies drove the expansion of the Bahraini insurance sector in 2016. The value of contributions jumped from BHD52.2mn to BHD62.1mn, a figure that now accounts for just under 23% of the premiums written in the Kingdom.

Motor insurance remains the largest category, however, and posted 4% growth in 2016. With total written premiums of BHD78.9mn, it accounted for 29% of the entire market.

Long-term life and savings-type insurance products generated premiums of BHD51.6mn in 2016. Their share of the total market was 19%.

Overall gross premiums in 2016 were in line with the 2015 total and reached BHD272.81mn.

Bahrain currently has 25 locally incorporated insurance companies and 11 branches of foreign companies. 14 of the local companies are conventional insurers and six are takaful firms. In addition, there are two conventional reinsurers, two retakaful companies, and one captive insurer. The overseas branches are composed of eight conventional insurers and three reinsurance companies. The gross premiums of Bahrain-based reinsurance and retakaful firms reached BHD378.97mn in 2016.

## Capital markets stall

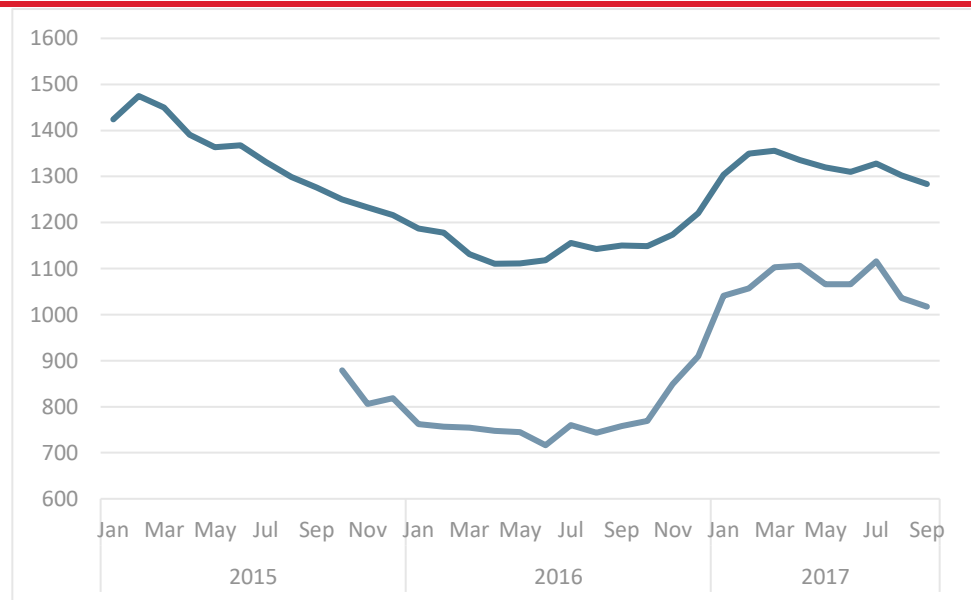
*Bahrain Bourse closed the first half of 2017 with a 7.3% net gain*

Echoing regional trends, Bahraini Bourse was virtually flat during Q3. In spite of a 2% drop during Q3, the Bahrain All Share Index remained up 5.6% YTD and 11.6% YoY.

The Bahrain Islamic Index declined by nearly 4.4% during Q3 but was up 24.3% in YTD terms and a remarkable 34.2% YoY.

The capitalization of the Bourse reached BHD20.8bn at the end of Q3. This was marginally up on BHD20.63bn at the end of Q2. It marked a 14.7% YoY increase. The total value of shares traded in Q3 was BHD49.17mn, down on BHD77.89mn in Q2.

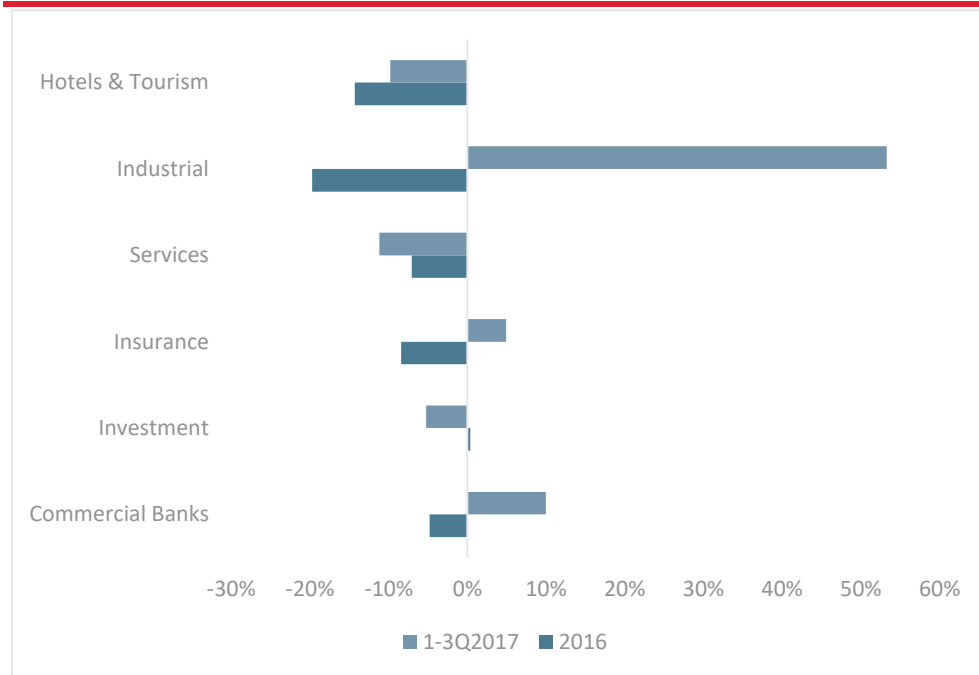
### Bahrain All Share Index and Bahrain Islamic Index



Source: Bahrain Bourse

The performance of individual sectors was highly variable. The sharpest improvement continued to be seen in the industrial sector, which was up a remarkable 53.3% in YoY terms. This marked an impressive turnaround from a 19.7% correction during 2016 as a whole. Commercial banks were the second the strongest sector with a 10% YoY advance. The insurance sub-sector posted a 4.9% gain. The other three indices were negative: investment -5.2%, hotels & tourism -9.8%, and services -11.2%.

### Sectoral stock market indices, 2016-3Q2017



Source: Bahrain Bourse

In the fixed income space, the CBB in mid-July placed a BHD200mn five-year Government Development Bond with a coupon of 5.35%. Subscriptions totalled BHD224mn. This was followed by a BHD125mn *ijarah* sukuk with a tenor of three years and a rate 4.2%. The offering was 152% oversubscribed.

In September, Bahrain tapped the international markets with a three-tranche USD3bn placement. This was composed of a USD850mn, 7.5-year sukuk tranche and two tranches of conventional bonds: USD1.25bn with a 12-year tenor and USD900mn with a 30 tenor. In something of a recent regional record, the combined offering was five times oversubscribed with offers of more than USD15bn. The three tranches were priced at 5.25%, 6.75%, and 7.5%, respectively, tighter than initially expected. The issue was arranged by BNP Paribas, Citigroup, Gulf International Bank, JP Morgan, and National Bank of Bahrain.

Interest rates for short-term Treasury Bills have edged up slightly during the quarter. The total value of outstanding bills in early October stood at BHD1.985bn.

Nogaholding has reportedly hired banks to prepare for the issuance of a 10-year bond.

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

Issue date	Issue	Value, BHD mn	Maturity, days	Average interest/ profit rate, %	Average price, %	Over- subscript ion, %
2 Jul 2017	Treasury bill No. 1658	35	182	2.45	98.776	128
5 Jul 2017	Treasury bill No. 1659	70	91	2.33	99.414	100
12 Jul 2017	Treasury bill No. 1660	70	91	2.30	99.421	100
13 Jul 2017	Sukuk al ijarah No. 143	26	182	2.45		100
26 Jul 2017	Treasury bill No. 1661	70	91	2.30	99.422	160
27 Jul 2017	12-month Treasury bill No. 35	100	365	3.13	96.931	124
2 Aug 2017	Treasury bill No. 1662	70	91	2.31	99.419	122
6 Aug 2017	Treasury bill No. 1663	35	182	2.52	98.740	120
9 Aug 2017	Treasury bill No. 1664	70	91	2.36	99.408	105
10 Aug 2017	Sukuk al ijarah No. 144	26	182	2.52		100
16 Aug 2017	Treasury bill No. 1665	70	91	2.54	99.363	128
23 Aug 2017	Sukuk al salam No. 196	43	91	2.36		100
30 Aug 2017	Treasury bill No. 1666	70	91	2.45	99.385	120
31 Aug 2017	12-month Treasury bill No. 36	100	365	3.22	96.844	128
3 Sep 2017	Treasury bill No. 1667	35	182	2.75	98.630	111
6 Sep 2017	Treasury bill No. 1668	70	91	2.46	99.383	109
13 Sep 2017	Treasury bill No. 1669	70	91	2.49	99.375	100
14 Sep 2017	Sukuk al ijarah No. 145	26	182	2.75		100
20 Sep 2017	Sukuk al salam No. 197	43	91	2.45		100
27 Sep 2017	Treasury bill No. 1670	70	91	2.57	99.355	143
28 Sep 2017	12-month Treasury bill No. 37	100	365	3.29	96.781	100
1 Oct 2017	Treasury bill No. 1671	35	182	3.01	98.502	120
4 Oct 2017	Treasury bill No. 1672	70	91	2.61	99.344	111

Source: Central Bank of Bahrain

## Continued labour market growth

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

The aggregate number of people employed in Bahrain attained 763,618 by the end of June, according to a report by the Ministry of Labour and Social Development. This marked a 1.2% increase over a year earlier.

The number of Bahraini nationals working in the private and public sectors taken together reached 157,261 in a 0.3% YoY increase. By contrast, the number of expatriates employed in the Kingdom increased by 4.7%.

## External assessments

Index/report	Description	Global rank	MENA rank	Key strengths highlighted
<b>Expatriate Insider Survey</b> by InterNations	Compiled by a 2.8mn-strong global expatriate network present is 390 cities, the index ranks locations based on quality of life indicators, the ease of settling in, as well as metrics of working abroad, family life, and personal finance.	1	1	Bahrain leapt from 19 <sup>th</sup> to 1 <sup>st</sup> place in recognition of: <ul style="list-style-type: none"> <li>✦ The ease of settling in (76% feel welcome)</li> <li>✦ Career satisfaction (73% satisfied with their jobs)</li> </ul>
<b>Global Human Capital Index</b> by World Economic Forum	Measures four key areas of human capital development: <ul style="list-style-type: none"> <li>✦ Capacity (existing stock of education)</li> <li>✦ Development (current education and upskilling efforts)</li> <li>✦ Deployment (application and skills acquisition through work)</li> <li>✦ Know-how (breadth and depth of specialized skills at work)</li> </ul>	47 (out of 130)	2	Bahrain has regionally high education levels but lower investment in further development than the rest of the region. Employment levels are higher than in neighbouring countries but weaker in lower skilled positions.
<b>Global Competitiveness Index</b> by World Economic Forum	Measures national competitiveness based on three sub-indices: <ul style="list-style-type: none"> <li>✦ Basic requirements (institutions, infrastructure, macroeconomics, health and primary education)</li> <li>✦ Efficiency enhancers (higher education and training, goods and labour market efficiency, financial market development, technological readiness, market size)</li> <li>✦ Innovation and sophistication (business sophistication, innovation)</li> </ul>	44 (out of 137)	3	Recognizes Bahrain as an “innovation-driven economy.” Key positives include: <ul style="list-style-type: none"> <li>✦ Strong institutions</li> <li>✦ Sound infrastructure</li> <li>✦ Higher education and training</li> <li>✦ Efficient labour market regulations</li> <li>✦ Technological readiness</li> </ul>

## KEY SECTORS

### TAPPING INTO CROWDS

#### Introducing crowdfunding

The Central Bank of Bahrain in August unveiled pioneering crowdfunding regulations for conventional and Shariah-compliant financial institutions. This build on an earlier initiative to create a regulatory sandbox for Fintech firms which attracted its first two entrants in August. These were a London-based provider of foreign exchange cash management solutions for business and a Dubai-based account and remittance service for GCC-based low income workers.

Following the latest innovation, it will be possible for local small and medium-sized businesses to raise funding outside of the established channels. The maximum paid up capital for such companies is BHD250,000. The regulations provide exclusively for person to business lending. Financing can be provided to companies outside of Bahrain provided the platforms highlight the relevant risks. Lenders are responsible for evaluating the credit worthiness of their borrowers. Platforms have to be fully transparent about their fees, charges, and commissions.

The CBB will license crowdfunding companies under its Rulebook Vol. 5: Financing Based Crowdfunding Platform Operation. The regulations are identical except in terms of mandating Shariah approval for relevant entities. This can be done by engaging an advisor or outsourcing the function. The minimum capital requirement for platforms is BHD50,000. Only accredited expert investors are allowed to provide funding through the platforms. They can only lend up to 10% of their net assets to a single recipient.

A borrower can raise a maximum of BHD100,000 in crowdfunding in a given calendar year. The tenor of such financing should not exceed five years. If an attempt to raise funding through a platform fails to meet at least 80% of the offer, the deal is cancelled, and all monies received have to be refunded within seven calendar days. Crowdfunding platforms are required to comply with the CBB's anti-money laundering and combating financing of terrorism regulations.

In a further major step to supporting the growth of Islamic finance, the CBB in September released a new Shariah Governance module. Following consultations with the industry as well as the CBB's centralized Shariah Supervisory Board, the module is likely to set a new benchmark for Shariah governance. The new regulations will apply as of 30 June 2018. Among other things, the CBB has now made an independent external Shariah compliance audit mandatory. Regular annual reporting of the audit results will commence in 2020 in a major step toward higher transparency standards. The module further delineates the authority of the Shariah Supervisory Board and enhances its independence. It defines eligibility criteria, roles, and responsibility for the members. It requires board rulings, along with their justifications, to be made public. Shariah coordination/implementation and internal Shariah audit are required to report independent to the board.

*The introduction of crowdfunding regulations marks another important milestone in Bahrain's journey to becoming a Fintech hub*

## Driving the ICT agenda

*Q3 saw the first-ever Bahrain Technology Week and the announcement by Amazon Web Services of its new Middle East Region*

In September, Bahrain held its first Technology Week. Sponsored by the Economic Development Board, the event was designed to showcase ways in which disruptive technological change is reshaping the global and regional economy. Focus areas included Fintech, artificial intelligence, cybersecurity, and cloud computing. The Technology Week coincided with the Amazon Web Services (AWS) summit on cloud computing and the first region Innovation Forum of MIT Enterprise Pan-Arab hosted by the EDB and Investcorp. The forum was designed to foster innovation, entrepreneurship, and technology adoption. It covered a wide range of emerging technology trends, such as cloud computing, autonomous driving, cybersecurity, artificial intelligence, and blockchain. In connection with the Technology Week, Tamkeen hosted the StartUp Bahrain competition with USD75,000 of prizes.

During the AWS Summit, the company announced that it intends to open a new infrastructure region in the Middle East, headquartered in Bahrain, in early 2019. The company currently provides 44 such zones across 16 infrastructure regions. A further five AWS Regions and 44 Availability Zones are expected to become operational by the end of 2018. Globally, AWS provides cloud storage services to more than a million customers in 190 countries. Cloud services hold particular appeal because of the low initial costs, which makes them attractive to SMEs. They are also flexible and scalable as end-users buy a service rather than expensive infrastructure.

The presence of a dedicated AWS Region in the Middle East will give business faster access to data though lower latency as well as lower costs. Cloud services hold particular appeal because of the low initial costs, which makes them attractive to SMEs. They are also flexible and scalable as end-users buy a service rather than expensive infrastructure.

Cloud services hold particular appeal because of the low initial costs, which makes them attractive to SMEs. They are also flexible and scalable as end-users buy a service rather than expensive infrastructure. The Government of Bahrain has pioneered in the adoption of cloud with, for instance, the Information & eGovernment Authority observing a 'cloud first' policy.

Bahrain is seeking to further partner with the AWS Educate program to develop local cloud computing skills. Courses will be offered at the University of Bahrain as well as Bahrain Polytechnic. Local incubators and accelerators are working with the AWS Activate program to help with their own globalization.

## Introducing Industry 4.0

Bahrain has in recent months taken pioneering steps toward the adoption of Industry 4.0 as an important engine of productivity and innovation. Industry 4.0 refers to the use of automation and digitized data exchange in manufacturing. It relies on cyber-physical systems, the Internet of Things, cloud computing, and cognitive computing to create a 'smart factory' where cyber-based systems monitor physical processes and create a digital replica of them. This allows for decentralized decisions but also for full integration and optimization as different process can communicate with each other in real time. This approach permits the optimization of production processes but also the efficient integration of broader value chains. The increased visibility across

processes and supply chains can boost awareness and lead to more efficient decision. Machine-generated data can also enhance the analytical capabilities of an organization and drive better decisions.

As the Gulf economies transition to a more productivity-driven model of development, Industry 4.0 holds considerable promise as a way to create more efficient companies and processes. In recognition of this, Bahrain has launched a number of interconnected initiatives to drive the adoption of Industry 4.0 in the country.

BFG International, a Bahrain-based producer of composites technologies has partnered with the EDB and Tamkeen to launch a first-in-kind Industry 4.0 project at its Mina Salman facility and eventually across the group. BFG International's factories will be automated and all its business areas integrated through a software solution supplied by QiO Technologies. This will establish full transparency across the entire value chain and allow for the production process to be optimized. The four-year project will be supported by Tamkeen. As part of the project, BFG will train local to acquire relevant skills and become capable of producing new solutions for the local market.

Bahrain attracted more than USD200mn of investment into its manufacturing and logistics sector in the first half of the year. The investments are expected to engender a total of 1,000 jobs over the coming three-year period. The new investments include a major expansion by Mondelez International which is building a biscuit factory in the Kingdom with an initial employment impact of 200 jobs. This builds on Mondelez' existing presence in the country which has produced its brand products for 47 markets since 2008.

### Strong momentum in tourism investment

Bahrain is currently at various stages of implementing tourism projects worth approximately USD10bn. Major developments include the following:

- ✦ The Avenues shopping mall with a value of USD145mn, due to launch in October
- ✦ A number of new hotel projects including:
  - The One & Only Resort in Seef
  - The Wyndham Grand in Bahrain Bay
  - The DusitD2 boutique hotel of Dusit International
  - The Wyndham Garden in Juffair which, with 450 keys, will be the largest hotel in the Kingdom. It is being developed by Mannai Holding
- ✦ The Marassi Galleria mall, which offers 180,000 sq m of retail space. The facility is part of a largest Marassi al Bahrain development managed by Abu Dhabi-based Eagle Hills
- ✦ The Mall of Dilmunia will have a build-up area of 125,000 sq m and a gross leasable area of 47,300 sq m. The total investment is estimated at USD137mn

*Industry 4.0 is emerging as an important new driver of efficiency and innovation with the first pioneering initiatives underway in Bahrain*



*An unprecedented investment pipeline is reshaping the tourism sector in Bahrain*

Important additions to leisure facilities around the island include a new adventure park at Bahrain International Circuit and a range of water-based activities in Bahrain Bay provided by the Bahrain Rowing Club and Beach Culture. The companies involved are Bahrain-based start-ups hoping to deliver new tourism experiences.

Improved accessibility is an important aspect of ongoing tourism sector developments. The Bahrain Airport Company is overseeing the investment of approximately USD1.1bn in the modernization of the Bahrain International Airport, including a new terminal. The construction is now 40% complete with the launch scheduled for 3Q19. The new facility will be four times the size of the existing airport and opportunities in retail and restaurants, along with other facilities, will be offered to investors soon. The national carrier Gulf Air is purchasing a total of five Boeing 787-9 Dreamliners which are expected to be delivered in 2018.

Bahrain has recently seen the launch of two inbound tour operators that are offering packages targeting travellers from key source markets outside the GCC. Visit Bahrain and @Bahrain offer scheduled tours, well-trained staff, and innovative service solutions.

The Bahrain Tourism and Exhibition Authority plays a key role in driving the further development of the sector by standardizing classifications, developing regulations, opening new markets through their seven international marketing offices, and creating a diverse calendar of events. The Bahrain Authority for Culture and Antiquities has established Bahrain as a centre for culture, art, and history. They are instrumental in providing an array of activities and events that highlight global, regional, and national art and culture.

The tourism sector infrastructure development is taking place against the backdrop of a continued strong increase in tourist numbers. According to the Bahrain Tourism & Exhibitions Authority, the aggregate total number of tourists visiting Bahrain during the first three quarters of 2017 was 8.7mn – up 12.8% on 1-3Q16. The total number of tourist visitors across the King Fahad Causeway rose by 13% YoY during the first half of 2017 to reach a total of 4.9mn. The annual rate of increase in tourists arriving through the airport was 23% to 616,230. Cruise ship arrivals numbers 43,191, a 44% YoY increase. The average stay of these tourists during 1H17 was 2.3 days, although 63% of them were day visitors. The average expenditure per day reached BHD77 with the total tourist expenditure estimated at BHD631.4mn. 87% of all tourists in January-September came from Saudi Arabia and 9.8% from the rest of the Gulf region.

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