Bahrain: Reinvigorating reform

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- **Bahrain has allocated around USD 30B for future infrastructure projects, which will create jobs, increase tourism, and further diversify the economy ahead of Bahrain Vision 2030.**
- **A VAT rate hike next year will almost double the country's tax revenue and boost state coffers.**
- **While balancing the budget by 2024 will be challenging, Bahrain is set to post steady growth underpinned by ambitious reforms and supportive oil prices.**

Familiar challenges on the fiscal front

The GDP of Bahrain, the GCC's smallest country, contracted by 5.1% in 2020 which is coincidentally the average contraction for the 6-member gulf union. The island kingdom is forecast to register 2.4% and 3.1% growth in 2021 and 2022, respectively. This is underpinned by supportive oil prices and ambitious reforms.

➢ Bahrain's economic downturn last year was driven by low oil production and pandemic-related disruptions to non-oil activities mainly in the financial services and tourism sectors.
  - On a positive note, the crisis has sped up the digital transformation journey of the banking sector.

➢ Although 2020 was a difficult year for countries across the world, Bahrain had already been struggling to keep its public finances in check long beforehand. The onset of the COVID-19 pandemic only exacerbated things.
  - Bahrain has not registered a budget surplus since 2008, when oil prices reached their peak of around USD 130 pb.
  - Fiscal strings were further tightened in the wake of the 2014 shock to oil prices. Bahrain and Oman are the GCC's weak links with regard to their fiscal balance and public debt (twin deficits).
  - The budget deficit of Bahrain is projected to remain at 8% of GDP in 2021 and 2022, the highest in the GCC.
  - The kingdom is forecast to remain as the GCC's most fiscally-squeezed member state (Figure 2).
    - Oman is likely to post its first budget surplus since before 2018 (1.1% of GDP in 2022).
    - The GCC as a bloc is expected to just fall short of balancing its budget next year (-0.4% of GDP), with Qatar forecast to have the highest surplus (5.7% of GDP).
  - Bahrain is the only GCC country to sit above a 100% public debt-to-GDP ratio (129.7% of GDP in 2020), a position to which it first slipped into in 2019.
    - Medium-term, we expect this statistic to remain above the 100% threshold.

➢ Promising efforts were made under Bahrain's 2018 Fiscal Balance Program (FBP), through which the kingdom hopes to balance its budget by 2022.

Bahrain macroeconomic indicators[1]

	2018	2019	2020	2021f	2022f
Real GDP Growth (%)	1.7	2.6	-5.1	2.4	3.1
Crude Oil Production (M bpd)	0.2	0.2	0.2	0.2	0.2
Oil GDP Growth (%)	-1.3	2.2	-0.1	0.0	0.4
Non-oil GDP Growth (%)	2.4	2.0	-5.5	3.0	3.7
CPI Inflation (%)	2.1	1.0	-2.3	1.0	2.7
Fiscal Balance (% of GDP)	-11.8	-9.0	-17.9	-8.0	-8.0
C/A Balance (% of GDP)	-6.5	-2.1	-9.3	-2.9	-2.9
Total Gov't. Gross Debt (% of GDP)	95.0	102.1	129.7	123.3	125.6
Total Gross Extrn'l Debt (% of GDP)	204.6	225.8	251.6	235.1	233.2
Gross Official Reserves (Mos. of Imports)	1.0	2.0	1.0	2.2	2.1
Nominal GDP (USD B)	37.7	38.5	34.7	39.1	41.1
Population (Millions)	1.5	1.5	1.5	1.5	1.6

  - The gap between the fiscal breakeven price and the actual oil price in 2019 narrowed from USD 47 pb to USD 35 pb

➢ This progress was interrupted by the COVID-19 pandemic and the resultant historic low oil prices which hovered above USD 40 pb.
  - In 2020, the gap between Bahrain's fiscal breakeven price and actual oil price rocketed to USD 77 pb.
  - The reinvigorated FBP now seeks to achieve a zero-deficit national budget by 2024. It plans to undergo further radical fiscal adjustments to alleviate public debt, including its value-added tax (VAT) rate from 5% to 10% (2nd highest in the GCC after KSA), effective 1 January.
    - VAT revenue comprised 1.7% of Bahrain's GDP in 2021 and is forecast to rise to 3% by 2022.

➢ Energy market conditions have also favoured Bahrain fiscally in recent months. Since the beginning of the year, Brent crude oil has rallied by more than 40% to USD 75 pb.
  - In the coming months, the risks are tilted downwards, albeit slightly. But prices are likely to remain well supported by a combination of factors including a now fairly vigilant and experienced OPEC+.
    - On 26 November 2021, oil prices dropped to USD 72 pb after floating above the USD 80 pb mark for several weeks.
    - This was the biggest one-day drop since April 2020, shortly after the World Health Organisation recognised the COVID-19 outbreak as a pandemic.
  - Countries such as China, India, Japan and the US had been considering an injection of Special Petroleum Releases (SPR) to cool prices.
  - Like other countries, Bahrain will have to deal with the consequences of Omicron, and this could challenge its reform momentum, especially the tourism related component.
    - Egypt, Kuwait, Qatar, Saudi Arabia and the UAE have suspended flights from various countries in southern Africa, where the variant is believed to have appeared.

[1] Arabia Monitor; IMF.

- But now the variant has also appeared in North Africa, as reported on a case detected in Saudi Arabia.

➢ Bahrain will continue to receive support from its GCC allies, as long as it implements necessary economic reforms.
- In 2018, the FBP was introduced and Bahrain received a USD 10B fiscal reform-conditional package from its wealthier neighbours, avoiding a credit crunch as a result.
- As of 2020, Bahrain had received USD 6.3B of this bailout. By the end of 2021 the country looks set to receive USD 1.85B before securing USD 1.42B in 2022 and the rest of the agreed aid package in 2023.

➢ The renewed reform plan includes cutting down on operational government expenditures and social subsidies over 2023 and 2024.
- Bahrain has a unique and delicate socio-political environment which has impeded past government reform efforts, and navigating these will be key to radical reform.

➢ Beyond public finances, Bahrain aims to bolster its economy holistically.
- To stimulate post-pandemic economic recovery, the government announced on 31 October 2021 its new Strategic Projects Plan, which will invest around USD 30B in infrastructure development in the coming years ahead of Bahrain Vision 2030.
  - The aim of CAPEX is to fuel economic growth by boosting employment and attracting around USD 2.5B in FDI.

➢ The plan consists of 22 projects across prioritised sectors such as telecommunications, tourism, education, manufacturing and health.
- Flagship projects include a new four-lane causeway to Saudi Arabia, a 68-mile (109km) metro system connecting all of Bahrain's cities and the construction of five new artificial islands that will increase the country's land area by over 60%.
  - These ventures will catalyse future non-oil GDP growth and business development, as private developers will be able to bid for contracts.

➢ The main obstacles facing the kingdom's economic growth are the prolonged effects of the COVID-19 pandemic, oil market volatility, and the extent to which the government is committed to implement its reform plans.
- The sudden emergence of the Omicron variant means that OPEC+ policy changes and resultant negative effects on oil production cannot be ruled out.

Figure 1: Bahrain fiscal indicators (% of GDP)[2]

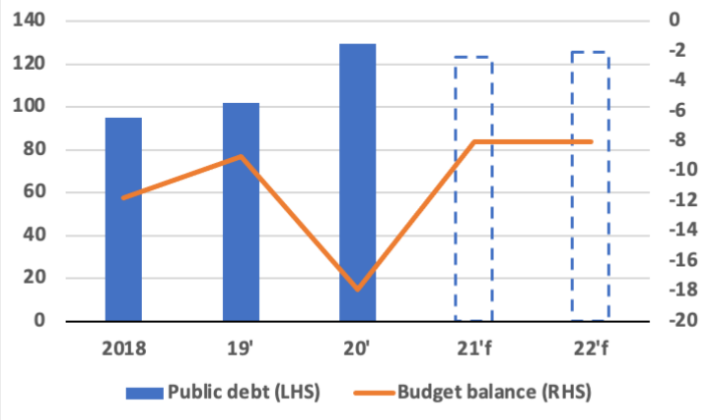


Figure 2: GCC fiscal balance (LHS) & public debt (RHS) - (% of GDP)[3]

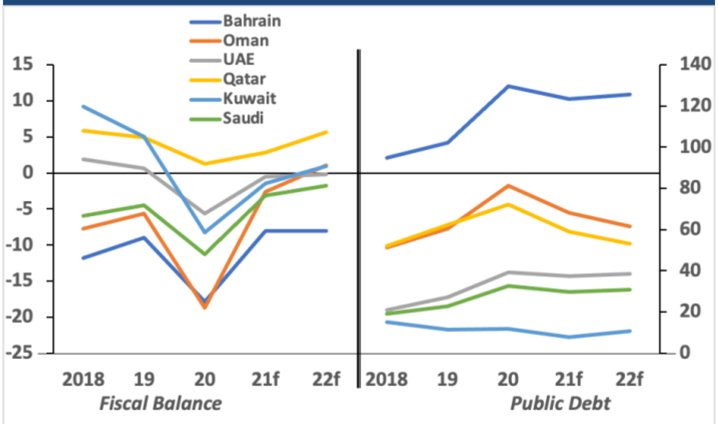
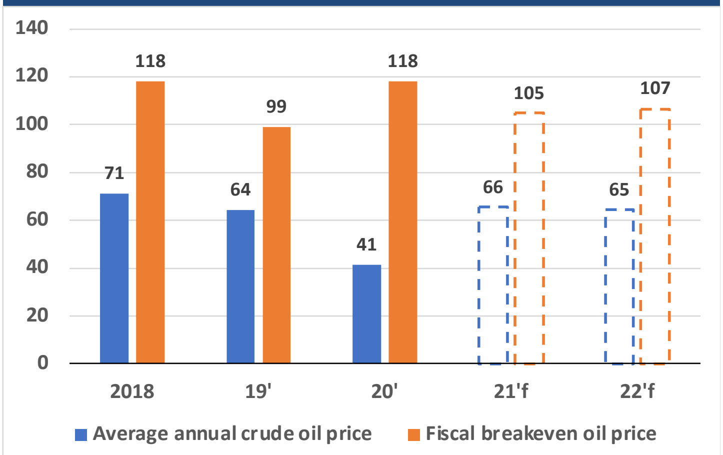


Figure 3: Bahrain fiscal breakeven oil price vs average spot price (USD pb)[4]



[2] Arabia Monitor; IMF.
[3] Arabia Monitor; IMF.
[4] Arabia Monitor; IMF.

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