

# Bahrain

*The economy will see a return to moderate growth this year at around 2%, with the ease in restrictions helped by a rapid vaccination rollout. The fiscal deficit is expected to narrow, reaching 7.2% of GDP in 2021 while averaging 4% of GDP in 2022-23, down from an estimated 13% in 2020. Debt levels will remain above 100% of GDP during the forecast period, making fiscal adjustment a priority once the impact of the crisis subsides, including a medium-term goal of balancing the budget which should help put debt on a downward path. Meanwhile, inflation will pick up but only to about 1% in 2021 mainly due to sluggish real estate rents.*

## Gradual post-pandemic recovery

Economic recovery is expected to be gradual with GDP up 2% in 2021, then a stronger 3.9% on average over the medium term. (Chart 1.) Our outlook reflects the expected recovery in the non-oil sector, which contracted an estimated 7.5% in 2020 including a confirmed -7.8% y/y in Q1-Q3 led by falls in the hospitality, telecommunications and transportation sectors. Non-oil growth is seen at 3.6% in 2021 assisted by rapid vaccine deployment – which stood at around one-quarter of the population by mid-March and could reach above the 60% threshold by the end of August as Bahrain ranked as one of the top performers on vaccination rollout. Moreover, the expansion of Bapco's oil refining capacity (expected completion in 2022) could help lift non-oil growth to around 3.3% over the medium term. However, the recovery in the hospitality sector (around 7% of GDP) to pre-crisis levels could be delayed to beyond 2023 as it hinges more on the global path of the pandemic and unwinding lockdowns.

Oil GDP is expected to fall by 4.4% in 2021 following the estimated rise of 2.9% in 2020. The decline reflects the anticipated fall in oil production by 5.9% on average in 2021 to 175,000 b/d due to the OPEC+ agreement. Over the medium term, oil production is likely to increase to around 200,000 b/d in 2023, while gas output is estimated to grow by 5% annually, reflecting the gradual pickup in global energy demand with the development of the Khalij al Bahrain field and gas reservoirs.

## Modest inflation over the medium term

Monetary policy will remain accommodative over the medium term; with interest rates typically tend to move in line with the US policy rates given the pegged exchange rate regime. Inflation was negative at -2.3% in 2020 but could increase moderately in 2021 due to weaknesses in real estate after the fall in expat population by 2.9% in 2020. Government stimulus that have supported the economy so far could be gradually withdrawn in 2022. Inflation could increase mildly over 2022-23 at 1.2%, up from -2.3% in 2020 (Chart 2.). In addition, the loan installment deferment (until June 2021) will provide some support to domestic demand this year. Retail banks' credit to the private sector could rise by 3.6% during 2021-23, boosted by economic recovery and government support policies (Chart 3).

## Declining fiscal deficit to help lower the debt ratio

The dual shock of Covid-19 and the plunge in oil prices worsened the fiscal position with the deficit estimated at 13% of GDP in 2020. The government fiscal and monetary packages estimated at BHD 4.5 billion, or 34% of GDP (BHD 3.7 billion of which for raising the central bank loan facilities, allowing instalments to be deferred and credit to be extended) while the rest include salary payments for Bahrainis, waiving utility bills and municipality fees. These measures are expected to increase spending by BHD 0.9 billion compared to 2020 budget. However, the so-far high rate of vaccination deployment could allow economic support measures to be withdrawn faster. The budget for 2021-22 is estimating a deficit of \$3.2 (around 9% of GDP) billion on slightly lower recurrent spending while increasing capital spending by 35% to \$0.7 billion. However, we expect the deficit to decline to around 7.2% of GDP in 2021, and to an average of 4% of GDP in 2022-23 on higher oil revenues and non-oil economic recovery (Chart 4.).

Public debt is estimated at 114% GDP in 2020 and will stay above 100% over 2022-23. The government was successful in retaining market access with a total of \$5.5 billion in medium and long-term bonds and Sukuk in 2020 at favorable pricing at yields ranging from 3.95-7.38% given Bahrain's non-investment credit rating. Nevertheless, we expect an easing in financing needs due to the government's commitment under the \$10 billion aid package from some GCC neighbors in 2018 to consolidate its budget, though the target of balancing the budget by 2022 is no longer feasible.

## Foreign reserves could recover over the medium term

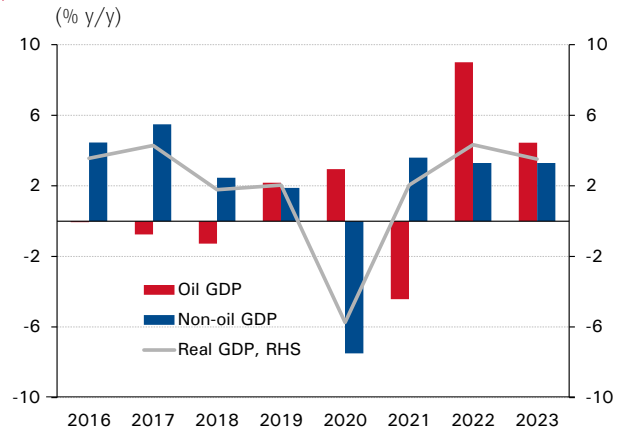
Higher oil prices are expected to decrease the current account deficit to around 3.8% of GDP over the forecast period, up from 9.6% in 2020, with non-oil exports rising alongside the rebound in the non-oil economy. This will help to replenish central bank foreign reserves, which stood \$2 billion (less than 3 months of imports) in December 2020 (Chart 5). Medium-term risks to the economy include a slower economic recovery linked to virus pressures, inadequate fiscal adjustment and possible changes in the credit profile rating, making medium-term debt sustainability harder to achieve.

**Table 1: Key economic indicators**

		2019	2020e	2021f	2022f	2023f
Nominal GDP	₹ billion	38	34	36	39	42
Real GDP	% y/y	2.0	-5.7	2.0	4.3	3.5
- Oil	% y/y	2.2	2.9	-4.4	9.0	4.4
- Non-oil	% y/y	1.9	-7.5	3.6	3.3	3.3
Budget balance	% of GDP	-4.7	-13.0	-7.2	-4.4	-3.5
Current account	% of GDP	-2.1	-9.6	-3.5	-4.1	-3.8
Headline inflation	% y/y	1.0	-2.3	0.9	1.0	1.4

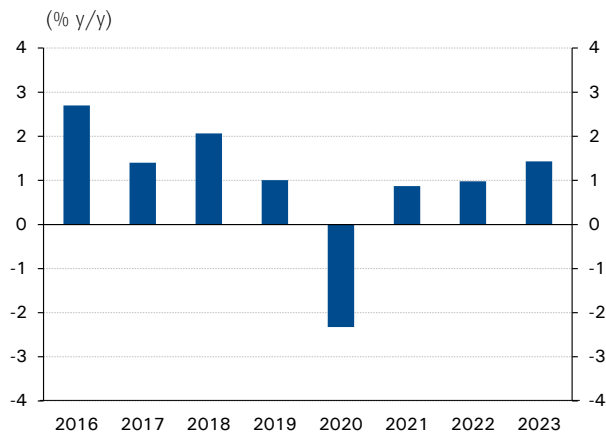
Source: Official sources, NBK estimates

**Chart 1: Real GDP**



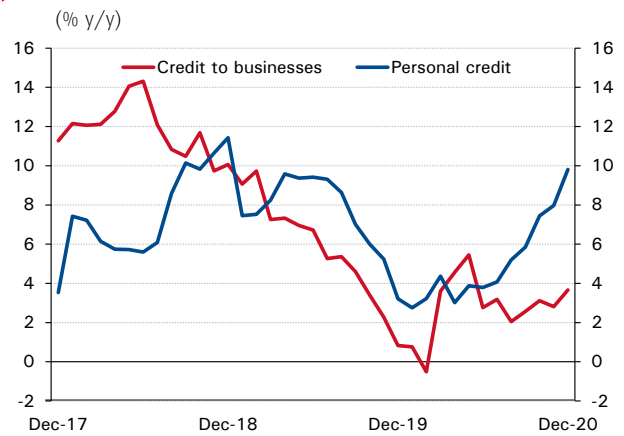
Source: Information & e-government Authority, NBK estimates

**Chart 2: Headline inflation**



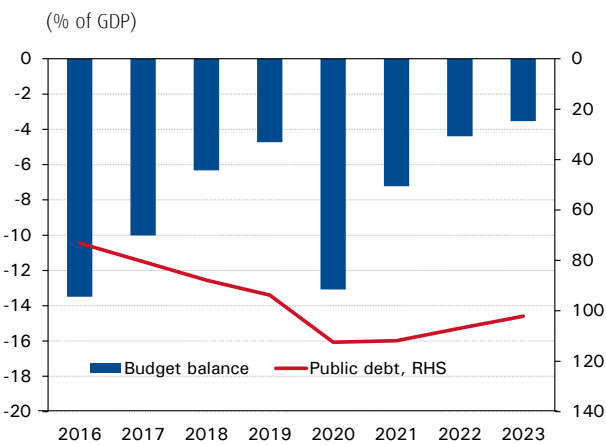
Source: Information & e-government Authority, NBK estimates

**Chart 3: Credit to businesses & personal credit**



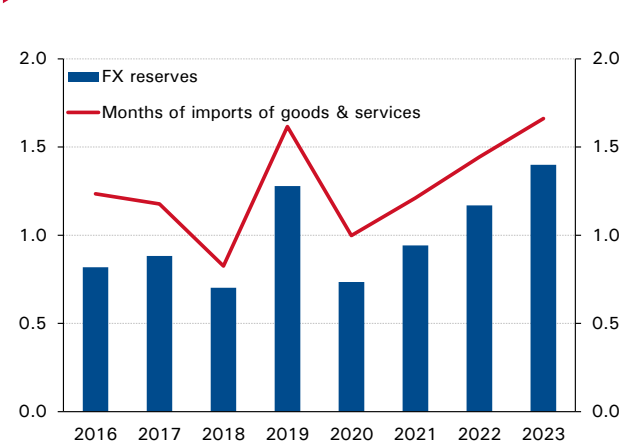
Source: Central bank of Bahrain, NBK estimates

**Chart 4: Budget balance and public debt**



Source: Ministry of finance, NBK estimates

**Chart 5: Central bank foreign reserves**



Source: Central Bank of Bahrain, NBK estimates