Bahrain

Growth is seen picking up to 3.0% in 2021 as virus pressures fade and tourism and service industries recover, then average 3.1% in 2022-24 helped by oil & gas expansion projects and GCC-funded infrastructure schemes. The goal under the FBP of balancing the budget was delayed due to Covid, but fiscal consolidation efforts are well underway including cuts in spending and potentially a hike in VAT in 2022. Continued progress in this area will help sustain good access to international capital markets and could also unlock further GCC assistance.

Return to decent growth expected as pandemic eases

The economic recovery is proceeding apace, and higher oil prices are providing a welcome boost to government revenues as the government looks to get its crucial Fiscal Balance Program (FBP) back on track post-pandemic. After contracting 7.1% last year, non-oil GDP rose a reported 2.2% y/y in 1H21, and we forecast a further improvement to 3.1% for 2021 as a whole given successful vaccine deployment (more than 60% of the population fully vaccinated), an easing of health restrictions locally and in the GCC, a recovery in the tourism and service sectors, higher oil prices, and progress on infrastructure projects financed by the GCC Development Fund. (Chart 1.)

Meanwhile, the hydrocarbon sector contracted by -0.1% last year with oil output relatively stable at 0.194mb/d (holding up better than other participants in the OPEC+ agreement) and natural gas output edging down 0.4% to 610 bcf. Overall GDP growth could average around 3% in 2022-24 from 2.5% in 2021 and -5.8% in 2020, with oil and gas projects (including Bapco's refinery modernization and development of the Khaleej al Bahrain) contributing despite the sector's relatively modest share of GDP (around 18%).

Fiscal deficit falls sharply, but more consolidation needed

A pandemic-related plunge in revenues (-28%) and higher spending (+5%) pushed the fiscal deficit to 12.9% of GDP in 2020 from 4.7% in 2019, and necessitated a delay to the goal of balancing the budget to 2024 from 2022 targeted under the original FBP. The deficit is already set to fall sharply this year to 5.8% of GDP thanks to much higher oil prices, and despite the extension of stimulus measures such as the salary support program, which will push up spending. But the need for fiscal adjustment remains. Priorities will include further cuts in public spending while increasing its efficiency, and boosting non-oil revenues by raising utility charges. In addition, a doubling of VAT to 10% is expected from 2022. Together with higher oil prices than last year, this should reduce the deficit to an average of 3.1% in 2022-24 (Chart 2). However, delays in reforms and the persistence of off-budget spending are risks to the fiscal outlook.

The accumulated fiscal deficits have pushed public debt levels from around 30% of GDP in 2010 to 94% in 2019, and further to 116% last year. Despite measures to reduce the deficit, public debt is likely to remain above 100% during the forecast period. Credit agencies Moody's and S&P both assigned the government's sovereign rating a negative outlook earlier this year reflecting the scale of the debt challenge including high debt servicing costs. Nevertheless, the country was able to tap international markets by issuing $2.5 billion of conventional bonds in the first three quarters of 2021, albeit at yields of up to 6.25% (30-year maturity). Successful progress on the FBP could also unlock further project-related funds from GCC neighbors.

Inflation low, but to rise if VAT is hiked in 2022

Having been negative since early 2020, consumer price inflation returned to positive territory in June 2021 as the economy improved and deflation in various key sectors including food, clothing and hospitality faded. Housing rents declined by 2.0% y/y in 7M20 though have also now started to edge higher. The outlook for inflation depends partly upon VAT, which if increased next year as mooted could lift inflation to around 3% on average in 2022, after which it should fall back. (Chart 3.) Monetary policy will remain accommodative but with a possibility of interest rate hikes in late 2022, given that policy rates are guided by the dollar peg and usually follow moves by the US Fed. Retail banks' credit, which has been supported by the loan deferral program that is due to expire at the end of 2021, stood at 5.4% y/y in August and could increase by an average of around 4% in 2022-24. (Chart 4.)

External position improved, but import coverage low

The current account deficit widened to 9.3% of GDP in 2020 from 2% in 2019, but will improve sharply this year on higher oil prices and the gradual revival of tourism. We expect it to remain below 5% of GDP over the forecast horizon, based upon oil prices not falling below $60/bbl. The central bank's foreign reserves stood at $3.7 billion in August 2021, providing a coverage ratio for imports of below three months. (Chart 5.) Over the medium term, reserves could be strengthened by recovering tourism, further debt issuance, and strong GCC backing. Main risks to Bahrain's outlook revolve around the pace of the economic recovery (including due to Covid or slowing global growth), the low credit rating, high public debt levels, and delays to the fiscal consolidation program.

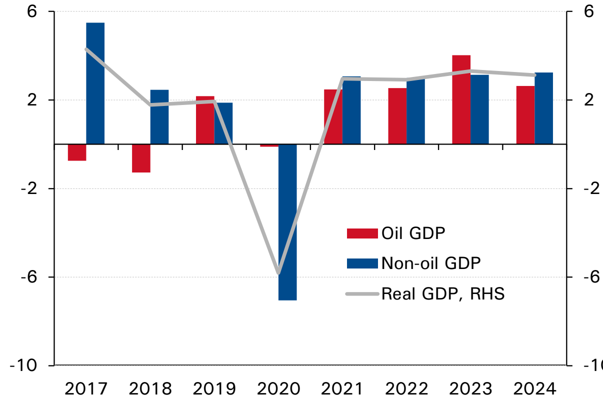
Table 1: Key economic indicators

		2020	2021[e]	2022[f]	2023[f]	2024[f]
Nominal GDP	$ billion	35	37	39	41	43
Real GDP	% y/y	-5.8	3.0	2.9	3.3	3.1
- Oil	% y/y	-0.1	2.5	2.5	4.0	2.6
- Non-oil	% y/y	-7.1	3.1	3.0	3.1	3.2
Budget balance	% of GDP	-12.9	-5.8	-4.9	-3.2	-1.2
Current account	% of GDP	-9.4	-2.2	-4.1	-3.9	-3.6
Headline inflation	% y/y	-2.3	-0.2	3.1	1.2	1.4

Source: Official sources, NBK estimates

Chart 1: Real GDP

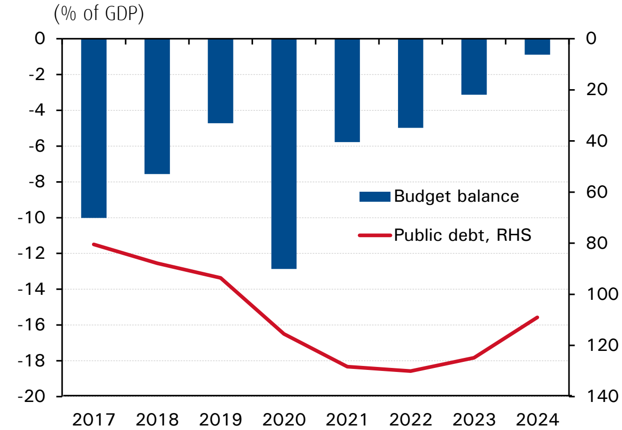
(% y/y)



Source: Information & e-government Authority, NBK estimates

Chart 2: Budget balance and public debt

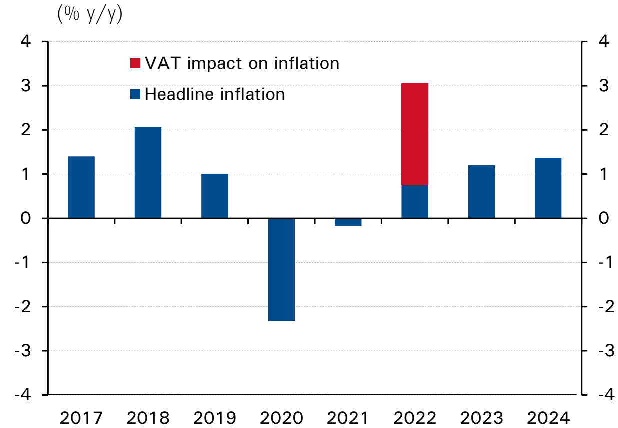
(% of GDP)



Source: Ministry of Finance, Information & e-government Authority, NBK estimates

Chart 3: Headline inflation

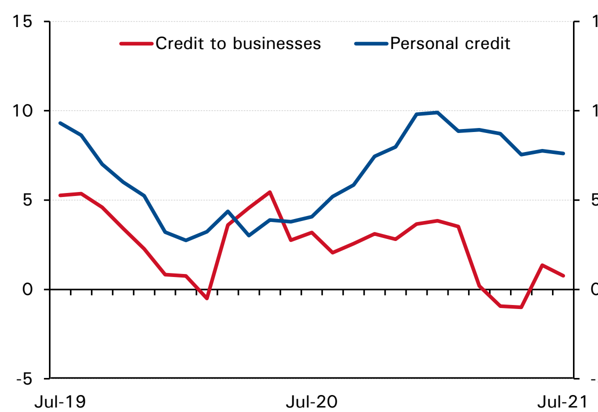
(% y/y)



Source: Information & e-government Authority, NBK estimates

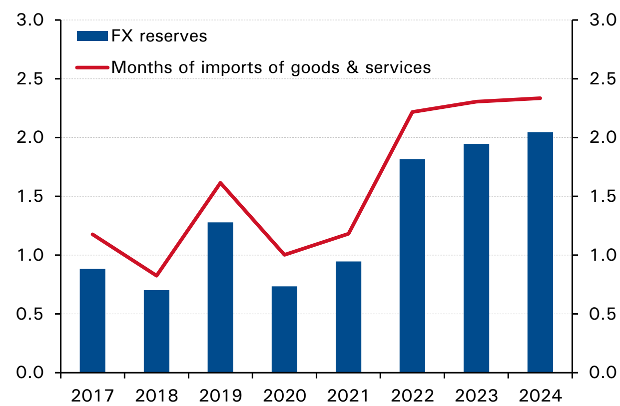
Chart 4: Retail banks personal and business credit

(% y/y)



Source: Central Bank of Bahrain, NBK estimates

Chart 5: Central bank foreign reserves



Source: Central Bank of Bahrain, NBK estimates