Bahrain

Higher oil prices, a post-pandemic rebound, ongoing aid from GCC neighbors and rising oil output will push growth to 3% in 2022, leaving GDP above pre-pandemic levels. The government announced an ambitious $30bn reform and development plan in late 2021 which, if implemented, will underpin the medium-term outlook. The fiscal balance should swing back in to surplus this year, beating the target of achieving balance by 2024, though high debt levels remain a concern. Risks include a fall back in oil prices or incomplete implementation of FBP goals, while successful reform execution could lift economic growth and the credit rating.

Higher oil prices should underpin Bahrain's economic recovery, which was already making progress amid fading pandemic pressures, the adoption of a comprehensive reform program and ongoing financial support from GCC neighbors. After growing 2.2% last year, GDP is forecast up 3.0% in 2022, which would see output exceed pre-pandemic levels. (Chart 1.) Although Bahrain is one of the Gulf region's most diversified economies, it could benefit even more than others from higher oil revenues given its particular financial vulnerabilities that the reform program aims to address. Indeed, the government could record its first fiscal surplus in 14 years in 2022, beating its (pandemic-delayed) target of balancing the budget by 2024.

Reform program to drive medium-term growth outlook

Non-oil growth is forecast at 3% in 2022 – slightly better than last year – with Covid-related restrictions largely lifted through 1Q22 and not re-imposed in our baseline forecast. The tourism and hospitality segments should also continue to recover, while the important financial sector (20% of non-oil GDP) will benefit from stronger activity and higher interest rates. This should help offset the drag on activity from fiscal consolidation measures. Meanwhile, the hydrocarbon sector is projected to expand slightly in accordance with OPEC+ planned output hikes. The sector is forecast to grow by 3.6% in 2022 as crude production is lifted from 193 kb/d to 200kb/d.

Longer-term prospects center around the government's $30 billion multi-year Economic Recovery Plan announced late last year. It includes the building of five offshore cities, expanded infrastructure and trade routes, the creation of 20,000 jobs annually for citizens by 2024, regulatory reforms to help attract $2.5 billion of FDI by 2023, and growth in targeted sectors including tourism, logistics, finance and IT. If successful, the plan would significantly boost growth prospects. It also incorporates the expansion in state-owned Bapco's refining capacity (expected 2H2024) by 42% to 380 kb/d and a rise in shale oil output from the recently-discovered Khaleej Al-Bahrain field. The government has also set a target of net zero carbon emissions by 2060, including through use of carbon capture technology.

Inflation to increase on higher food prices and new taxes

Inflation jumped to a six-year high of 3.2% y/y in February 2022, driven mostly by the doubling of VAT to 10% from January 2022. A combination of this, recovering demand, and higher global commodity prices will push inflation to a still-moderate 3.0% on average in 2022-23. (Chart 2.) Interest rates were hiked 25bps in March 2022 in line with US policy rates and further substantial tightening is expected this year, which may help cap inflationary pressures. Meanwhile, retail banks' credit rose 4.8% y/y in February 2022, and will be supported by the extension of the deferral of loan installments until June 2022. (Chart 3.)

Fiscal balance on the horizon as oil prices surge

The government's revised targets under the Fiscal Balance Program (FBP) were based on a projected oil price of $60/bbl in 2022-24, which now looks too pessimistic. We see the budget swinging from a deficit of 3.7% of GDP in 2021 (government definition) to a small surplus this year and next. As well as the jump in oil revenues, non-oil receipts will be boosted to around 6.2% of GDP in 2022-23 (3.4% in 2018) by the impact of higher VAT and enhanced revenue collection. The government also looks set to stick with FBP initiatives of rationalizing spending including reducing manpower and streamlining subsidies, reinforcing its commitment to reform. It is targeting spending of 20% of GDP by 2024, down from a recent peak of 28.7% in 2020.

These steps have helped to stabilize the country's credit rating (S&P: B+, Fitch: B+), albeit at below investment grade level. High government debt levels remain a concern, especially amid rising global interest rates and relatively limited assets in the sovereign wealth fund (43% of GDP). Still, given the improving fiscal position and higher GDP base, the government's aim of stabilizing then reducing debt to GDP from 115% in 2020 now looks very achievable. Ongoing progress on FBP-related reforms will trigger further disbursements of the $10 billion aid program from Gulf neighbors agreed in 2018, supporting liquidity.

Current account surpluses, reserves improving

Meanwhile, there has also been a major improvement in the external position, with the current account recording its first surplus in seven years last year at 6.7% of GDP, driven by a surge in aluminum and iron exports and a recovery of inbound tourism. Overall, we expect the current account to remain in comfortable surplus during the forecast period. This will help replenish the central bank's foreign reserves which stood at $4.3 billion in February 2022 (less than three months of imports), and improve resilience against any further external shocks.

The main risks to the outlook are a sudden fall back in oil prices, which would reverse the recent improvement in the fiscal and external positions, and incomplete implementation of FBP goals in light of any social or political pushback. Higher interest rates could also worsen public sector debt dynamics. On the other side, higher oil prices or rapid and successful reform execution could improve non-oil growth and the government's credit rating.

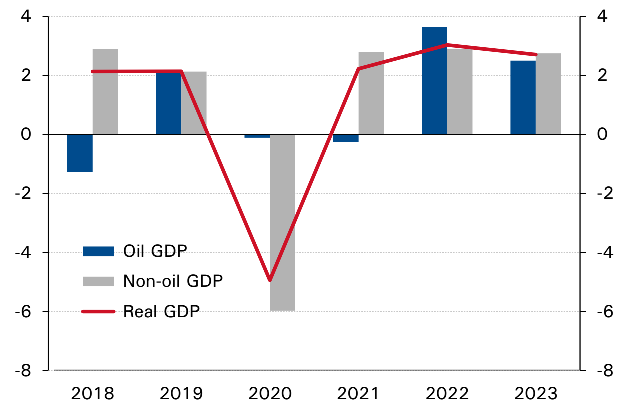
Table 1: Key economic indicators

		2020	2021e	2022f	2023f
Nominal GDP	($ bn)	34.7	38.9	42.5	42.3
Real GDP	(% y/y)	-4.9	2.2	3.0	2.7
- Oil	(% y/y)	-0.1	-0.3	3.6	2.5
- Non-oil	(% y/y)	-6.0	2.8	3.0	2.8
Inflation (average)	(% y/y)	-2.3	-0.6	3.2	2.8
Fiscal balance	(% of GDP)	-12.8	-3.7	2.5	0.7
Government debt	(% of GDP)	114.5	113.6	110.5	108.7
Current account	(% of GDP)	-9.3	6.7	7.6	6.7

Source: National authorities, NBK forecasts

Chart 1: Real GDP

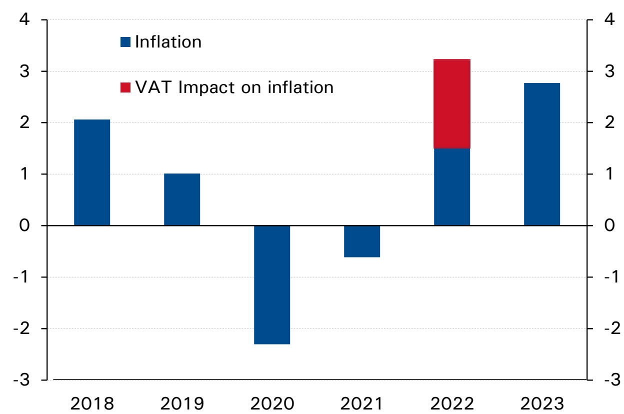
(% y/y)



Source: Information & e-government Authority, NBK forecasts

Chart 2: Headline inflation

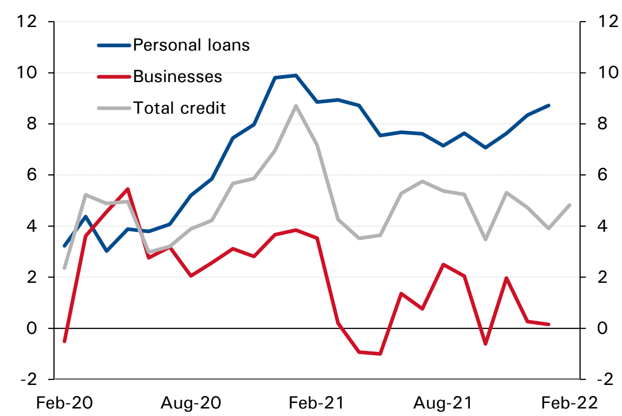
(% y/y)



Source: Information & e-government Authority, NBK estimates

Chart 3: Retail banks personal and business credit

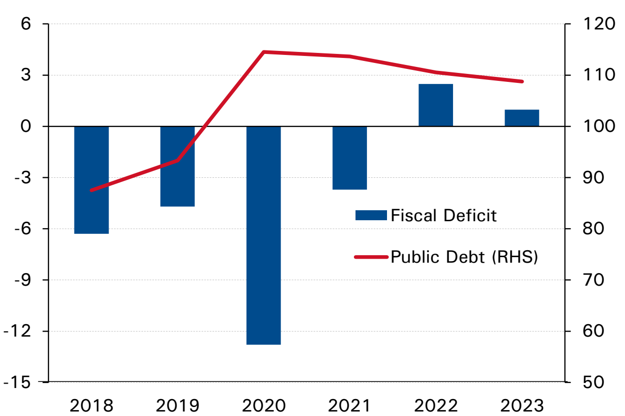
(% y/y)



Source: Information & e-government Authority

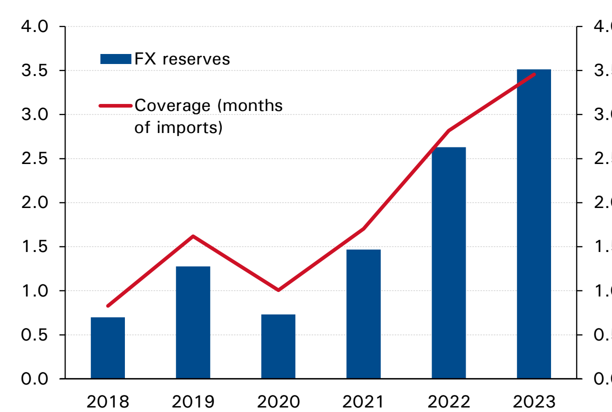
Chart 4: Budget balance and public debt

(% of GDP)



Source: Central Bank of Bahrain, NBK estimates

Chart 5: Central bank foreign reserves



Source: Central Bank of Bahrain, NBK estimates