



وَدَارَةُ الْمَالِيَّةِ وَالْاِقْتِصَادِ الْوَطَنِيَّ

Ministry of Finance
and National Economy



Bahrain Economic Quarterly Q1 2019



2030

البحرين
BAHRAIN

SUMMARY

BAHRAINI GROWTH PICKS UP IN Q4 2018

The Bahraini economy continued its upward growth trajectory in 2018¹, albeit at a slower rate, with a real gross domestic product (GDP)² estimated at 1.8%. More notably, the Kingdom concluded the year with pronounced accelerations in headline growth, with its Q4 2018 real GDP estimated at 4.6%. This healthy growth pace continued into 2019 and shows no signs of slowing down. In fact, the Bahraini economy is projected to grow by 2.3% in 2019 and 2.7% in 2020. The regional and global contexts for growth have generally improved in recent months.

- ◆ **During 2018, the Bahraini economy expanded by an estimated 1.8%.** This is an unusually low figure by recent standards, partly caused by a 1.3% contraction in the oil sector which saw a 1.6% drop in total crude oil production compared to 2017. Meanwhile, the non-oil sector posted an estimated 2.5% growth during the year.
- ◆ **The Bahraini economy expanded by an annual real GDP of 4.6% in Q4 2018.** This was led by 11.3% rebound in the oil sector, whose output had been disrupted briefly by seasonal maintenance a year earlier. Encouragingly, non-oil sector growth improved noticeably to an annual pace of 3.2%, above the 2-2.5% range obtained during Q1-Q3.
- ◆ **Confidence in the Bahraini economy continued with the inflow of Foreign Direct Investments (FDI).** Inward FDI totalled USD1.5bn in 2018, up from USD1.4bn a year earlier. In addition, international trade improved in 2018 by just under 7% on the previous year, while exports of domestic origin and imports rose by an annual 9.2% and 12.6%, respectively.
- ◆ **The global and regional backdrop is improving.** Overall, the gradual outlook for monetary policy normalization in the U.S. should provide a more accommodative monetary environment for the planned fiscal consolidation in Bahrain. Moreover, Bahrain will enjoy positive spill-overs from the steady economic growth in the Gulf region, supported by growing non-oil sectors and improving oil prices under the agreed global oil production control measures.

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¹ 2018 figures are estimates.

² All references to GDP in this report refer to the real (inflation adjusted) GDP.

Bahrain Economic Outlook

	2017	2018e	2019f	2020f
Real GDP growth (%)	3.8%	1.8%	2.3%	2.7%
Non-hydrocarbons sector	4.9%	2.5%	2.8%	3.2%
Hydrocarbons sector	-0.7%	-1.3%	0.0%	0.5%
Nominal GDP growth (%)	9.9%	6.5%	3.3%	4.7%
Inflation (CPI %)	1.4%	2.1%	2.8%	2.5%
Current account (% of GDP)	-3.8%	-5.9%	-3.2%	-2.0%
Fiscal balance (% of GDP)	-10.1%	-6.2%	-4.7%	-3.9%
Crude Oil Brent (USD per barrel)	53	72	65	62

Source: Ministry of Finance and National Economy estimates

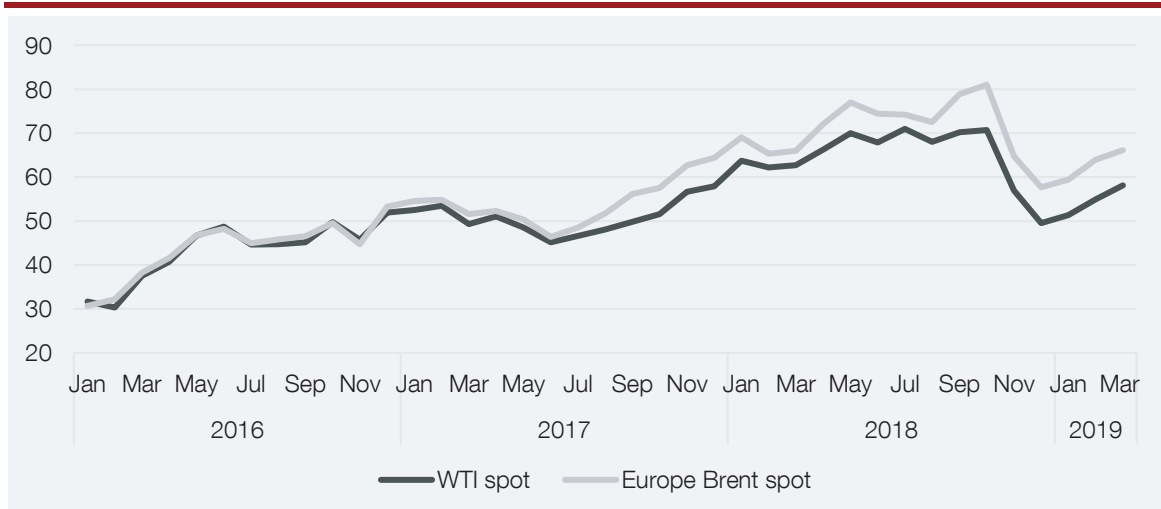
EXTERNAL CONTEXT

Global Prospects

The stint of severe global financial market turbulence at the end of 2018 was, relatively quickly, followed by both a broad-based reassessment of the global growth outlook and a return to a more permissive monetary policy stance. The U.S. Federal Reserve has signalled no further interest rate increases in 2019 and the possibility of only one further increment over the coming two-year period, contrary to their earlier indication of 4 interest rate hikes. This should translate into relative continuity in the cost of capital and favourable liquidity conditions. Moreover, it should reduce the risk of capital outflows from emerging markets. Trade tensions between the U.S. and its partners remain the main risk to this outlook.

In line with the global market rebound, the sharp decline in the price of oil observed at the close of 2018 has been reversed, with Brent posting a 2019 high of USD68.7 per barrel in March 2019. Oil prices have benefited from Organization of the Petroleum Exporting Countries (OPEC)'s commitment to rebalancing the markets, although political tension in a number of exporting countries is likely to contribute to risk perceptions. While U.S. production is continuing to rise, infrastructure bottlenecks are curbing exports.

Monthly Average Crude Oil Prices (USD/barrel)

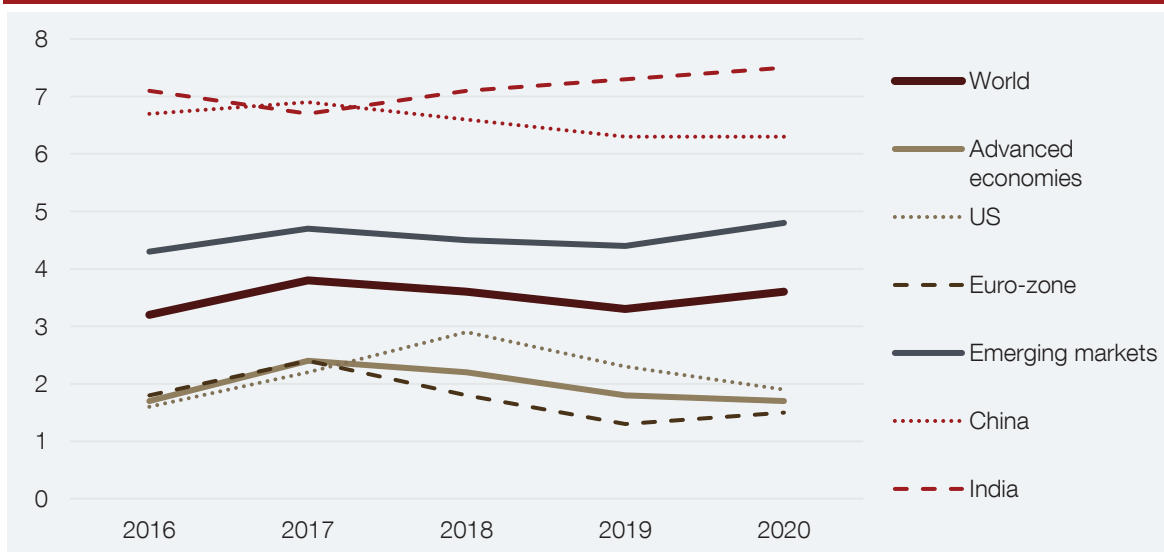


Source: US Energy Information Administration

Overall, global growth is expected to moderate somewhat in the near term before rebounding in 2020. In its April 2019 World Economic Outlook report, the IMF reduced its global growth forecast for 2019 from 3.5% to 3.3%, marking the slowest global growth rate since 2009. The projection for the advanced economies was brought down to 1.8% and that for emerging markets to 4.4%. The global growth rate is expected to accelerate marginally in 2020 to 3.6% with advanced economies expected to slow further to 1.7%, while emerging markets should see a rebound to 4.8%.

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Global Real Growth Outlook (%)



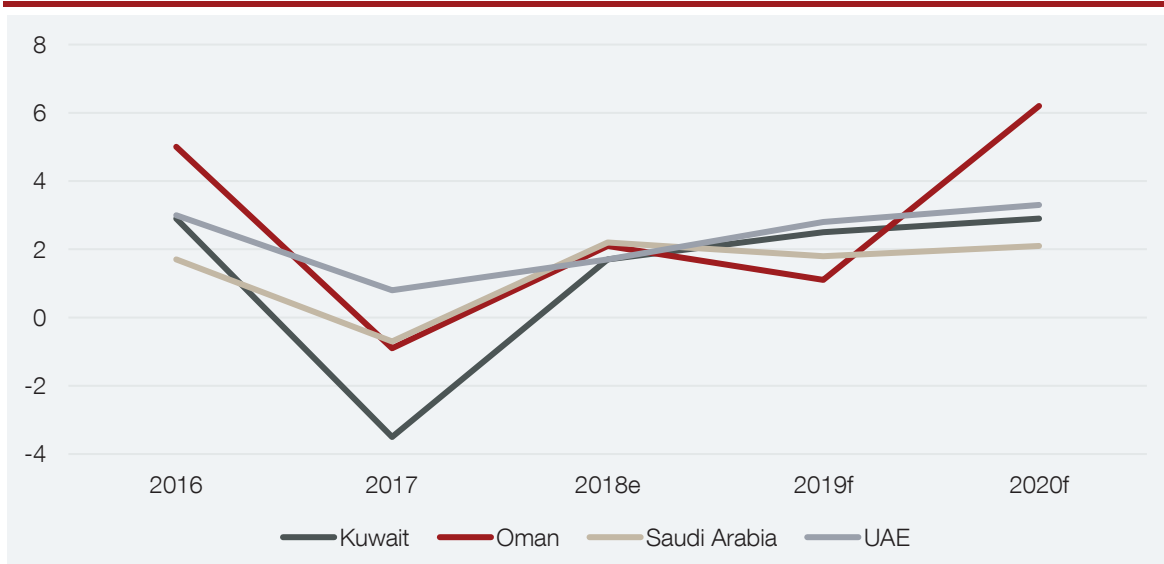
Source: International Monetary Fund, World Economic Outlook, April 2019

GCC Economic Outlook

Growth dynamics across the Gulf region in 2018 maintained a very gradual upward trend, a process that looks likely to continue into 2019. In 2018, headline economic growth in the region is estimated to have varied in a fairly narrow range between 1.7 and 2.2%. The range of growth rates projected by the IMF for 2019 varies from 1.1% in Oman to 2.8% in the UAE. Inflationary pressures across the region remain subdued. Higher oil prices have helped boost bank lending and overall liquidity somewhat. The capital markets are benefiting from their inclusion in international benchmark indices.

In general, the regional context should translate into generally positive spill-overs for Bahrain through increased visitor traffic, as well as stronger trade and investment flows. However, the rate of increase is likely to remain measured by historical standards.

GCC Real Growth Dynamics (%)



Source: International Monetary Fund, World Economic Outlook, April 2019

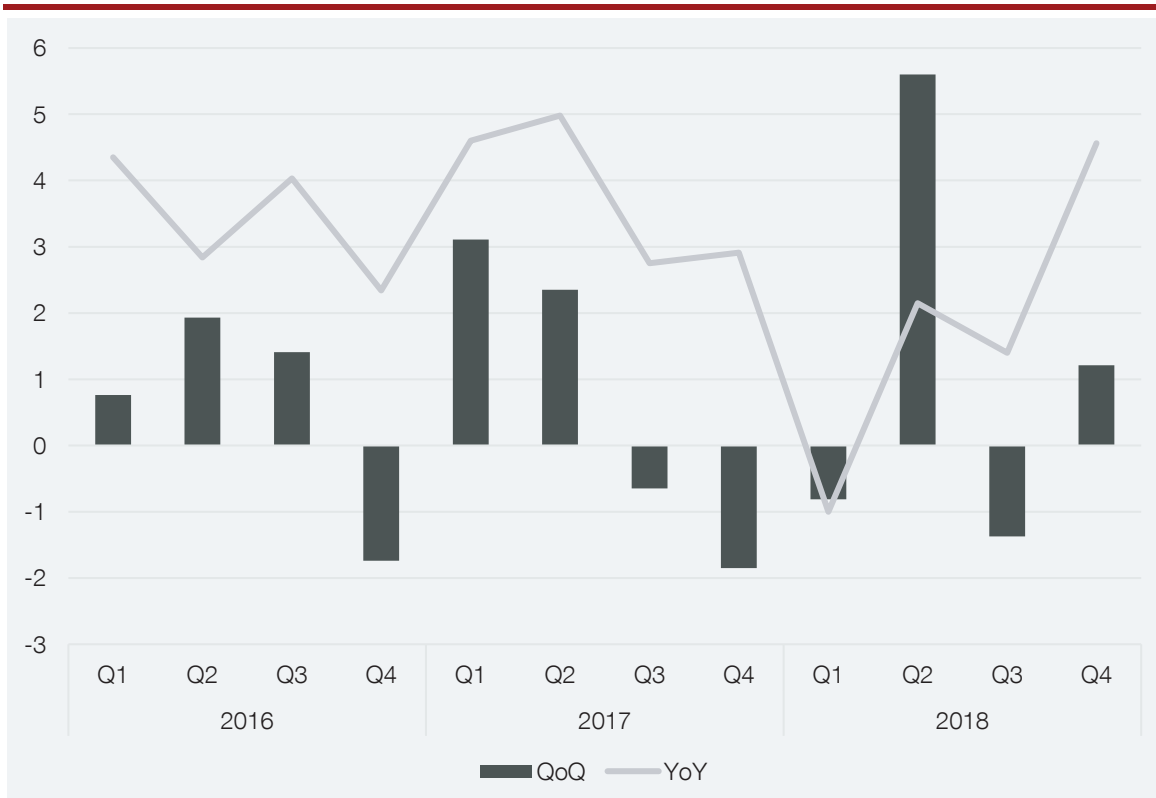
BAHRAIN

Economic Growth Overview

Economic growth in Bahrain accelerated markedly in Q4 2018 with an annual rate of 4.6%. This was primarily due to unusually fast oil sector growth, at 11.3% YoY, thanks to base effects. Offshore oil production a year earlier had been temporarily depressed by seasonal maintenance. The non-oil sector also saw a pronounced acceleration to an annual pace of 3.2%, after narrowly fluctuating between 2.1-2.5% earlier in the year.

During 2018 as a whole, the Bahraini economy is estimated to have expanded by 1.8% in real terms. While not inconsistent with the situation elsewhere in the Gulf region, this is an unusually low figure by recent Bahraini standards. It compares to a headline annual real growth figure of 3.8% in 2017. The most significant factor contributing to the slower rate of growth in 2018 was a 1.3% YoY contraction in the oil sector, which compared to a 0.7% drop in 2017. Furthermore, the growth rate was likely affected by uncertainties around fiscal consolidation before the unveiling of the government's Fiscal Balance Program in October 2018 and the timing of large infrastructure projects, the vast majority of which are in their infancy stage and are expected to play a significant factor in driving higher growth in the short and medium terms. The non-oil sector performed better, growing at an annual rate of 2.5%, down from 4.9% a year earlier.

Real GDP Growth (%)



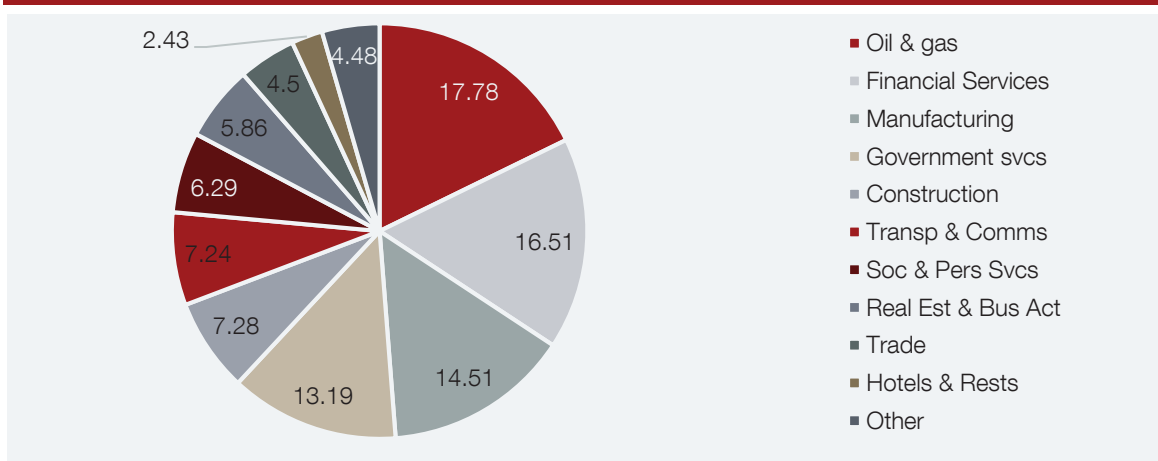
Source: Information & e-Government Authority

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Economic Diversification

Bahrain continues to make strides in diversifying the structure of its economy. Based on the 2018 preliminary data, the largest individual sector was still the oil sector which accounted for 17.8% of the Kingdom’s real GDP. Financial services continued to be the largest non-oil sector contributing 16.5% to the total GDP. The Manufacturing sector stood at 14.5% followed by Government Services at 13.2%, reflecting brisk growth in recent years. As for the Construction sector it accounted for 7.3%.

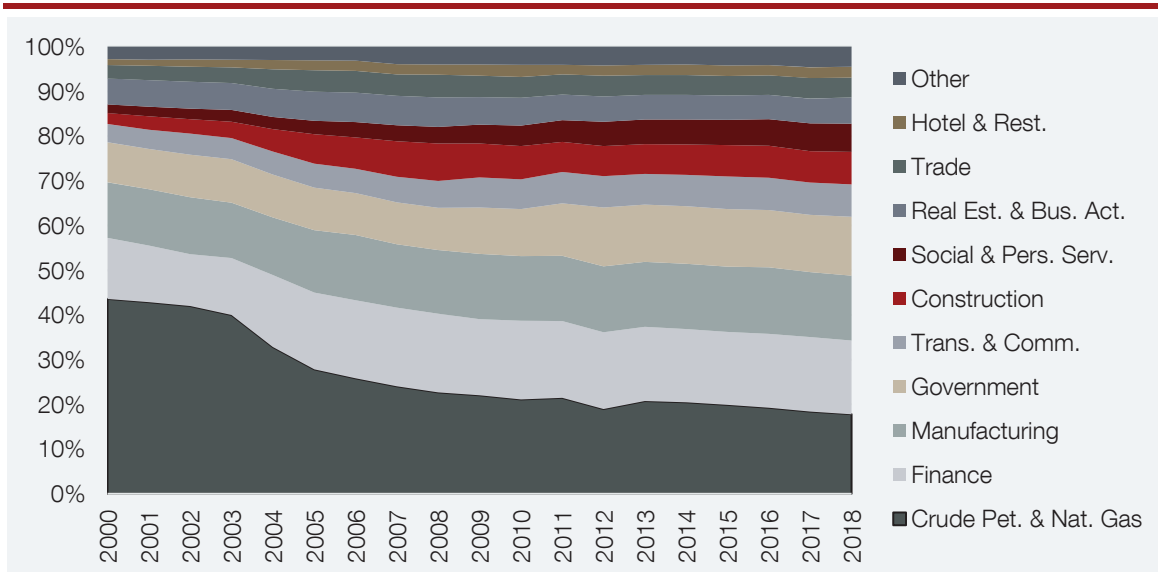
Sector Composition of Bahrain’s Real GDP (%)



Source: Information & eGovernment Authority

Bahrain has seen transformative changes in the structure of its economy since the turn of the millennium. The real GDP share of the oil sector has fallen from 43.6% in 2000 to 22.7% in 2008 and 17.8% in 2018. On the other hand, the Financial Services sector increased its weight from 13.6% in 2000 to 17.6% in 2008 and 16.5% in 2018. The share of Manufacturing has risen from 12.4% in 2000 to 14.3% in 2008 and 14.5% in 2018.

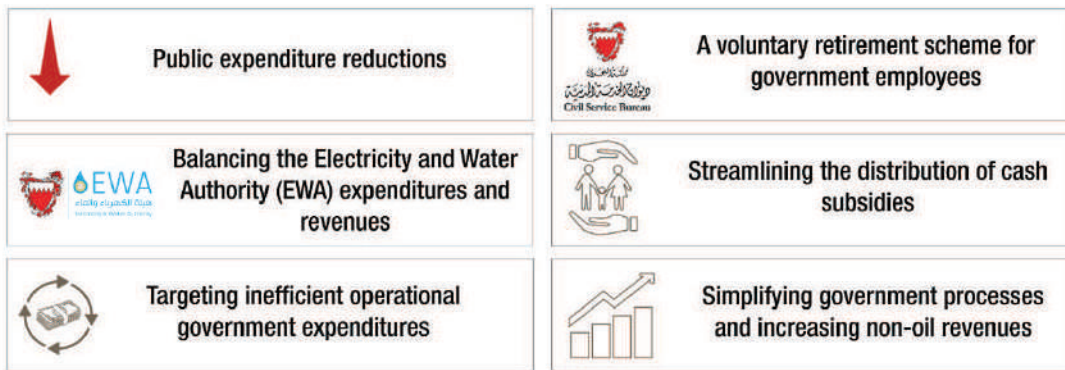
Evolution of Bahrain’s Real GDP Composition Since 2000



Source: Information & eGovernment Authority

Launching the Fiscal Balance Program

the Government launched the Fiscal Balance Program with the overall objective to achieve a balanced budget by 2022. To achieve this goal, six initiatives were introduced with a projected impact of BHD 800mn on an annual basis by the year 2022.



Since the launch of the program on the 4th of October 2018, actions have been taken to implement these initiatives.

- ◆ **Targeting inefficient operational expenditures:** This initiative aims at activating the six government task forces to identify and implement savings in government operational expenditure by set spending controls. Accordingly, a decision was issued with regards to forming the task forces and appointing their head of each team. Implementation of the new procedures started on 21 October.
- ◆ **A voluntary retirement scheme for government employees:** A one-time voluntary retirement scheme was offered to employees working in government sector under the umbrella of the Civil Service Bureau. The scheme provides its participants with the opportunity to contribute to the Kingdom's economic growth through entrepreneurship or participation in the private sector by providing a set of incentives. The registration period for the voluntary retirement program ended on the 8th of November 2018. The total number of applicants was 9,117 and 8,711 were accepted.
- ◆ **Simplifying government processes and increasing non-oil revenues:** In order to increase the non-oil revenues, the government worked on implementing a series of projects to facilitate the provision of services to citizens, such as the launch of "Benayat" the building permits issuance system, and "Sijilat" the commercial registration system. In addition, a number of supporting laws were issued including the Personal Data Protection Act and the Electronic Transactions Law. Value Added was introduced on 1 January 2019.

- ◆ **Public expenditure reductions:** To strengthen financial and administrative control and governance of disbursements in government entities, In addition to increasing the efficiency of government spending and setting the necessary mechanisms for auditing them, the government adopted a number of initiatives that would contribute to achieving these objectives. Including the establishment of the Office of Public Debt Management, the Central Internal Control Unit, the Central Government Procurement Unit and the Central Efficiency Unit to be affiliated to the Ministry of Finance. All financial managers and heads of financial resources departments from all ministries were transferred to the Ministry of Finance and National Economy to ensure the efficiency of the application of financial regulations.
- ◆ **Balancing the EWA expenditures and revenues:** This initiative includes gradual adjustments to electricity and water tariffs while preserving benefits for Bahrainis in their primary households, with the aim of enhancing efficiency and reducing spending to balance the Authority's expenditures and revenues by 2022.
- ◆ **Streamlining the distribution of cash subsidies:** The current cash subsidies program comprises multiple allowances typically regulated and allocated by multiple entities. The consolidation and redirection of cash subsidies towards eligible citizens is an important part of ensuring fairness and improving quality of life.

Forecast: Fiscal Consolidation and Infrastructure Investments

Bahrain economic outlook

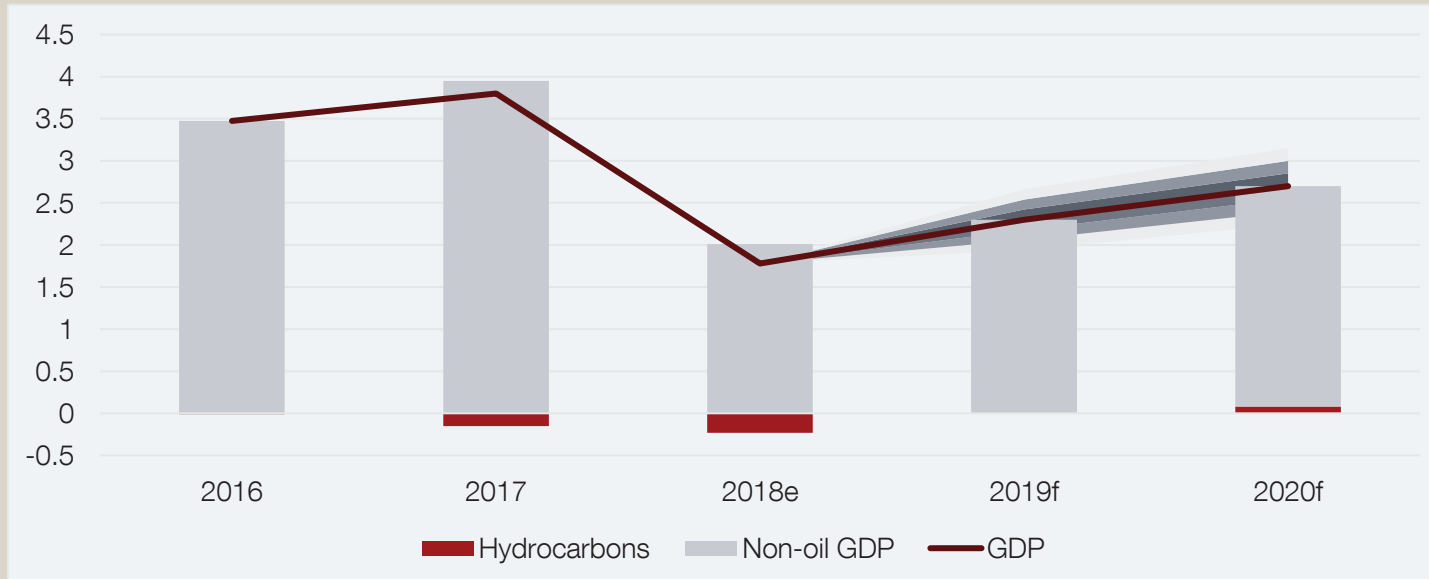
	2017	2018e	2019f	2020f
Real GDP growth (%)	3.8%	1.8%	2.3%	2.7%
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Source: Ministry of Finance and National Economy

Economic growth in the near term will be shaped by the conflicting forces of fiscal consolidation under the Fiscal Balance Program and infrastructure investment.

Substantial infrastructure investments will continue to drive growth. In particular, the Hydrocarbons sector is seeing the implementation of an unprecedented investment pipeline of projects, led by the Bapco Modernization Program, the largest single infrastructure project in Bahrain's history. Work is also progressing on the development of the new offshore oil and deep gas reserves. In the Manufacturing sector, Alba Line 6 is now active and will be scaling up to full capacity towards the middle of 2019. This will boost the sector's growth and national exports. On the other hand, the oil sector is expected to remain static during 2019. Significant activity is underway on several major strategic projects which are not due to be completed in the year. The value of these projects is currently driving growth in the Construction sector and it is expected to contribute to oil sector growth once they are completed.

Real GDP Growth Composition



Source: Ministry of Finance and National Economy, Information & eGovernment Authority

Oil Sector

Oil production levels in Bahrain were steady in recent months. Overall oil production in Q4 2018 totalled 197,990 bpd, a 12.4% YoY increase, but a 0.5% drop from Q3 levels. Production from the offshore Abu Sa'afah field totalled 156,368 bpd, a 17.7% YoY increase primarily because output in Q4 2017 was depressed by maintenance. The onshore Bahrain field generated 41,622 bpd in Q4, a 3.7% YoY decline.

During 2018 as a whole, crude production in Bahrain reached 194,179 bpd, a 1.6% drop compared to 2017. Output from the offshore Abu Sa'afah field totalled 152,057 bpd, a 0.6% decline in YoY terms. Production from the Bahrain field reached 42,122 bpd, a 4.8% drop YoY.

Oil production during the opening months of 2019 continued broadly in line with last year's levels. Production from Abu Sa'afah averaged 153,225 bpd in January-February, whereas the output of the Bahrain Field reached 41,020 bpd.

Crude Oil Production (bpd)



Source: National Oil and Gas Authority

Apart from the initial development of the recently discovered Khaleej al Bahrain (KAB) Basin and the deep gas reserves, the oil sector in Bahrain is continuing to see significant project activity across the value chain:

- ◆ The new floating LNG terminal is set to start commercial operations in May 2019 receiving its first shipment from Abu Dhabi. Bahrain signed supply agreements with more than 25 companies and countries. Bahrain LNG includes a receiving and regasification terminal at the Khalifa bin Salman Port in Hidd. The operating company is 30% owned by Teekay LNG Partners (US), 20% by Samsung C&T (Korea), 20% by Gulf Investment Corporation (Kuwait), and 30% by Nogaholding (Bahrain). The facility will have the capacity to import up to 800mn cubic feet per day (cu ft/day), which compares to overall current consumption of some 1.5bn cu ft/day.
- ◆ 2018 saw the completion of the USD600mn Banagas plant 3 project involving the construction of a plant for recovering high-value-added petroleum constituents (LPG and naphtha) contained in petroleum-entrained gas which have not been recovered in the past. The plant processes associated gas from the Bahrain field. The project was undertaken by South Korea's GS Engineering & Construction.
- ◆ A USD4.2bn EPC contract, which is a key element of the Bapco Modernization Project is currently underway. The project is expected to be completed by the end of 2021. The capacity of the refinery will increase from 267,000 bpd to some 400,000 bpd. The new AB-4 pipeline commissioned in October 2018, has capacity to supply 350,000 bpd of Saudi crude to the refinery.
- ◆ The front-end engineering and design have been completed for the planned USD1.5bn aromatics facility. The project is expected to produce 1.44mn tons of paraxylene a year, which is used in the synthesis of various polymers, including polyethylene terephthalate (PET). PET in turn is used as an ingredient for clothing fibres, liquid and food containers, thermoforming, and engineering resins. The planned plant is expected to be integrated with the Bapco refinery, which will supply its feedstock.
- ◆ In January 2019, Nogaholding signed an agreement with Italy's Eni for the joint exploration of Bahrain's offshore Block 1, an area spanning 2,800 square kilometres (sq km) to the north of Bahrain with a depth of 10-70 metres.
- ◆ Bahrain and Saudi Arabia have set up a team to assess the feasibility of using carbon dioxide from Saudi Aramco to boost Bahrain's oil production through carbon dioxide injection technology. Nogaholding and Aramco have agreed to set up a carbon dioxide transport and distribution network.

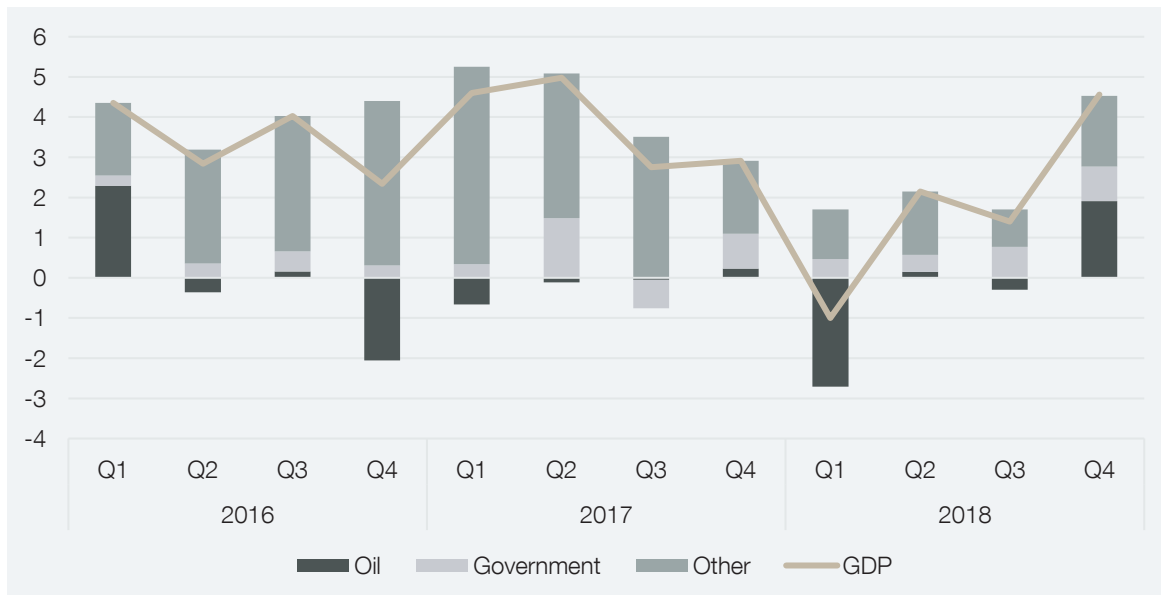
Non-oil Sector Growth

Following a clear deceleration in non-oil sector growth during Q1-3 2018, a fairly broad-based rebound materialized in Q4. This is likely to have been, at least partly, due to buyers bringing forward their purchases ahead of the phased implementation of VAT on the 1 January 2019. Indeed, the Trade sector, which had seen a small YoY contraction earlier in the year, posted 2.1% YoY growth in Q4. Similarly, the Hotels & Restaurants sector, which had posted a sharper YoY decline in Q1-3, experienced a rebound to 6.1% in Q4. The Financial Services sector, also impacted by the change in consumption behaviour, rebounded from near-zero growth to 2.7%. Having said that, the fastest growing sector in the non-oil economy in Q4 2018 was Government Services, which saw growth accelerate to 6.7%.

The Hotels & Restaurants sector improvement marks a significant break in the trend and reflects increased events activity with a clear improvement posted in hotel occupancy. Overall, Bahrain welcomed a record 12.8mn visitors in 2018, a 6% increase over the year, according to data compiled by the Bahrain Tourism and Exhibitions Authority. The government hopes to see the number increase to 15mn over the coming four years.

During 2018 as a whole, the non-oil economy achieved estimated real growth of 2.5%. The fastest growing sector was Construction, which expanded by an annual 5.6%. The Government Services sector posted 5.0% YoY growth, which was clearly above the trend of recent years. Social & Personal Services (mainly private education and health care) expanded by 3.0%. The only non-oil sector to post a YoY contraction was Hotels & Restaurants, which saw a 1.1% contraction in spite of the year-end rally. Similarly, growth in the Trade and Transportation & Communications sectors remained unusually subdued at 0.1% and 0.2%, respectively.

Real GDP Growth Composition



Source: Information & eGovernment Authority

Sector-specific real growth rates, YoY (%)

YoY growth (%)	2017		2018			
	Annual	Annual	Q1	Q2	Q3	Q4
Crude Pet. & Nat. Gas	-0.7	-1.3%	-14.7%	0.8%	-1.5%	11.3%
Manufacturing	1.1	1.9%	2.7%	2.8%	1.2%	0.8%
Construction	1.7	5.6%	6.7%	6.6%	5.4%	3.9%
Trade	8.5	0.1%	-0.6%	-0.8%	-0.5%	2.1%
Hotels & Restaurants	9.5	-1.1%	-2.7%	-6.1%	-1.4%	6.1%
Transp. & Comm's	6.2	0.2%	2.6%	-0.1%	-1.9%	0.3%
Social & Pers. Serv.	9.4	3.0%	4.1%	3.2%	3.1%	1.7%
Real Est. & Bus. Act.	6.4	2.8%	3.7%	3.0%	2.9%	1.5%
Finance	5.0	0.9%	-0.1%	0.1%	0.8%	2.7%
Government	3.9	5.0%	3.7%	3.1%	6.6%	6.7%
Other	9.7	5.1%	-3.6%	12.4%	1.7%	11.2%
GDP	3.8	1.8%	-1%	2.2%	1.4%	4.6%
<i>Non-oil GDP</i>	<i>4.9</i>	<i>2.5%</i>	<i>2.1%</i>	<i>2.5%</i>	<i>2.1%</i>	<i>3.2%</i>

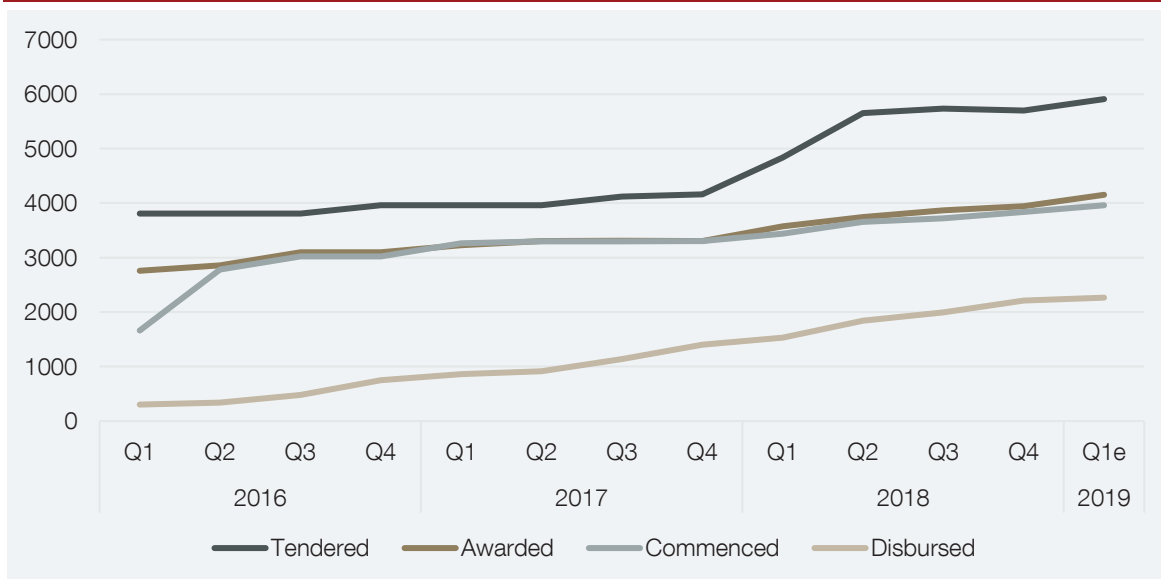
Source: Information & eGovernment Authority

Non-oil Sector Projects

Project activity remains an important source of prosperity for Bahrain's non-oil sector. For instance, according to estimates made by MEED Projects, Bahrain saw a total of USD2.4bn worth of contract awards in 2018, compared to a total of USD1.8bn in 2017.

Projects supported by the GCC Development Fund remain an important element of the overall infrastructure project pipeline. The cumulative total value of tendered projects rose by an annual 22.2% to USD5.9bn as of Q1 2019. The total value of the projects that have broken ground reached USD4.2bn, marking a 16.2% YoY increase. The cumulative cashflow of the GCC projects reached USD2.3bn after a remarkable 48.2% YoY increase.

GCC Development Fund Overview, Cumulative Totals (USD mn)



Source: Government sources

Infrastructure projects in the non-oil economy are driving growth across all sectors:

- ◆ The Telecommunications Regulatory Authority is in the process of finalizing the licensing and spectrum allocation for the launch of the planned 5G networks in June 2019, which will make Bahrain one of the first markets globally to offer commercial 5G services. The 5G roll-out is in turn expected to enable other developments including new innovations in areas such as virtual/augmented reality and autonomous vehicles. Bahrain is the top ranked Arab country in the ITU's ICT Development Index as well as the fourth country globally in the UN's Telecommunications Infrastructure Index, which is part of the E-Government Development Index.

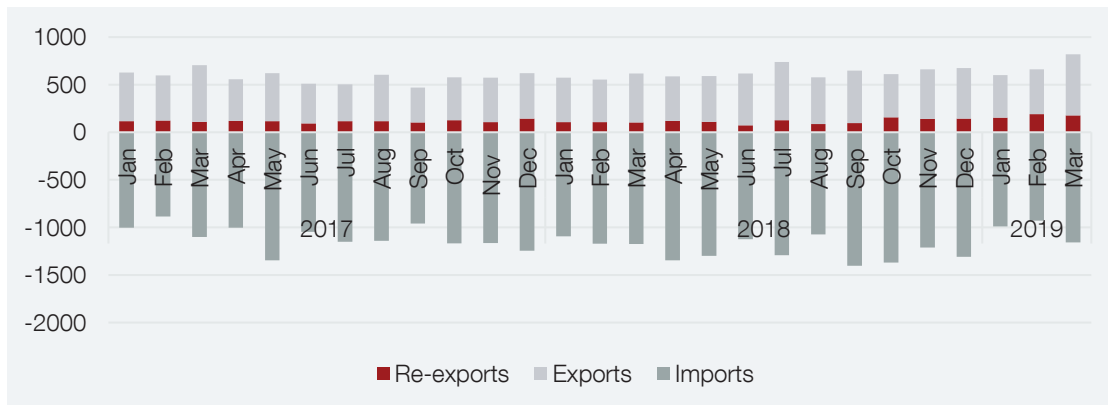
- ◆ The Electricity and Water Authority (EWA) is in negotiations for the construction of a 100 megawatts (MW) photovoltaic solar power plant on the Al Askar landfill site. Bahrain is planning to generate 5% of its power needs from renewables by 2025.
- ◆ A consortium led by Saudi-based ACWA Power and Japanese contractor Mitsui & Company was awarded the contract for the planned Al-Dur 2 independent water and power project in Bahrain with a capacity of 1,500MW and a desalination component of 50 million imperial gallons a day.
- ◆ Proposals have been submitted for a new sewage treatment plant in southwestern Bahrain. Work is currently underway on expanding the capacity of the Tubli wastewater plant from 200,000 cubic meters per day (cu m/day) to 400,000 cu m/day.
- ◆ Work on the new King Hamad Causeway is expected to begin by mid-2021. The project is expected to cost USD3-4bn and will also include a rail line connected to the wider GCC network, as well as vehicle lanes and cargo trains. The project will be implemented on a public-private partnership (PPP) basis and will include the operation and maintenance of the existing King Fahad Causeway.
- ◆ The Ministry of Transport and Telecommunications has invited bids for the financial, technical, and legal consultancy services associated with the first phase of Bahrain's planned light rail network, due to be completed by 2030. The Bahrain Metro will have driverless trains and cover 109 km via 6 lines. With the capacity to transport 43,000 passengers an hour, it will significantly reduce the congestion on the roads and consequent air pollution, as well as offer a budget-friendly transport method for commuters.
- ◆ Bahrain has approximately 22 hotel properties in the pipeline for the coming four years. One major project is a USD545mn contract that is due to be signed for the Al Sahel hotel development on Bahrain's west coast. The Al-Sahel Resort project company is jointly owned by Mumtalakat and Dubai Properties Group. The hotel is part of a much larger Bilaj al Jazayer seafront tourism development. Another key project is the development of a new exhibition centre in Sakhir, next to the Bahrain International Circuit. It will include 10 exhibition halls and a conference centre with three halls. Bahrain's core markets, currently led by Saudi Arabia, will be developed with a more strategic posture through events participation and advertisements, as well as new representative offices.

International Trade

Bahrain's non-oil trade dynamics improved in 2018 with the overall value of non-oil merchandise exports reaching USD7.5bn, up just under 7% YoY. While re-export trade remained static, the value of exports of domestic origin rose by an annual 9.2% to USD6.1bn. The value of merchandise imports increased by 12.6% to USD14.9bn.

The dynamics appear to have changed somewhat during Q1 2019. The preliminary customs data for January-March indicated total exports worth USD2.1bn, which marked a 19.3% YoY increase. A particularly clear improvement was observed in March with the monthly total of USD820.5mn up 33% YoY. The value of imports stood at USD1.9bn, which marked a 10.5% YoY decline in the earlier months of 2018. The figure was down a notable 20.9% in Q4 2018. This suggests that a substantial proportion of imports were most likely brought forward toward the end of the year in anticipation of the implementation of VAT. However, import volumes were once again showing signs of normalisation by March.

Non-oil Trade (USD mn)

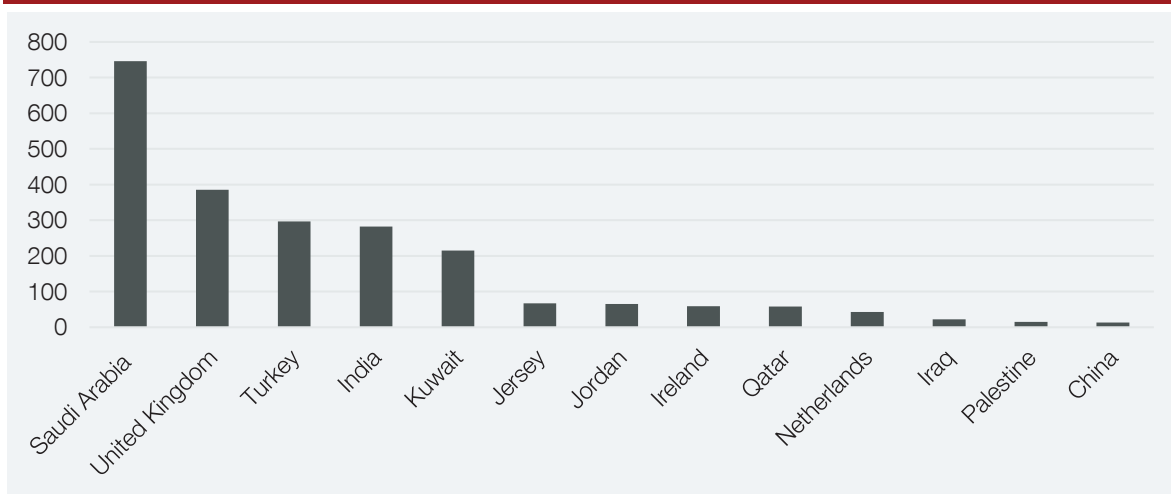


Source: Information & eGovernment Authority, preliminary data from Customs Affairs

Inward Foreign Direct Investment (FDI)

According to the preliminary results of the Foreign Investment Survey conducted by the Information & eGovernment Authority (IGA), inward FDI flows are continuing to grow reaching an estimated USD1.5bn in 2018, up from USD1.4bn a year earlier. The years 2017-2018 in turn marked a sharp improvement on the USD240mn total seen in 2016. Inward FDI flows are now running at just over 4% of GDP.

The Main Sources of Inward FDI (flows), 2018e (USD mn)

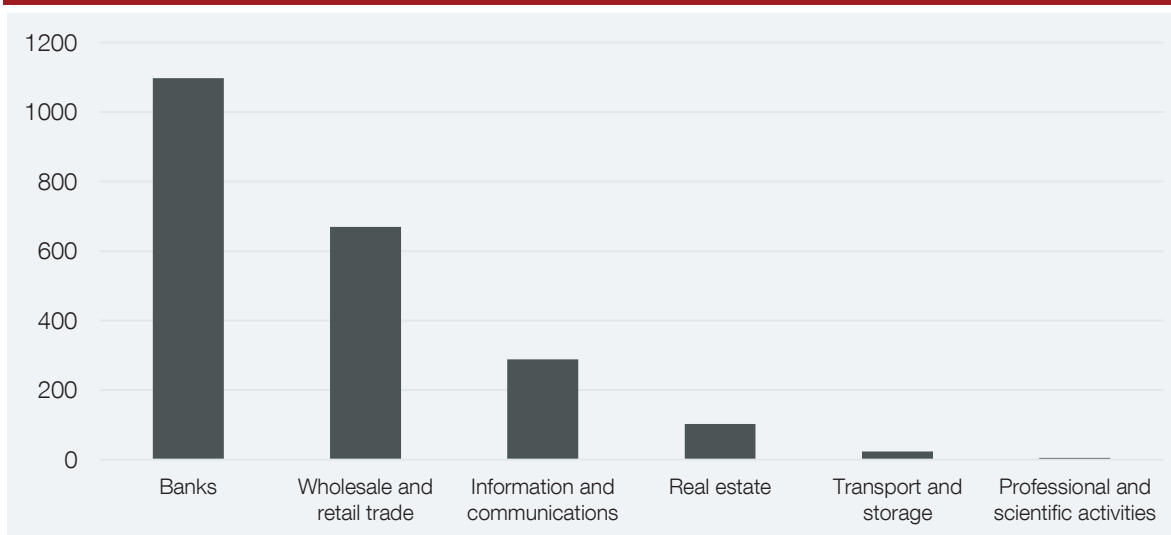


Source: Information & eGovernment Authority

The main source of FDI in 2018 was Saudi Arabia, much in line with past trends. Saudi Arabia's investments totalled USD745.7mn. This was followed by USD385.7mn from the UK and USD296.8mn from Turkey.

The banking sector was the single most important recipient of FDI inflows at just under USD1.1bn, followed by wholesale and retail trade at USD669.4mn and information and communications at USD288.9mn.

The Sector Breakdown of FDI Inflows (USD mn)



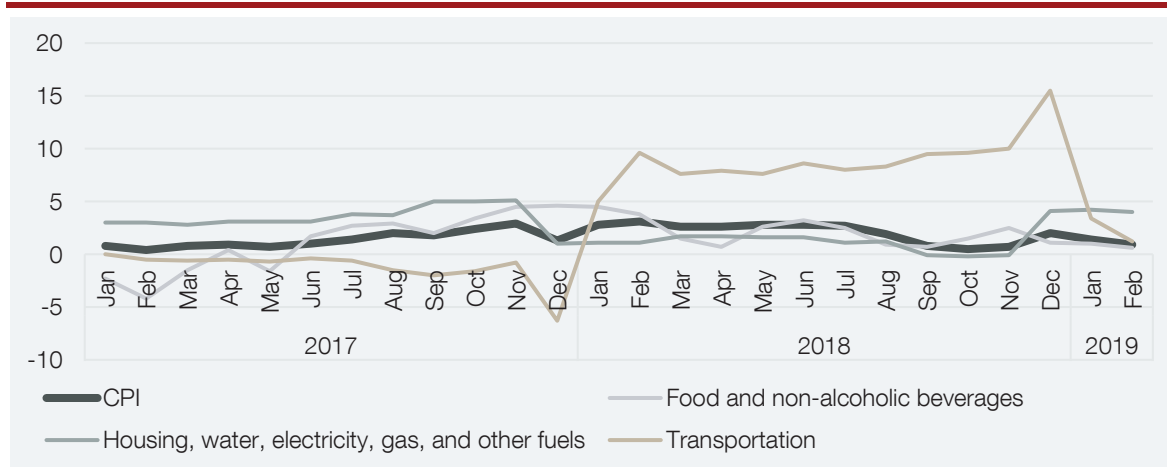
Source: Social Insurance Organization

Inflation

Consumer price index (CPI) inflation in Bahrain remained subdued by historical standards in spite of ongoing fiscal consolidation measures, including the introduction of VAT in January 2019. CPI inflation reached 2.1% in 2018, up from 1.4% the year before, partly driven by the planned increase in prices of gasoline. In contrast, the pricing of housing and food saw relatively minimal price pressures throughout the year. Overall, the pace of price increases was more moderate throughout the year.

The trend of subdued inflation has continued even after the implementation of VAT. CPI inflation stood at an annual 1.4% in January and moderated further to 0.9% in February 2019, while housing cost inflation has accelerated to the neighbourhood of 4%, largely due to the removal of utilities subsidies. Although transport inflation was high during 2018, base effects meant that its inflationary contribution largely wore off a year after the price increases. Food prices have been almost static with an increase of 0.6% recorded in February. The weaker than expected inflationary pressures are, in part, due to the strength of the US Dollar, which has reduced imported inflation, as well as the government's plan to phase out the implementation of the VAT.

Consumer Price Inflation (%) YoY



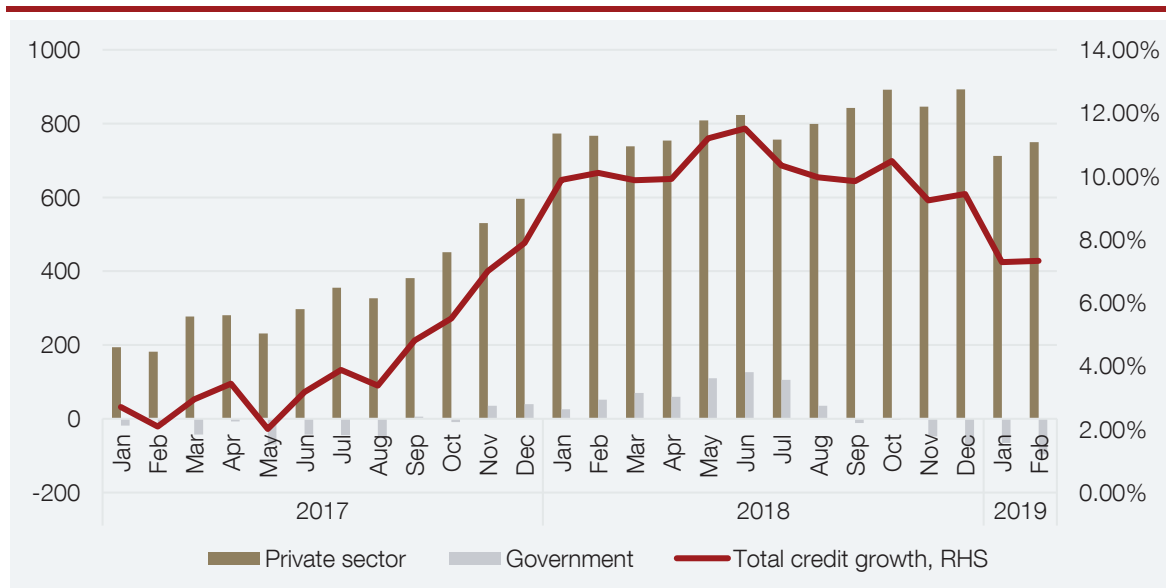
Source: Information & e-Government Authority

Credit and Lending

Bank lending in Bahrain continued to expand at a relatively brisk pace in recent months. The YoY growth rate of retail bank lending has moderated somewhat from the 11.5% YoY peak seen in May 2018, although remains high by regional standards. 2018 lending growth closed at a rate of 9.4%, which moderated further to 7.3% in January-February 2019. However, part of the slower growth in recent months has been attributed to a renewed decline in lending to the government. By contrast, credit growth to the private sector has remained close to 2018 levels.

Business loans made up 53.5% of the retail banking portfolio as of the end of 2018, and a comparable 53.6% in February 2019. Business loans were growing at an annual 9.7% growth rate in February. The fastest-growing sector was manufacturing, which made up 10% of the total retail portfolio in February, posting an annual growth of 27.7%. Loans to the construction and real estate sector accounted for 19.8% of the retail banking portfolio, following a 12.2% YoY growth. Personal loans expanded by an annual 7.5%, representing 44.1% of the total portfolio. Total retail bank lending to non-banks stood at 56.3% of their deposit base in January, up 50.8% compared to a year earlier.

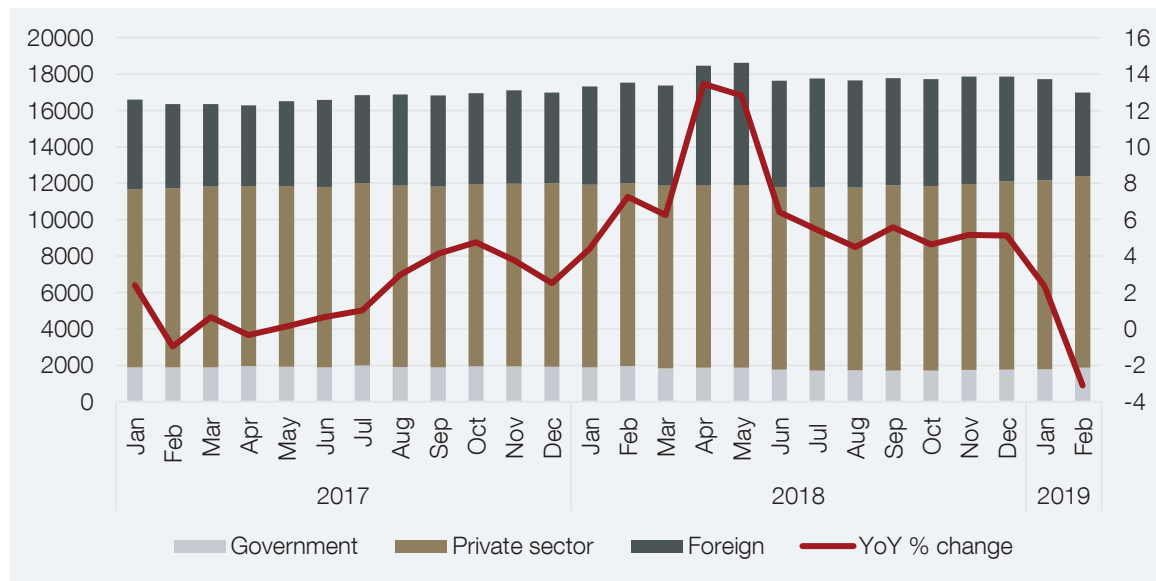
YoY Growth in Credit Issued by Retail Banks (BHD mn)



Source: Central Bank of Bahrain

Deposit growth, having hovered around 5% YoY in the second half of 2018, decelerated noticeably at the beginning of 2019. In fact, the YoY growth of retail bank deposits turned negative in February for the first time since April 2017, dropping by 3.1%. The drop was entirely due to an unusual erosion in foreign currency deposits. Both government and private sector Dinar deposits posted growth.

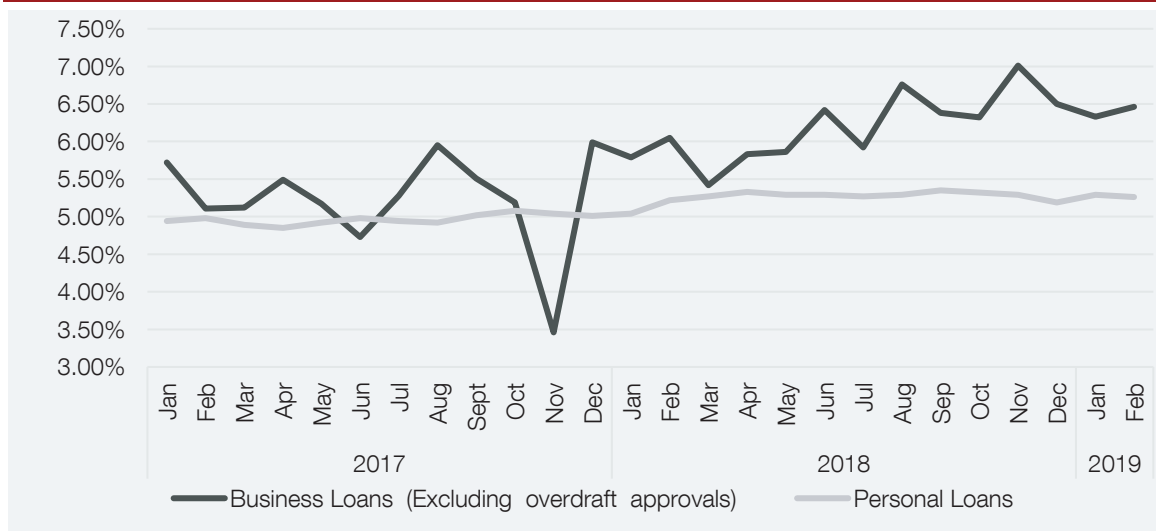
Deposit Liabilities to Non-banks (BHD mn)



Source: Central Bank of Bahrain

The cost of borrowing is showing renewed signs of stabilisation after a sustained increase over the course of 2018. The average cost of conventional business loans having peaked at 7% in November 2018, fell to 6.3% in January and 6.5% in February 2019, compared to 5.9% a year earlier. The cost of personal loans has been much more static and stood at 5.3% in January-February. This was up marginally compared to 5.1% a year earlier.

Average Rate of Interest on Credit Facilities - Conventional Retail Banks

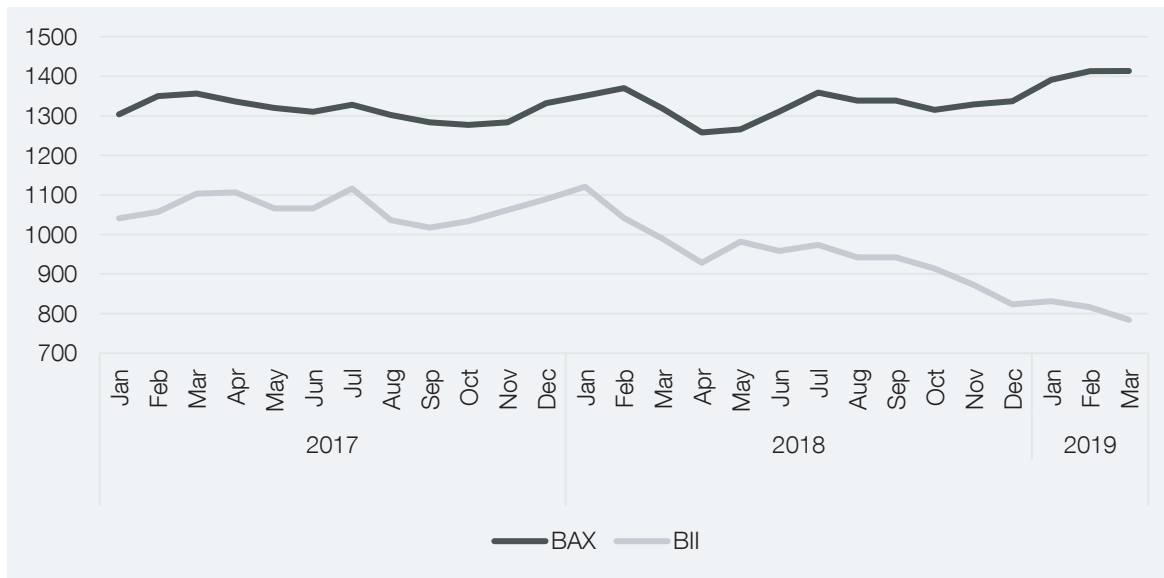


Source: Central Bank of Bahrain

Financial Market

Bahrain Bourse had a positive start to the year with the Bahrain All-Share Index advancing by 5.7% during the first three months of 2019. However, the Bahrain Islamic Index declined by 4.7%. The total market capitalization of the Bourse stood at BHD8.7bn at the end of Q1. This represented a 7.2% YoY increase.

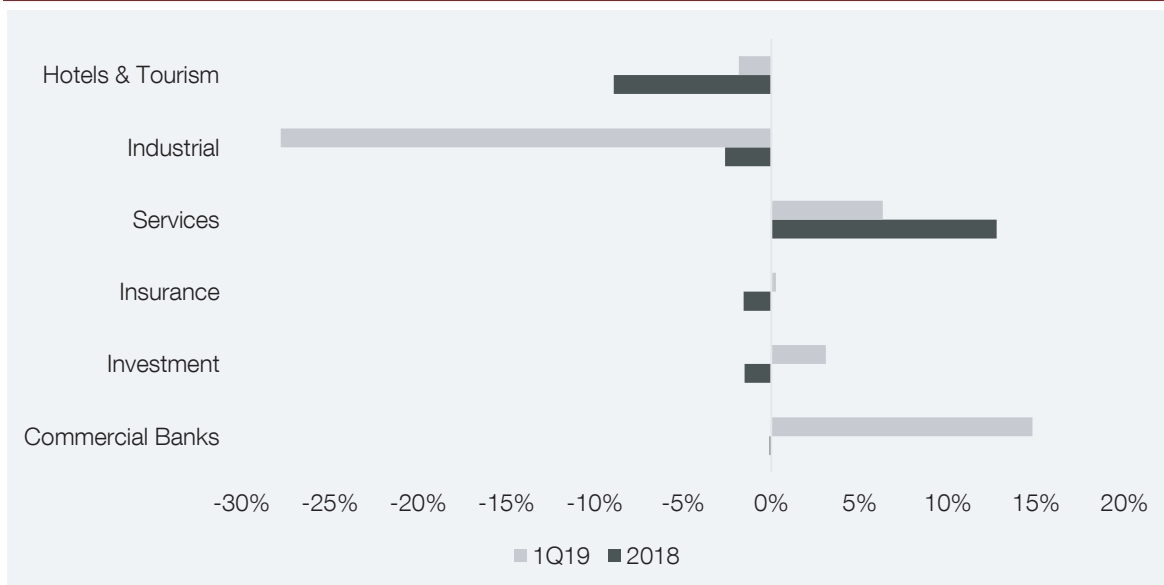
Bahrain All Share Index and Bahrain Islamic Index



Source: Bahrain Bourse

The best performing sector index during Q1 was commercial banks, which advanced by 14.8%. The Services index posted a 6.3% increase while the Investment index increased by 3.1%. At the other end of the spectrum, the Industrial index lost 27.8%, whereas hotels & tourism shed 1.8%.

Changes in Sectoral Stock Market Indices (Q1 2019 vs. 2018)



Source: Bahrain Bourse

In the fixed income space, the Central Bank of Bahrain (CBB) continued with its regular issuance of short-term Treasury bills and sukuk. The average interest rates declined steadily during Q1 2019 and most issues were substantially oversubscribed, some of them at record rates. This reflects increased confidence in sovereign issuance following the recent fiscal reforms.

Short-term bond and Sukuk Issues Arranged by the Central Bank of Bahrain

Issue date	Issue	Value, BHD mn	Maturity, days	Average interest/profit rate (%)	Average price (%)	Over-subscription (%)
2 Jan 2019	Treasury bill No. 1737	70	91	4.25	98.936	132
9 Jan 2019	Treasury bill No. 1738	70	91	4.24	98.939	106
10 Jan 2019	Sukuk al ijarah No. 161	26	182	4.40	-	100
16 Jan 2019	Sukuk al salam No. 213	43	91	4.24	-	213
23 Jan 2019	Treasury bill No. 1739	70	91	4.25	98.938	115
24 Jan 2019	12-month Treasury bill No. 53	100	365	4.88	95.299	203
30 Jan 2019	Treasury bill No. 1740	70	91	4.24	98.939	118
3 Feb 2019	Treasury bill No. 1741	35	182	4.39	97.827	120
6 Feb 2019	Treasury bill No. 1742	70	91	4.23	98.943	226
7 Feb 2019	Sukuk al ijarah No. 162	26	182	4.39	-	119
13 Feb 2019	Treasury bill No. 1726	70	91	4.19	98.952	188
20 Feb 2019	Sukuk al salam No. 214	43	91	4.15	-	153
27 Feb 2019	Treasury bill No. 1744	70	91	4.15	98.962	163
28 Feb 2019	12-month Treasury bill No. 54	100	365	4.72	95.447	327
3 Mar 2019	Treasury bill No. 1745	35	182	4.25	97.895	449
6 Mar 2019	Treasury bill No. 1746	70	91	4.05	98.987	244
13 Mar 2019	Treasury bill No. 1747	70	91	3.96	99.009	166
14 Mar 2019	Sukuk al ijarah No. 163	26	182	4.20	-	498
20 Mar 2019	Sukuk al salam No. 215	43	91	3.95	-	292
27 Mar 2019	Treasury bill No. 1748	70	91	3.90	99.023	100
28 Mar 2019	12-month Treasury bill No. 55	100	365	4.39	95.748	369
31 Mar 2019	Treasury bill No. 1749	35	182	3.95	98.041	364
3 Apr 2019	Treasury bill No. 1750	70	91	3.75	99.06	199
10 Apr 2018	Treasury bill No. 1751	70	91	3.62	99.094	269
11 Apr 2019	Sukuk al ijarah No. 164	26	182	3.95	-	621
17 Apr 2019	Sukuk al salam No. 216	43	91	3.62	-	529

Source: Central Bank of Bahrain

In a key development for the national capital markets, the CBB issued its Resolution No. 23 of 2019 in March 2019 for the Issuance of Regulations in respect of Short Selling and Giving Securities on Loan. The initiative reflects a growing regional trend and is intended to improve market liquidity as well as the overall efficiency of local capital markets. It is expected to foster new investments and permit further diversification of trading strategies.

The CBB also issued resolutions on a range of activities related to crypto assets, building on its efforts to develop Bahrain's fintech ecosystem. The objective is to ensure that blockchain-distributed ledger systems come under formal regulation and supervision as the sector expands. In addition, the CBB also issued draft directives on digital financial advice for robo-advisory service providers.

As part of the Global Financial Innovation Network (GFIN), the CBB invited companies to apply for multi-jurisdictional testing of their products and services. GFIN currently involves 29 international regulators and other organizations committed to supporting financial innovation in the interests of the consumer. The trial is carried out under the auspices of the CBB's Regulatory Sandbox.

Labour Markets

According to the data released by the Social Insurance Organization, there was little change in the Bahraini labour market during Q4 2018. This is a continued trend of relative stability since the end of 2017. The total number of contributors stood at 644,824. The number of Bahrainis working in the public sector reached 53,707 while those working in the private sector totalled 93,751, which was 1.7% higher than a year earlier. The number of expatriate contributors declined by an annual 1.2% due to the data cleansing exercise undertaken by the IGA on a periodic basis.

The reported average salary of expatriates in Q4 stood at BHD236. The average for Bahraini private sector employees was BHD723, compared to BHD902 in the public sector.

Change in Social Insurance Organization Contributors (%)

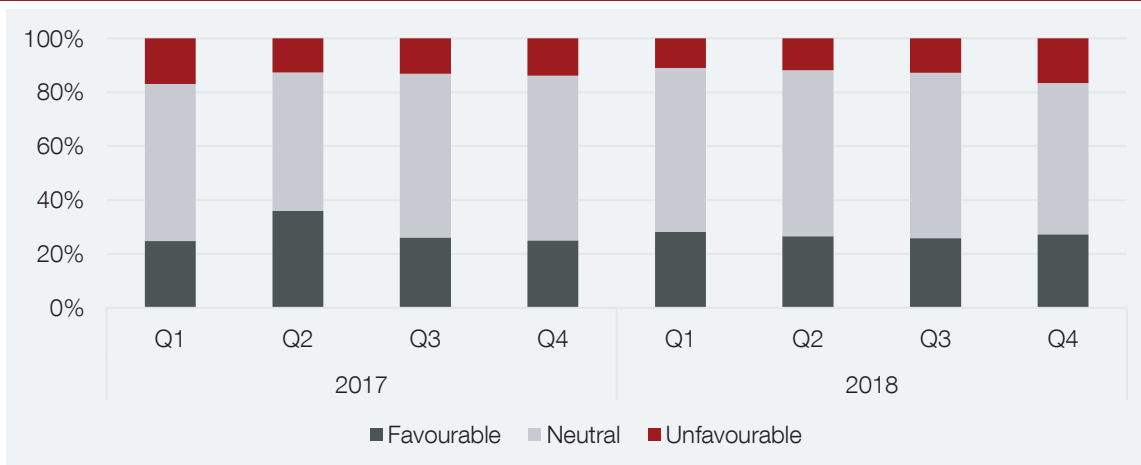


Source: Social Insurance Organization

Business Expectations

Business expectations in Q4 2018 remained positive, although somewhat less than that during the preceding quarters. Just over a quarter (27.3%) of all Bahraini businesses were positive about their performances, while 16.6% expressed a negative opinion leaving the majority (56.2%) neutral. However, the share of both optimists and pessimists increased in Q4 and the net balance became marginally more negative when compared to Q3.

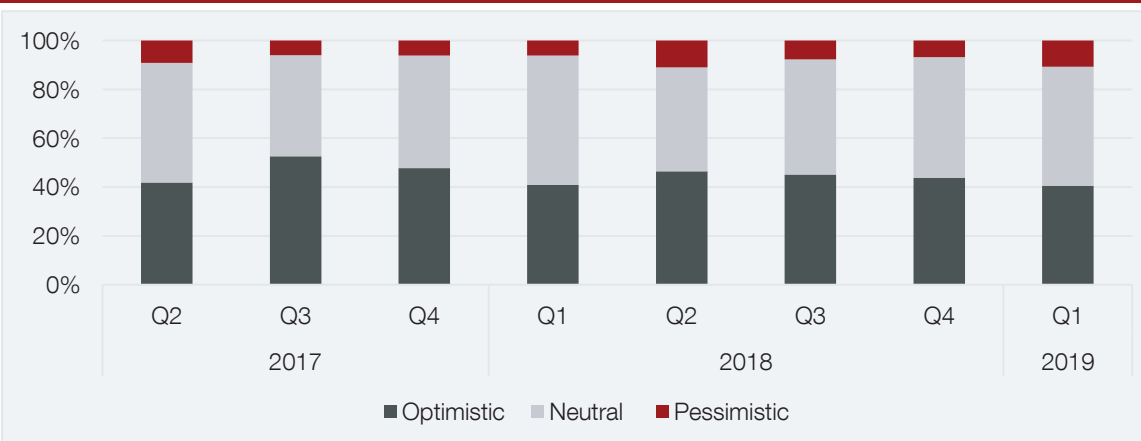
Bahrain Business Confidence Index - Current Business Performance



Source: Information & eGovernment Authority

Forward-looking expectations were marginally less favourable. Nonetheless, 40.6% of businesses expected their conditions to improve in Q1 2019 while 48.7% foresaw no material change. The share of pessimists increased, but they remained a small minority at 10.7%.

Bahrain Business Confidence Index - Forward-Looking Expectations



Source: Information & eGovernment Authority

In general, smaller businesses were the most optimistic in Q4 while larger companies were the least optimistic. The lowest level of optimism was reported in the Construction sector, while banks reported the highest positive balance. Construction also saw the largest drop in business confidence. The Trade and Hotels & Restaurants sectors also reported a decline in confidence.

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