



الوكالة الإسلامية الدولية للتصنيف
Islamic International Rating Agency

ECONOMIC & BANKING SECTOR OVERVIEW

Kingdom of Bahrain

October, 2018

ECONOMIC OVERVIEW

Table 1: Bahrain- Key Economic Indicators			
%, unless otherwise stated	2015	2016	2017
Population (thousand)	1,370	1,424	1,501
GDP per capita (USD)	22,689	22,561	23,655
Real GDP growth (%)	2.9%	3.2%	3.9%
Inflation (CPI Year End, %)	1.8%	2.8%	1.4%
Unemployment Rate (%)	1.2%	1.3%	1.3%
Current Account Balance as % of GDP	-0.2%	-4.6%	-3.8%
Fiscal Balance as % of GDP	-12.5%	-13.4%	-10.1%
Central Government Domestic Debt as a % of GDP	35.4%	38.5%	37.6%
Gross External debt as % of GDP	26.4%	34.9%	43.2%

(Source: CBB Statistical Bulletin, EDB Quarterly Report, World Bank)

Of the six-member Gulf Cooperation Council (“GCC”)¹ states, the Kingdom of Bahrain (“Bahrain” or “the country”) is the smallest economy with a nominal GDP of US\$34.9b at 2017. With a population base of 1.5m and a GDP per capita of US\$23,655 in 2017, the country is classified as ‘high-income earning’ by the World Bank.

Akin to most other GCC states, Bahrain has been working towards economic diversification to reduce dependence on oil and gas sector, which accounted for 18.4% of its real GDP in 2017 (2016: 19.2%). During 2017, the country posted better than expected growth of 3.9% (2016: 3.2%) which is the highest growth in GCC during the period, led by superior growth of around 5% in non-oil

sector. The hydrocarbon related GDP contracted marginally by 0.7% in 2017 (2016: -0.1%) as production was curtailed owing to the OPEC agreement. Despite 3.5% lower offshore production on account of scheduled maintenance, oil production in the country remained stable during 2017. The country’s announcement of offshore shale reserves has not substantially impacted economic sentiment given uncertainty of time line till production and financial benefits thereof. However, given that this marks the largest discovery for the country since 1932, with an estimated reserve deposit of 81.5 billion boe² and 13.7tcf³ of light gas, it may be considered an important development for the economy over the long term.

The country posted positive growth in all other sectors of the economy, with mining sector surging by 22.7% during 2017 compared to 13.7% decline in 2016, primarily benefiting from the improvement in international prices of commodities including aluminum. Manufacturing and construction sectors also recorded double digit growth during 2017. Further, hospitality industry registered high growth of about 10.0% in 2017 (2016: 2.76%) owing to higher tourism activity with total visitors’ count having grown by 11.9% during the year. Financial services also grew by ~6.6% in 2017.

With the recovery in oil prices, the current account deficit also registered some improvement in 2017 to 3.8% from 4.6% in 2016. Crude prices started moderating last year, averaging at about US\$54.2/bbl⁴ in 2017 (2016: US\$43.5/bbl). Most recently in 2018, price levels have surpassed US\$70/bbl; however well below Bahrain’s fiscal break-even price⁵. In the absence of a comprehensive tax regime, the country remains reliant on oil and gas related revenues that constitute majority of government’s revenue at 75.4% in 2017, having declined from average 83% during 2012-2016, when average oil prices were higher at US\$83/bbl. Non-oil revenues including taxes and fees grew about 20.5% in 2017 from a year ago, leading to marginal diversification in government streams. The country introduced excise tax towards the end of 2017 and further plans to implement VAT by year-end 2018.

With twin deficits, amidst low-oil price environment since 2015, the country increased its debt issuance, which also led to an uptick in the debt-to-GDP ratio to 80.8% at end-2017, up from 73.3% as at prior year-end. Of the total debt, about 53% comprised external debt at end-2017 (up from 47.6% at 2016). Given that the country has upcoming obligations on debt in Q4’18 with no clearly demarcated repayment streams, this has raised concerns in the international markets, and given the

¹ Including With Saudi Arabia leading at US\$683.8b and leading Qatar at US\$166.3b at 2017 (Source: IMF – Regional Economic Outlook, May 2018)

² Barrels of oil equivalent

³ trillion cubic feet

⁴ bbl: barrel; Source: EIA – Brent spot price

⁵ As per IMF statistics, Bahrain’s fiscal break-even oil price for 2018 and 2019 is US\$113/bbl and US\$110.6/bbl, respectively

local banking sector's significant investment in government securities. Other GCC states have publicly indicated to support the country in this regard, which needs to be closely watched.

Further, there are external challenges emanating in the form of escalating trade disputes and inter-regional diplomatic relations, which may further exacerbate the business operating risk.

ISLAMIC RETAIL BANKING SECTOR

Bahrain has rapidly become a global leader in Islamic finance despite being a relatively small economy in GCC; Bahrain is host to the largest concentration of Islamic Financial Institutions. There has been remarkable growth in Islamic banking in particular, the market share of Islamic banks increased from 1.8%⁶ of total banking assets in 2000 to 14.3%⁷ at H1'18. The domestic retail banking segment is a highly competitive landscape which has evolved over the years, comprising 23 conventional and 6 Islamic banks, and altogether representing 57.7%⁸ of the overall banking sector assets; the remaining industry assets mostly comprise wholesale banking assets. The Shari'a Governance ("SG") module sets higher standards of transparency, governance and competence for Islamic Banks in Bahrain; these new regulations are applicable from 30 June 2018 on all Islamic retail and wholesale banks.

The IRB industry assets⁹ and deposits declined by 1.7% and 2.1%, respectively, in 2017. Overall industry capitalization is adequate, and both CAR and tier-1 CAR are comfortably high.

Notwithstanding this, general asset quality remains an industry-wide concern, although asset concentration has been observed to be reducing, with increasing sector diversification in comparison to historical trends. The industry depicts considerable concentration in the personal consumer finance sector. The share of real estate/ construction lending has decreased. Along with this, industry trends have generally evidenced increasing investment in capital light assets, such as sovereign issuances by Bahrain and other GCC nations. On the profitability front, industry spreads have narrowed as a result of a general uptick in cost of funding, whilst pricing on facilities has remained sticky, given the competition in the banking industry.

All figures are percentages	Q3'16	Q3'17
CAR	17.1	18.2
Tier I CAR	14.9	15.3
Net NPFs to Equity	28.3	26.1
Gross Impairment	12.1	9.0
Provisions Coverage	34.1	44.1
Real Estate / Construction Exposure	29.4	24.0
RoA	0.2	0.4
RoAE	1.6	4.5
Efficiency	82.9	78.2
Liquid Assets to Total Assets	12.3	11.5
Financings to Deposits	82.9	89.1

(Source: CBB Financial Stability Report – Feb. 2018)

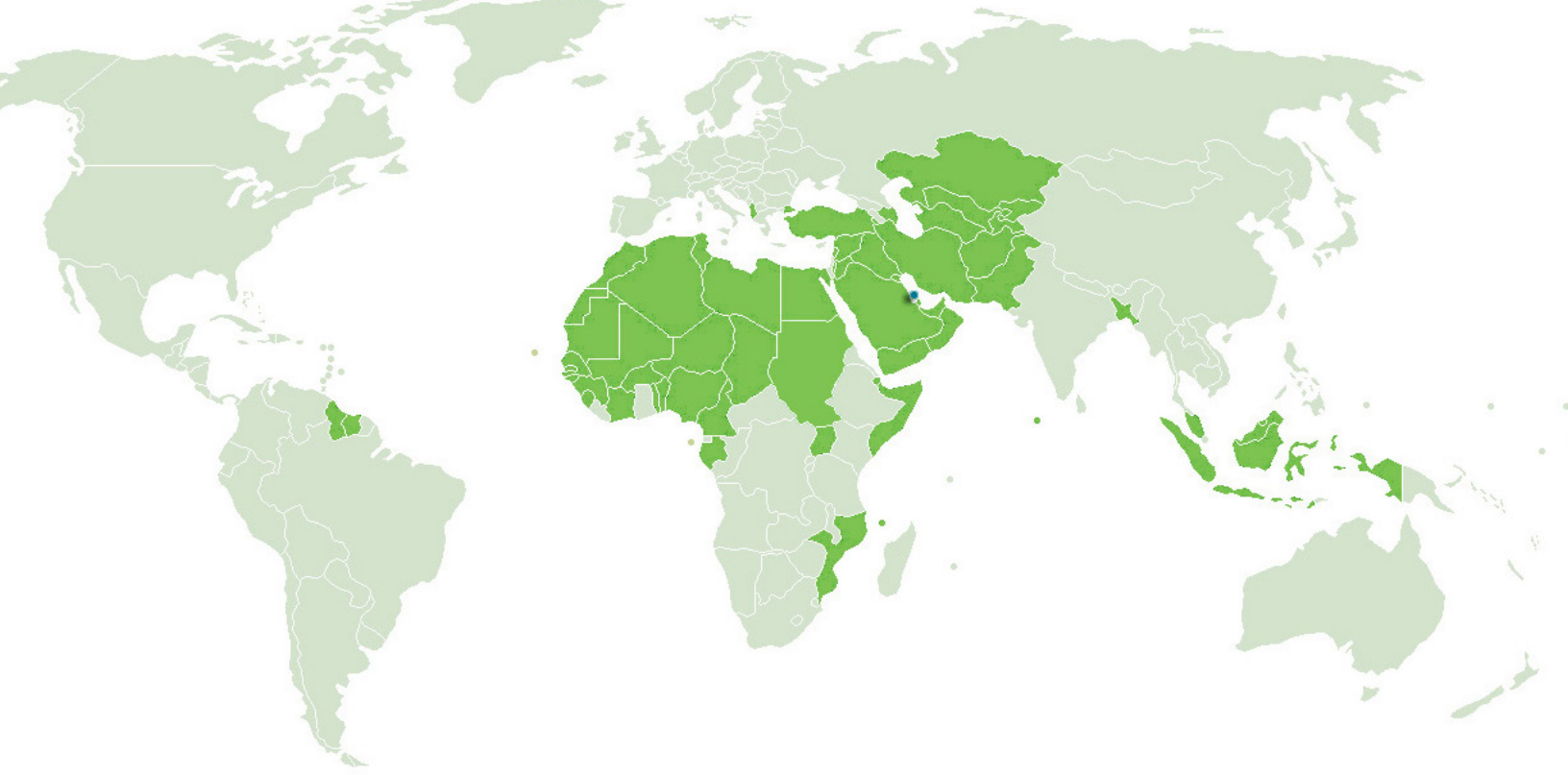
Our future outlook on the banking sector remains less than optimistic. Islamic banks' profitability may be impacted by strained spreads and expected credit losses in the next two years, as weak macroeconomic conditions persist. Banks' exposure to subcontractors and SMEs is most vulnerable to potential credit losses.

⁶ Oxford Business Group – Bahrain report

⁷ CBB – Statistical Bulletin

⁸ CBB Financial Stability Report February 2018

⁹ Adjusted for effect of consolidation



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