



IIRA Assesses Sovereign Ratings of the Kingdom of Bahrain

Manama, July 21, 2020 – The Islamic International Rating Agency (“IIRA”) has assessed the local and foreign currency ratings of The Kingdom of Bahrain (“Bahrain” or “the Country”) at ‘BB+ /A3’ (Double B Plus / Single A-Three) on the international scale. Outlook on the ratings is ‘Negative’.

With a well - developed social and physical infrastructure, Bahrain is a high income economy marked by a strong linkage of external and fiscal accounts to hydrocarbon fuel receipts. The assigned ratings on the sovereign are underpinned by resultant vulnerabilities, and challenges posed by worldwide implications of the ongoing Covid-19 crisis. Positive traction had been noted in Bahrain’s key fundamentals in 2019, affirming the impact of fiscal reforms and gradual economic repositioning in recent periods. Expectations for 2020 are dampened by the ongoing and further likely adverse implications of the global health emergency, in the form of disruptions in trade, tourism, logistics, supply chain and commodity demand. Amidst the challenges, Bahrain’s economy is expected to witness contraction in the current year with sub-par activity levels, although buffered in large measure by the economic support package given by the government. Gradual recovery is expected to materialize in 2021 and is like to be initially accelerated given base effects. Our expectation of continued economic collaboration amongst the GCC provides support to ratings at current levels, although moderated by the broad based implications of economic pressures throughout the region.

While the country has posted oil trade and services surplus over the years, other goods and services balance and outward remittances weaken Bahrain’s current account. Lower hydrocarbon prices in recent years had driven the current account into a deficit since 2015, but had posted considerable rebalancing in 2019. The renewed pressure on prices in the current year on the heels of contraction in global demand, is expected to reverse the improvement in current account deficit noted last year. Foreign exchange reserves have been depleting, with falling coverage of imports. Expected decline in imports and outward remittances partly counter the effects of pressure on exports, with IIRA’s forecasted deficit for 2020 at just over 5% of GDP.

As oil receipts have been a key driver of Government revenues, the fiscal position of Bahrain has been under pressure in recent years, compounded also by higher interest costs on increasing debt levels. Some upside stemmed from lower Government spending in 2019, adjusted in response to the weak oil price environment, under the Fiscal Balance program (“FBP”), which combined with VAT and excise collection has reinforced revenues, resulting in improvement in fiscal deficit in 2019, at 4.7%. While poised to have improved further in 2020, as indirect tax revenues were set to increase, the cost of the fiscal stimulus in response to the prevailing health crisis and higher cost of indebtedness, may push the fiscal deficit above 10% in 2020. Given the ongoing need to provide relief to economies on the one hand and the evolving nature of fiscal response on the other, fiscal balance expectations may yet be viewed with caution. Our long-term expectations of fiscal discipline remain informed by the country’s commitment to the FBP, implying resumption of an improving trajectory as the macroeconomic environment returns to normalcy.

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Weak current account and fiscal position, though gradually ameliorating, have necessitated increased funds sourcing from both domestic and particularly overseas markets. Debt accumulation over the years has led to overall Government debt (excluding GREs) to exceed 100% of GDP by end-2019. Refinancing scheduled debt maturities may be at higher cost, further posing budgetary constraints.

The banking sector is characterized by adequate capitalization, profitability and liquidity indicators, having built buffers in recent years, in response to increasingly stringent regulatory requirements vis-à-vis capital and liquidity. System-wide, credit risk is heightened in the present scenario; IIRA shall continue to monitor the sector for adverse trends arising due to Covid-19.

Outlook

IIRA has assessed Bahrain's outlook as 'Negative', reflecting our expectations of continued stress in macroeconomic fundamentals of the Country. Following considerations may lead to IIRA lowering the ratings:

- a. Prolonged weakness in oil prices and global recession, or extended restrictions on movement impacting longer term forecasts of domestic economic activity and demand, and slowing the pace of economic recovery beyond expectations;
- b. Any further interruptions to the 'Fiscal Balance Program' beyond 2020, affecting long-term expectations of flattening the debt stock curve;
- c. Material deterioration in banking sector indicators.

Any upside in the ratings, may stem from achieving stability in growth and meaningful progress in weakening the correlation between fiscal and external account balances and commodity price movements, and reduced debt levels. The outlook may be revised back to 'Stable' in case of:

- a. Timely or faster economic recovery and stabilization than anticipated;
- b. Resumption of the improving trends in external and fiscal balances in 2021;
- c. Improvement in debt profile and reserve balance;
- d. Continued stability in the banking sector and remaining in compliance with international regulatory benchmarks for safety, in terms of capital adequacy and liquidity.

For further information on this rating announcement, please contact IIRA at iira@iirating.com.