

Bahrain Business Forecast Report Q2 2014

<https://marketpublishers.com/r/B7B2B012062EN.html>

Date: February 2014

Pages: 51

Price: US\$ 1,195.00 (Single User License)

ID: B7B2B012062EN

Abstracts

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Core Views

We expect Bahrain's economy to expand at a moderate pace over 2014 and forecast real GDP growth of 3.4%, down from an estimated 4.3% in 2013. Business activity in the non-oil sector will be underpinned by elevated public spending and GCC aid, but will remain subject to political risk. Output gains in the hydrocarbon sector will be more limited than in 2013, weighing on the headline growth figure.

A return to pre-crisis rates of real GDP growth above 7% remains off the cards in the near term. In light of record oil revenues and the weakness of private investment, we expect public spending to outperform over the coming quarters, which should support activity in the non-hydrocarbon economy. Efforts to address the shortage of affordable housing will see government CAPEX accelerate.

Bahrain's reputation as a stable and welcoming location to do business in the Gulf has suffered as a result of the volatile political climate. At the moment, it remains to be seen if Manama will be able to compete with Doha and Dubai in attracting investment into the all-important hospitality and financial services industry.

The economy's medium-term outlook remains contingent upon a lasting solution being found to the current political crisis. Unfortunately, we maintain our relatively guarded outlook on the prospects that the government and opposition can come to some form of agreement in the near term. Bahrain's weak medium-term fiscal prospects will force the government to make difficult choices. We believe that Manama will have little option but to introduce new taxes over the coming years, while the issue of spending consolidation will loom large on the agenda. Support from Saudi Arabia could delay these pressures,

but would entail a significant loss of sovereignty.

Key Risks To Outlook

A more pronounced regional crisis stemming from an uptick in tensions between Iran and the West could see risk premiums spike higher, particularly for Bahrain.

A marked drop in oil prices concomitant with a slowdown in growth in Europe, the US and China would pose a significant risk to the country's near-term growth outlook, and likely lead to a marked deterioration to the country's balance of payments and fiscal dynamics. In terms of the latter, Bahrain's breakeven oil price is now around US\$120/bbl, which is by far the highest in the Gulf. Failure to find a lasting solution to the political crisis could see the opposition becoming increasingly radicalised, and resort to militant tactics such as improvised explosive devices. This would result in Bahrain's 'safe haven' status suffering irreparable damage.

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End To Political Impasse Looking Ever More Distant the failure to make progress in national reconciliation talks between Bahrain's Sunni-dominated government and the Shi'a opposition leaves the regime with ever fewer options to end the country's political crisis. We retain our view that a breakthrough is unlikely over the year, with moderate figures on both sides now largely marginalised.

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Bahrain's political future is complicated by growing tensions between the Sunni elite and the Shi'a majority, labour and population imbalances, the need to stay on side with both Iran and Saudi Arabia, and economic vulnerability. We believe the most likely long-term scenario is for democratisation to be brought about by political and economic necessity, although there is no guarantee that this would be peaceful.

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We expect economic growth in Bahrain to be relatively robust over 2014, supported by GCC-financed infrastructure investments. We retain our forecast for real GDP growth of 3.4% this year, after an estimated 4.3% in 2013. However, output gains from the oil sector will be limited, while lower oil prices and the continuing political crisis present downside risks to growth.

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Bahrain's weak medium-term fiscal prospects will force the government to make difficult

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Support from Saudi Arabia could delay these pressures, but would entail a significant loss of sovereignty.

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