

Bahrain Infrastructure Report Q1 2012

<https://marketpublishers.com/r/BC5B5167674EN.html>

Date: December 2011

Pages: 75

Price: US\$ 1,295.00 (Single User License)

ID: BC5B5167674EN

Abstracts

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Despite a relative calming of tensions in Bahrain, uncertainty persists continue to undermine investor confidence in Bahrain's previously stable construction market. The tumultuous events in 2011 have weighed on sector growth, and while the industry saw a relatively swift resumption in stalled projects in the first half of the year, investors and developers remain wary over committing to long-term projects. Following only marginal growth of 0.7% in 2011, according to BMI forecasts, we expect a rebound in growth in 2012, as base effects and heavy government stimulus spending bolster growth. However, over the coming quarters, the kingdom will continue to feel the impact of weakened investor sentiment, facing increased competition from its GCC peers, notably Qatar and UAE. Key recent developments:

Persistent uncertainty and political instability continue to undermine investor confidence. Despite a relative calming of tensions in Bahrain, uncertainty persists, with large-scale antigovernment demonstrations continuing to take place. Fixed investment remains weak (BMI estimates that gross fixed capital formation (GFCF) will have contracted by -11.7% in real terms in 2011). Construction activity has slowed considerably since the start of 2011, with new construction licences issued in Q1 2011 down 36% year-on-year (y-o-y) and the number of new construction permits issued down 30% y-o-y (to 2,079), according to data from the Central Bank.

The temporary loss of confidence in Bahrain as a stable location for offshore financial services has had a negative impact on the kingdom's previously favourable reputation as an attractive environment for project financing. We believe that commercial loans for multi-year construction projects will remain difficult to secure over the coming quarters, as ongoing political uncertainty and

foreign capital outflows keep borrowing costs elevated. Moreover, with the kingdom's banking sector already heavily exposed to the construction and real estate sector - accounting for 30% of total banking loans – there may be reluctance to increase this exposure to long-term projects, while current levels of uncertainty persist.

This weakening in banking sector confidence – a key pillar of support for the construction sector - was explicitly illustrated mid-2011 when French banks BNP Paribas and Credit Agricole announced their intentions to permanently relocate staff - the latter shifting its regional headquarters to Dubai. Indeed, the fallout from recent political events has served to erode Bahrain's comparative advantage relative to UAE and Qatar, boosting the latter two markets' competitiveness in the infrastructure and tourism industries. We expect this trend to continue over the coming quarters, with UAE and Qatar continuing to draw investment away from the Bahrain construction industry.

The news in October 2011 that Bahrain's Premier has ordered the housing ministry to step up efforts to boost the supply of housing and reduce waiting lists is the latest in a string of such announcements by the government in recent quarters. It followed the announcement in July 2011 that 30,000 new housing units would be built in the kingdom over the next five years at a cost of US\$3.18bn. However, given the uncertainty and manifold risks still present within the kingdom following the Arab uprisings - not least the unresolved political issues - we view the programme's timely implementation as ambitious, but nonetheless one that provides upside risks to our forecasts.

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