IIRA improves outlook on the Sovereign Ratings of the Kingdom of Bahrain to 'Stable'

Manama, July 06, 2023 – The Islamic International Rating Agency ("IIRA") has reaffirmed the local and foreign currency ratings of The Kingdom of Bahrain ("Bahrain" or "the Country" or "the Kingdom") at 'BB+ /A3' (Double B Plus / Single A-Three) on the international scale. Outlook on the ratings is revised to 'Stable' from 'Negative', reflecting significant post-pandemic recovery in macroeconomic indicators, buoyed further by favorable hydrocarbon price dynamics. Ratings also derive strength from Bahrain's membership in the Gulf Cooperation Council ("GCC"), providing economic and social integration.

Bahrain is a 'high income' economy as per World Bank's classification backed by a strong social and physical infrastructure. While steady progress is being made to diversify away from hydrocarbons sector, the Country's trade and public finances remain highly correlated with oil receipts. Post-pandemic expansion in Bahrain's GDP has been led by a buoyant non-oil sector output, offsetting the deceleration in oil-sector. However, moderation in this pace may be expected due to a generally constrained global demand outlook and lingering uncertainty in the backdrop of the prevailing geopolitical conflict. Upward trend in inflation and a high policy rate environment will further contribute to lower growth expectations. With a pegged Bahrain Dinar, monetary policy is closely aligned with U.S. Fed's policy, leading to continued monetary policy tightening since 2022, albeit at relatively slower pace in H1'23, following which a generally easing trend is expected. The local banking sector remained resilient with capital and liquidity buffers remaining above the minimum regulatory requirements.

Uptick in oil prices vis-a-vis the pandemic-period lows led to notable improvement in external balances and public finances. While commodities price may edge relatively lower in the current year, expectations of still higher oil prices vis-a-vis 3-year pre-pandemic average and upward trend in tourism may remain supportive of favorable trends in the current account in 2023, albeit the surplus may moderate from prior year to about mid-single digit percent of GDP. Resumption of the revised 'Fiscal Balance Program' since late 2021 has also led to moderation in expenditures as planned, and expansion in non-oil revenue base. This coupled with higher oil revenues led to tapering off the fiscal deficits (in absolute terms and as % of GDP) over the last two years (2022: -1.1%; 2021: -6.4% of GDP), which may slightly reverse course in the current year with deficit of about 1.5% in relation to GDP.

External vulnerability due to debt pile-up over the years persists, although enhanced foreign exchange reserves and current account surplus comfortably cover short-term debt amortizations. While stabilizing and lowering debt in relation to GDP gradually by 2024, remains a key target under the revised fiscal balance program, clear time based targets beyond 2024 are not publicly available.

The Country ranks favorably in terms of human development index and world competitiveness. Further, along with 2 other GCC states, Bahrain announced ambitious net-zero target by 2060 in UN Climate Change Conference of the Parties (COP 26) summit in late 2021. Given that transition to cleaner and renewable energy sources is inevitable over the long-term, the government and CBB have taken initiatives towards environmental, social and governance ("ESG") integration in national policy and regulatory framework. At present, this does not materially impact IIRA's assessment of the sovereign credit ratings.

Outlook

IIRA has assessed Bahrain's outlook as 'Stable', reflective of marked improvement in economic indicators and underpinned by:

a. Resumption of, and continued commitment towards the 'Fiscal Balance Program' and visible recovery in core fiscal measures;

b. Expected tapering off in the pace of incremental debt creation over the next 12-18 months;

c. Continued stability in the capital and liquidity reserves of the banking sector;

Ratings may be revised downward in case of:

a. Slower than expected pace of economic growth and reversal of favorable trends noted in external balance from last year;

b. Fiscal underperformance vis-à-vis expectations due to non-adherence to FBP thereby resulting in higher than expected fiscal deficits;

c. Substantial increase in indebtedness in relation to international reserves and external position.

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