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March 15, 2021

**Statement by Ms. Senich and Ms. Robitaille on Kingdom of Bahrain
(Preliminary)
Executive Board Meeting
March 17, 2021**

We thank staff for their informative report and Mr. Mohieldin, Mr. Alhosani, and Ms. Merhi for their helpful Buff statement. Prior to the pandemic, Bahrain's government had been grappling with persistent fiscal and current account deficits, high public debt, and high debt service costs. The authorities had begun to take steps to address these macroeconomic imbalances in support of the fixed exchange rate policy. In response to the COVID-19 crisis, the authorities have appropriately focused on addressing the health and economic consequences of the pandemic. **Considering these very difficult circumstances, we welcome the authorities' responses to the pandemic, which have helped mitigate human suffering and ameliorate the economic hardships.**

As the economy recovers, the authorities' top priority must be to undertake an ambitious program of fiscal reform necessary to stabilize the path of public debt. We agree with staff that the authorities need to undertake a more aggressive fiscal consolidation program than was the case pre-COVID-19. We urge staff to continue to engage the authorities on boosting non-hydrocarbon tax revenues and setting clear priorities on fiscal spending. We thank staff for their recommendations on fiscal adjustment options, as outlined in Annex V. We also urge the authorities to take steps towards improving transparency and accountability by placing off-budget items on budget.

The government's borrowing from the central bank reinforces the perception that fiscal trends are not consistent with the fixed exchange rate regime. Government borrowing drove international reserves down to a very low level last spring, to less than 2 months of 2019 imports, and international reserves have remained equally low. The absence of any clarity on when these reserves will be repaid by the fiscal authority undermines confidence in the peg to the dollar. *How have the authorities responded to staff's recommendations to strengthen the transparency and governance of its lending to the government?* We commend

the Central Bank of Bahrain (CBB) for offering liquidity support to the banking system during the crisis, but we are intrigued that the uptake on its lending facilities was very limited.

We emphasize that the fragile state of Bahrain's public finances increases the country's vulnerability to turnarounds in investor sentiment that could lead to considerable financial turmoil. Although Bahrain has been receiving considerable external financial support from regional donors in recent years, the government has had to rely on global markets and domestic banks to meet its financing needs. The government's access to international capital markets over the past year has been facilitated by accommodative global financial conditions and investors' reach for yield, but external conditions could tighten sharply. We note with concern that the capital inflows associated with sovereign bond issues over the past year have been partly offset by sizeable private capital outflows. Bahrain's banking sector is very large relative to the size of its economy and banks rely heavily on funding from abroad, posing the risk that a sovereign and currency crisis could become a banking crisis. We take note of staff's observations that although the banking sector reports high levels of capital, falling profits and the potential need to reserve against loan losses could erode capital buffers. *We would appreciate more information on the evolution over the past year of private capital flows, including banks' foreign liabilities, and on the behavior of bank deposits.*

Finally, we request that Bahrain publish its Article IV report, as it remains one of the few IMF members that does not.