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December 31, 1986

To: Members of the Executive Board

From: The Secretary

Subject: Bahrain - Staff Report for the 1986 Article IV Consultation

Attached for consideration by the Executive Directors is the staff report for the 1986 Article IV consultation with Bahrain.

It is proposed to bring this subject to the agenda for discussion on Wednesday, January 21, 1987.

Mr. Maciejewski (ext. 7112) is available to answer technical or factual questions relating to this paper prior to the Board discussion.

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INTERNATIONAL MONETARY FUND

BAHRAIN

Staff Report for the 1986 Article IV Consultation

Prepared by the Staff Representatives for the
1986 Consultation with Bahrain

Approved by P. Chabrier and J. T. Boorman

December 30, 1986

I. Introduction

The 1986 Article IV consultation discussions with Bahrain were held in Manama during the period October 19-26, 1986. The Bahraini representatives included the Governor of the Bahrain Monetary Agency, the Under Secretaries of the Ministry of Finance and National Economy, the Ministry of Development and Industry, and the Ministry of Commerce and Agriculture, as well as other senior officials. The mission was composed of Messrs. H.E. Jakubiak, (Head), E. Maciejewski, S. Thayanithy, and E. Bell, and Ms. P. Herran (Secretary), all of MED. The last consultations were held in November 1984, and the Board discussion took place in March 1985. Bahrain is on an 18-month consultation cycle and the cycle has been exceeded by over four months. 1/

Bahrain accepted the obligations of Article VIII, Sections 2, 3, and 4 of the Fund's Articles of Agreement on March 20, 1973. 2/

II. Background

Bahrain is a small producer of crude petroleum and has made substantial progress in diversifying its economy. Crude oil output from Bahrain's onshore field and its half share in the offshore Abu Saafa field was about 110,000 barrels per day (b/d) in 1984. This output level represented a 15 percent increase over the average level during the previous three years, with the increase wholly attributable to higher production from the Abu Saafa field. Crude oil output from Bahrain's onshore field has been slowly declining for a number of years despite the application of enhanced recovery techniques, and present expectations are that over the medium term Bahrain will continue to be confronted with an unchanged crude oil output capacity. Apart from its share of Abu Saafa output, Bahrain exports only refined oil products, utilizing its domestic onshore crude oil output as well as imported oil as feedstock.

1/ The authorities requested this delay due to the occurrence of Ramadan during May 1986 and the limited availability of staff during the subsequent summer months.

2/ Bahrain's relations with the Fund and the World Bank Group are summarized in Appendices II and III, respectively.

In view of the declines in domestic oil production, the Bahraini authorities for some time have been making efforts to diversify the economy through promoting a regional services and financial sector and manufacturing activities. Bahrain's natural gas resources have provided the basis for energy-intensive industrial undertakings, in particular aluminum smelting and related downstream industries, and its offshore banking and financial market has been a stimulus to other service subsectors. As a result, by 1984 crude oil production had fallen to less than 20 percent of GDP. Bahrain recorded high real non-oil GDP growth rates of 8-9 percent in 1982-83, reflecting buoyant government spending, a continued rapid expansion of the offshore market, and a large increase in manufacturing output (Table 1 and Chart 1). However, real growth fell to 6 percent in 1984 due to a containment of budget outlays and slowed economic activity in neighboring countries. In recent years, the Government's development spending has been undertaken in large part in the context of an Economic and Social Investment Program, which was Bahrain's first attempt at medium-term planning of public sector investment outlays. The program, involving expenditure of about US$3 billion, consists mainly of economic and social infrastructure projects and was envisioned originally for implementation over the period 1982-85.

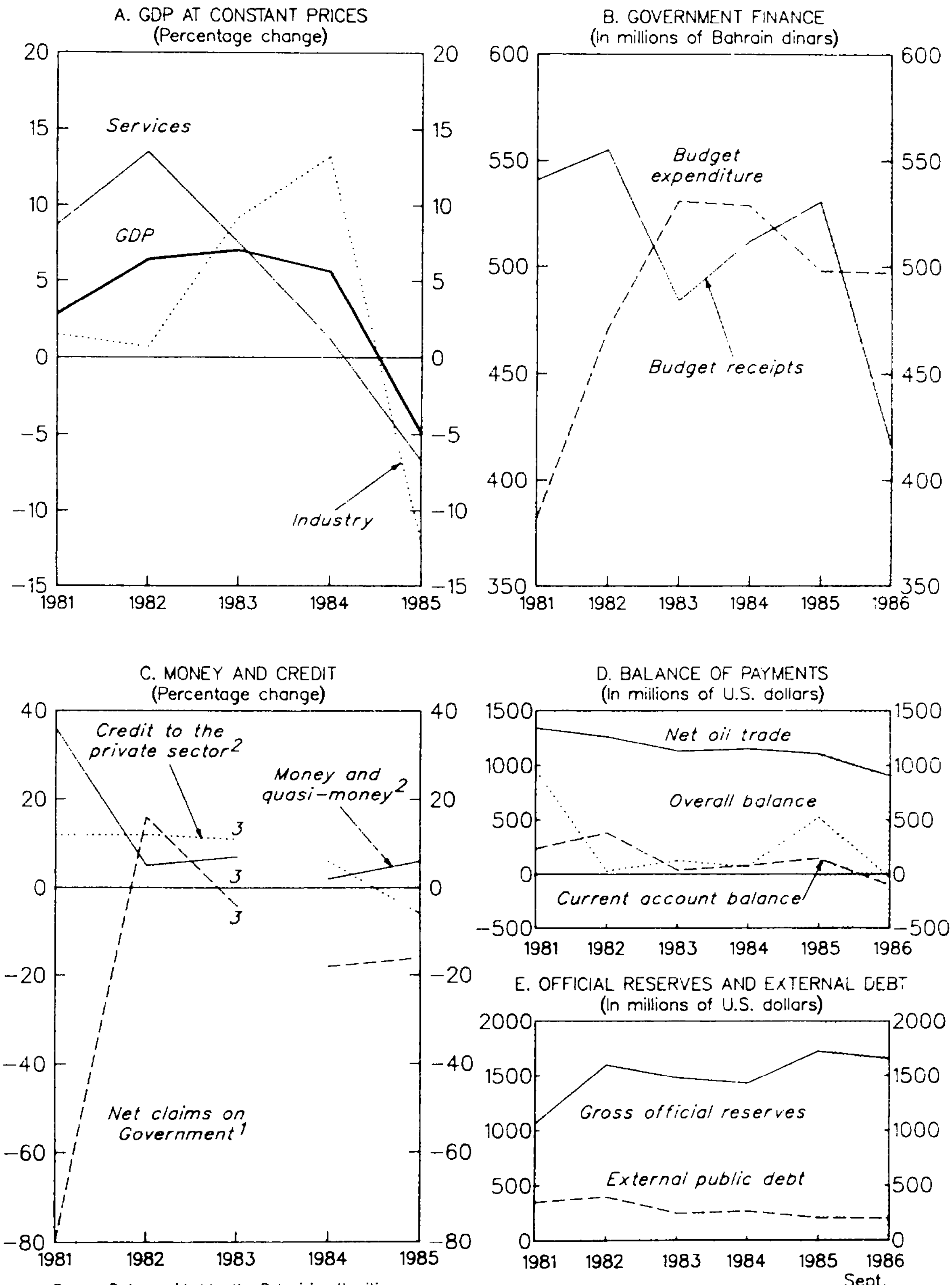
Despite economic diversification, petroleum receipts continue to account for the bulk of government budgetary revenue and the country's foreign exchange earnings. With this dependency, the declines in world oil prices beginning in 1982 contributed to a weakening of Bahrain's fiscal and external sector positions. In the official budget, oil and gas revenues fell by 18 percent over 1982-83, while spending rose by nearly 40 percent. As a result, the deficit moved from a large official surplus in 1981 to a deficit of 3 percent in 1983. The fiscal erosion was more pronounced in the overall budgetary position which incorporates the net extrabudgetary operations of the Government. While fiscal analysis is hampered by insufficient data on these transactions, 1/ sizable deficits were recorded on this account during 1982-83, and the overall fiscal deficits averaged 6 percent of GDP. In response to this development, the authorities undertook adjustment measures. The growth of current outlays in the official budget was sharply curtailed in 1983, and a considerable strengthening of the policy of spending restraint was introduced in 1984, when official budget outlays were contained to a level lower than in the previous year. This reflected, in particular, tight control over civil service salaries and hiring and over government purchases, as well as a reduction in capital spending. The latter reflected a decision to extend the implementation period for the Economic and Social Investment Program to 1987. At the same time, some measures were put in place to bolster non-oil revenues. With these policies and somewhat higher oil revenues as a result of the increase in Abu Saafa output, the 1984 official and overall fiscal positions moved toward approximate balance.

1/ See Bahrain--Recent Economic Developments, (to be issued shortly).

CHART 1

BAHRAIN

ECONOMIC INDICATORS, 1981–86



Source: Data provided by the Bahraini authorities.
[1] Includes nonfinancial public enterprises beginning July 1984.
[2] Excludes nonfinancial public enterprises beginning July 1984.
[3] Because of the reclassification of nonfinancial public enterprises, data for 1981–83 are not comparable with data for 1984–85.

Table 1. Bahrain: Selected Economic Indicators

(Changes in percent unless otherwise indicated)

	1981	1982	1983	1984	Prov. 1985	Official Proj. 1986
Production and prices						
Crude oil production 1/	-5	-8	3	15	-2	2
Non-oil GDP at constant prices	6	9	8	5	-8	...
Non-oil GDP deflator	12	4	2	-1	-3	...
Consumer price index	11	9	3	1	-3	...
Petroleum products export price	13	4	-13	-4	-4	-36
Non-oil import price index 2/3/	1	-4	-4	-1	-2	10 3/
Public finance						
Government revenues 4/	21	3	-12	8	4	-23
Oil and gas revenues	25	1	-18	8	6	-37
Non-oil revenues	7	15	12	10	--	19
Government expenditures	20	23	13	--	-6	--
Current	21	28	5	3	4	6
Capital	20	16	27	-5	-22	-12
Official budget balance (in percent of GDP)	10	5	-3	-1	2	-5
Overall fiscal balance 5/ (in percent of GDP)	12	-5	-5	--	1	-9
Money and credit						
Money and quasi-money	36	5	7	... 6/	6	3 7/
Claims on private sector	12	12	11	... 6/	-7	-3 7/
Net claims on Government	-80	16	-4	... 6/	-16	-1 7/
External sector						
Exports, f.o.b.	18	-12	-16	3	-10	-20
Imports, c.i.f.	17	-15	-6	9	-11	-15
Current account balance (in percent of GDP)	6	8	1	2	3	-3
Overall balance (in percent of GDP)	22	1	3	1	11	-1
Gross official reserves (in months of non-oil imports) 8/	17	14	12	14	17	...
Public debt service ratio (as percent of current earnings) 9/	8	8	1	1	3	1
Nominal effective exchange rate 10/ (depreciation -)	11	11	8	11	-12	-8 11/
Real effective exchange rate 10/ (depreciation -)	12	13	6	3	-17	-11 11/

Source: Based on data provided by the Bahraini authorities.

1/ Includes Bahrain's share from the Abu Saafa field.
2/ Partner countries' unit export values for non-oil trade.
3/ Staff estimate.
4/ Excludes grants.
5/ Includes extrabudgetary operations.
6/ Data for 1984 and subsequent years are not comparable with data for years prior to 1984, due to a reclassification of the positions of the nonfinancial public sector enterprises from the private sector to inclusion with Government.
7/ For six months ended June.
8/ Imports for domestic use.
9/ Current earnings are defined as receipts from net oil trade, non-oil exports of domestic origin, and services.
10/ Staff estimates. Calculated on a December to December basis, using the currencies of 16 import-trade partner countries.
11/ Change from December 1985 to September 1986.

The growth of domestic liquidity declined sharply in 1982-83 due essentially to substantially lower external sector surpluses (see below): monetary expansion averaged 6 percent compared with over 35 percent in 1981. However, the rate of private credit growth remained brisk at 11-12 percent. An accurate assessment of monetary growth and the behavior of certain monetary determinants is not possible for 1984 due to a major change in midyear in the compilation of the monetary accounts. Under this change, transactions of the nonfinancial public sector enterprises were reclassified from the private sector to the government sector. 1/ During 1982-84 Bahrain experienced a low rate of inflation with consumer prices and the non-oil GDP deflator rising on average by only 2-4 percent. This outcome reflected declining import prices, owing to the peg of the dinar to the U.S. dollar, and the lower growth of domestic liquidity. In the offshore market, following the rapid expansion in the assets of offshore banking units (OBUs) during 1980-82, their growth slowed noticeably in 1983-84, with total assets remaining essentially stagnant after early 1983 due to the slowdown in regional economic activity and in offshore lending generally in international markets.

In the balance of payments, the weakening of world oil prices was reflected in an erosion in Bahrain's net oil exports over 1982-84. This development along with a relatively brisk increase of non-oil imports resulted in the emergence of a growing merchandise trade deficit. Despite higher recorded net service earnings, 2/ the current account surplus fell as a proportion of GDP from a peak of 8 percent in 1982 to 1-2 percent in 1983-84. On the capital account, Bahrain benefited from continued large official grants and rising direct investment receipts which were the major factors accounting for overall external surpluses averaging about US$100 million in 1983-84.

Bahrain's exchange system is virtually free of restrictions on payments and transfers for current and capital transactions, and the trade system is almost fully open. Customs duties are relatively low, averaging effectively about 7.5 percent. Tariff policy is formulated in cooperation with the other member countries of the Gulf Cooperation Council (GCC). 3/ In this context, Bahrain in March 1983 abolished duties on GCC-produced goods and adopted the common GCC external tariff structure which applies charges of 4-20 percent to dutiable commodities imported from countries other than GCC countries. In principle, the Bahrain dinar is pegged to the SDR. However, the U.S. dollar/dinar rate has remained unchanged since December 1980 at BD 1 = US$2.66, and as a result the dinar appreciated in real effective terms by about 40 percent between December 1980 and February 1985, when the U.S. dollar peaked in value against most other world currencies (Chart 2). With the

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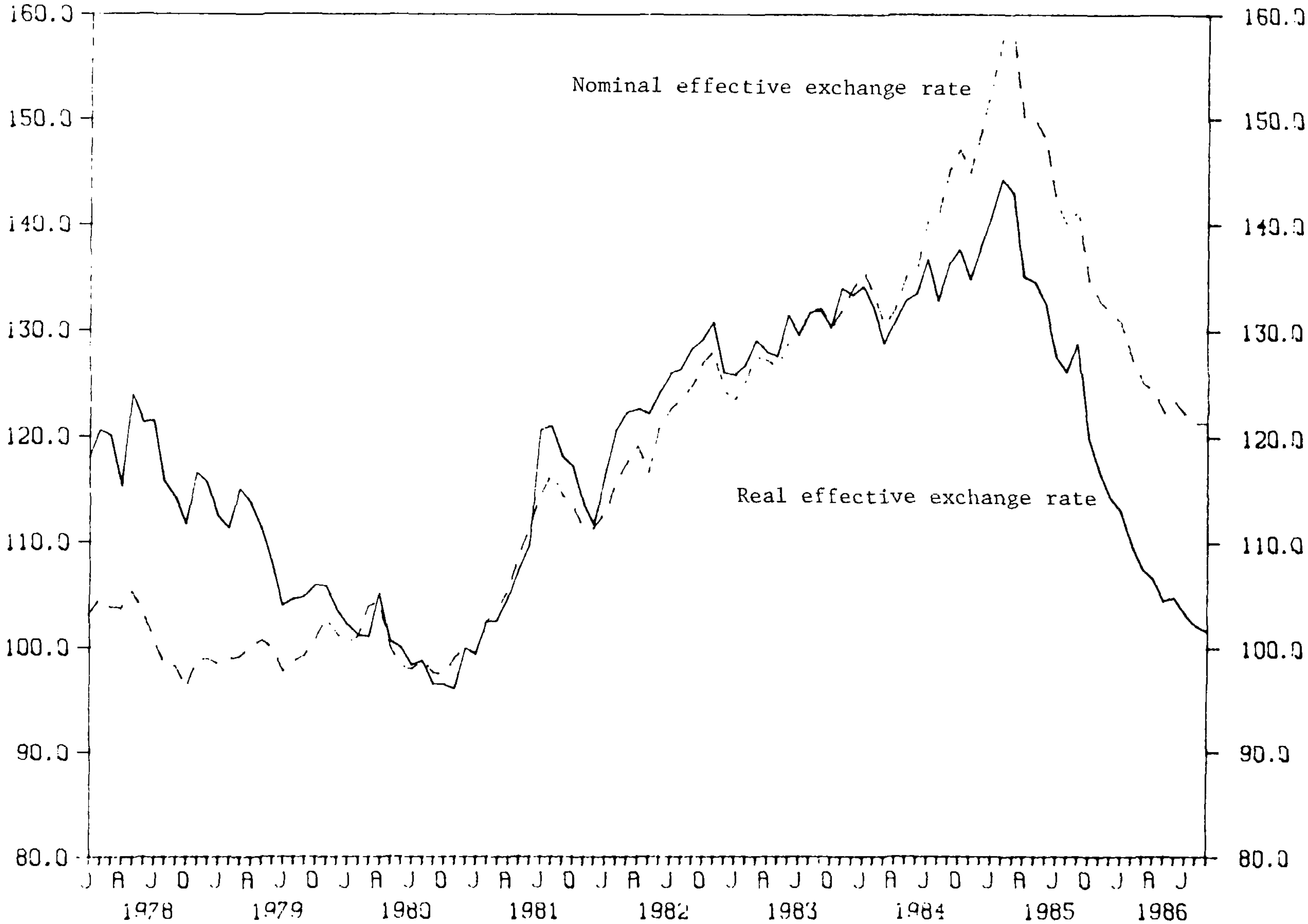
1/ As a result beginning July 1984, the monetary data on Government refer to the aggregate public sector.

2/ This development reflected largely major improvements in the coverage of investment income and other services receipts.

3/ The other member countries are Kuwait, Oman, Qatar, Saudi Arabia, and the United Arab Emirates.

CHART 2
BAHRAIN
EFFECTIVE EXCHANGE RATES 1/

(December 1980 = 100)



Source: International Monetary Fund, International Financial Statistics.

1/ Staff estimates based on 1980-82 import trade data for the sixteen major partners.

subsequent weakening of the U.S. dollar, the real effective exchange rate index for the dinar moved down over the period ended September 1986 to a level which broadly offset the real appreciation during 1981-84.

With regard to statistical data, Bahrain recently introduced improved data on consumer prices and service transactions in the balance of payments. However, substantive shortcomings exist in the quality of the fiscal, monetary, and balance of payments data which impair analysis of macroeconomic developments. Statistical issues are reviewed in Appendix IV.

III. Report on Discussions

The consultation discussions focused on economic and financial developments in 1985, the expected macroeconomic outcome for 1986, and the prospects and policies for 1987 in a medium-term context. In the discussions, the staff was guided by the Executive Board review of the 1984 consultation. On that occasion, Directors commended the authorities for their success in diversifying the economy and noted that growth had been brisk and increases in prices had been moderate. Directors observed that the changed conditions in the international petroleum market had been reflected in a weakening of Bahrain's fiscal and external positions and that the authorities had begun to adjust by taking action to curtail expenditure growth. However, they advised early action on the diversification of revenue sources, the integration of extrabudgetary accounts into the official budget, and monetary restraint to support fiscal policy in helping the balance of payments. They also noted the strong appreciation of the dinar in real effective terms and that the authorities were keeping an open mind on exchange rate flexibility.

1. Overview of developments in 1985

Fiscal policy in Bahrain in 1985 continued to be directed toward adjustment and was focused in particular on achieving a reduction in budgetary expenditures in order to dampen aggregate demand and pressures on the balance of payments. The Bahraini representatives explained that in the official budget their current spending target had been to freeze 1985 outlays at the level budgeted for 1984; 1/ this entailed holding the growth of current spending to 4 percent over the 1984 actual outcome. To this end, a decision was taken to effect 5-10 percent reductions from the 1985 budget allocations for manpower and purchases of goods and services. Moreover, the policy of postponing capital expenditures under the investment program was continued.

1/ As Bahrain is on a two-year budget cycle, the original 1985 budget estimates were formulated in late 1983.

The authorities were successful in implementing this tightening of expenditure policies and in achieving their budgetary objectives. Actual current spending turned out to be marginally lower than the 1984 budgeted level, with growth in this category largely limited to higher outlays for defense and public utilities. Moreover, capital spending was 22 percent below the 1984 outcome. As a result, total expenditures fell by 6 percent. This spending reduction was accompanied by a moderate increase in oil revenues due to higher receipts from Abu Saafa production. However, non-oil revenues were unchanged, reflecting partly the absence of new domestic revenue measures. Taken together, these factors were reflected in an official budget surplus equivalent to 2 percent of GDP. While extrabudgetary operations recorded a small deficit, the overall fiscal position achieved a surplus on the order of 1 percent of GDP.

Monetary growth was moderate in 1985 at 6 percent, and was entirely attributable to a considerable surplus reported for the balance of payments (see below). The change in net domestic assets was substantially contractionary. Private sector credit outstanding declined by 7 percent, reflecting weak loan demand due to recessionary developments in the economy (see below), while net deposits of the aggregate public sector rose sharply owing to a large increase in government foreign assets held by the domestic banking system.

In the balance of payments, the authorities' policy of fiscal restraint and the slowdown in the economy were reflected in a sizable reduction in non-oil imports. Consequently, although net oil export earnings declined due to lower petroleum prices and a fall in shipments of refined products, there was a reduction in Bahrain's trade deficit, and a commensurate increase in the current account surplus to US$145 million (or 3 percent of GDP). The overall balance of payments surplus, however, reached US$520 million due largely to sizable recorded and unrecorded private sector capital inflows. The Bahraini representatives explained that these flows reflected principally sales of equity in domestic companies, foreign borrowing by resident private sector companies, and repatriation of deposits held abroad. Bahrain's gross official reserves rose to US$1.7 billion at end-1985, equivalent to 17 months of projected 1986 non-oil imports (c.i.f.) for domestic use; somewhat more than half of these assets are held by the Government. Official external debt is small, and at end-1985 stood at about US$200 million (or 4 percent of GDP), entailing service payments equivalent to some 3 percent of receipts from net oil exports, other exports of domestic origin, and services.

Bahrain experienced a broad contraction in real economic activity in 1985. Non-oil GDP fell by 8 percent, with most subsectors of the economy recording lower levels of real value added. The sharpest declines occurred in offshore banking, real estate, construction, and petroleum refining. With the further slowdown in regional economic activity, total assets of the OBUs fell by 9 percent. The Bahraini representatives attributed the contraction of the economy essentially to lower government spending, particularly the reduction in capital expenditures, and the general economic recession in the region. Manufacturing output, however, registered an expansion with the coming on stream of two new major industrial operations, an aluminum rolling mill and a petrochemical facility. The decline in overall real GDP was less sharp (at 5 percent) due largely to the higher real value added recorded in the national accounts for Abu Saafa crude oil output. With the weakening of domestic aggregate demand and lower import prices, the domestic price level fell by 3 percent.

2. Financial policies

a. Fiscal policy

The original official budget for 1986, which had been prepared in late 1985, envisioned a deficit in the range of 1-2 percent of GDP. Oil revenues were expected to decline by 10 percent reflecting essentially a lower projection for Abu Saafa revenues as a result of weaker world oil prices. Regarding non-oil revenues, the Bahraini representatives explained that they had been concerned over the size of the initially forecast deficit, and in response had introduced a series of measures to strengthen domestic revenue performance. These had included increases in various fees and charges by 25-100 percent, a restructuring of water charges, and introduction of an airport departure tax. The projected expenditure level was 8 percent higher than the 1985 outcome due mainly to increased allocations for current spending on education and for capital outlays on defense and security. The deficit was expected to be in the range of 1-2 percent of GDP, and was to be financed through sales of development bonds to the domestic nonbank sector.

With the greater than anticipated weakening of world oil prices in early 1986, the authorities after midyear revised their budget forecasts. Total revenues were estimated to be 23 percent lower than the provisional outcome for 1985, and within this aggregate, oil and gas revenues were expected to fall by more than 35 percent. With this revenue reassessment, a decision was taken to freeze expenditures at about the 1985 level. This was to be achieved by a further reduction in capital spending, which would permit current spending to rise by about 6 percent. The revised forecast envisioned an official budget deficit equivalent to 5 percent of projected GDP. As a relatively large deficit is expected for net extrabudgetary operations, the overall deficit was forecast to reach 9 percent of GDP.

The Bahraini representatives observed that they were concerned regarding the size of the projected overall deficit and its implications for demand management. They were confident that the targeted non-oil revenue growth and the reduction in capital outlays would be achieved, and explained that the forecast increase in current spending was unavoidable, as it reflected essentially higher defense expenditures necessitated by regional security considerations. Regarding financing, the recent sales of development bonds to the domestic nonbank sector would now cover only about one quarter of the deficit, and it was expected that the balance would be covered by foreign grants related to defense expenditures and sales of Treasury bills and additional development bonds.

In commenting on the revised budget forecasts, the staff commended the authorities for the quick adjustment response to the fluid conditions in the world oil market. It was clear that a strong effort had been undertaken to raise non-oil revenues; however, this increase in resources would offset only a small proportion of the loss in oil revenues. Moreover, the lowering of capital spending would only just offset the expansion in current expenditures. It appeared that it was becoming more difficult to make the needed reductions in budget outlays, with the result that the level of total expenditure in the revised budget would be unchanged from last year. This would help sustain the level of domestic aggregate demand, which had implications for the external position, as the budget was an important policy tool in managing the balance of payments.

In the context of reviewing the 1986 budget forecasts, the staff asked about the objectives of the package of economic and financial measures introduced by the authorities in September 1986 and whether they signaled a shift in the stance of demand management policy. The measures included reductions in social insurance taxes, municipality fees, and port and warehouse charges; the abolition of re-export taxes; a lowering of interest rates (see below); payment of interest on half of commercial bank reserves held by the Bahrain Monetary Agency; an easing of regulations on the hiring of expatriate labor; a reduction in charges for international communications; and permission for GCC nationals to purchase up to 25 percent of domestic companies. The Bahraini representatives explained that the measures were intended in large part to contribute to the country's foreign exchange receipts and to cushion the effect of the reduction in government capital expenditures by providing a stimulus to private sector activity. The net cost to the budget had been estimated to be only about 0.3 percent of GDP.

Regarding the 1987 budget, the Bahraini representatives indicated that their original estimates, formulated in late 1985, were undergoing revision in response to the recent developments in world oil prices. The authorities believed that it would be difficult in the current economic climate to introduce new domestic revenue measures, but that greater maneuverability existed in the area of expenditures. Therefore, an exercise had been undertaken to effect a reduction in spending to a level below that of 1986. In this process, all current expenditure programs had been examined to eliminate nonessential outlays, and the investment program had also been reviewed. The expenditure reduction proposals were now with the Cabinet.

The staff observed that, in view of the expected magnitude of the 1986 fiscal deficit and the uncertainties regarding 1987 oil price developments, it would be important to effect a substantial curtailment of expenditures in order to help reduce the deficit. However, in view of the nominal effective depreciation of the dinar and the high import content of government spending, seeking to lower the deficit/GDP ratio only through expenditure reductions could entail sizable cuts in real outlays. Thus it would also be necessary to strengthen the domestic revenue effort. At present, Bahrain's revenue structure was highly dependent on the oil sector and on fees and charges, resulting in a narrow and inelastic base. The efforts to raise new resources through adjustments to fees and charges had been commendable, but discretionary changes were required to effect increased collections. Thus revenue performance would benefit from a reform of the tax structure, and in this context consideration should be given to adopting some of the far-reaching recommendations contained in the 1984 Fund technical assistance report. These included raising user charges for water and electricity to eliminate subsidization, basing property taxes on current market values (rather than 1951 assessments), the introduction of sales taxes, and the adoption of profits taxes. Most of these measures would take time to establish the needed administrative machinery, and as an interim approach import duties on consumer goods, particularly consumer durables, could be adjusted to generate additional revenue for the budget. Import duties were at present relatively low, compared with the GCC-permitted range. The Bahraini representatives responded that a number of the technical assistance recommendations had been adopted in the recent upward adjustments in fees and charges. Moreover, the report of the Strategic Choices Committee of April 1986 (see below) had accepted the principle that further increases in charges be made in order to achieve certain revenue targets by 1991; for example, service and electricity charges were to be increased. The Committee had also recommended privatization of certain other government services. At present, on an overall basis petroleum products were not subsidized, and government policy was to eliminate gradually subsidies for water and electricity. There was justification for raising property taxes, but at this juncture such action was considered politically inopportune; sales taxes could also not be introduced. As for profits taxes, there were doubts over their appropriateness, given the objective of further developing Bahrain as a services and offshore financial center. Increases in import tariffs could be given consideration.

b. Monetary policy

The Bahrain Monetary Agency (BMA) for some time has followed a policy of recommending interest rates for Bahrain dinar deposits. These recommendations are usually followed by the domestic commercial banks, and thus the recommended deposit rates have indirectly influenced dinar loan rates. In recent years, the recommended dinar deposit rates have been below interest rates in international markets. For example, over the 30-month period ended June 1985, the three-month recommended dinar deposit rate was in the range of 6.5-7.0 percent, while the comparable U.S. dollar Libor rate was in the range of 8-12 percent. Subsequently, the recommended three-month rate was lowered to 5 percent; however, with the declines in international rates, the spread narrowed.

In March 1986, the BMA introduced a new policy of also making explicit recommendations for maximum dinar loan rates; these were set at 9.5 percent for the prime rate up to a ceiling of 12 percent. The recommended loan rates were lowered as an element of the September 1986 measures, and the range was established at 7.5-10 percent. The Bahraini representatives explained that the recent adjustments in deposit rates had been made largely in response to declining rates on Eurodollar deposits and that the lowering of loan rates was undertaken with a view to stimulating domestic economic activity. Government policy was to keep interest rates as low as possible in order to encourage private sector investment. The staff commented that, in Bahrain's open economy where capital markets were closely integrated with those abroad, a more flexible interest rate policy seemed more appropriate. Under the present system of maximum rates, if dinar deposit and loan rates were adjusted downward faster than the declines in Eurodollar market rates, capital outflows or increases in aggregate credit and demand would be encouraged resulting in undue pressures on external reserves.

The Bahraini representatives responded that, as a general guideline, a deposit interest rate differential for the dinar of one percentage point below international rates was viewed as appropriate and would not engender capital outflows. The authorities were committed to pursuing a flexible interest rate policy and the September lowering of loan rates should not be viewed as permanent. An additional consideration underlying this decision had been the inability of some domestic borrowers to service their loans in an orderly manner and to maintain adequate collateral, partly due to the exogenous developments affecting Bahrain and the region and resulting in declining share and property values. Under these circumstances, lower loan rates were expected to be a help to the commercial banks. Moreover, the new policy of paying interest on half of commercial bank reserves held by the BMA was also intended to assist bank profitability.

Monetary growth in the first six months of 1986 (at 3 percent) was equivalent to the rate of expansion over the same period of 1985. The expansion reflected again an increase in foreign assets and a contractionary impact from the change in domestic credit. However, the decline in private credit outstanding and the increase in government net deposits were considerably smaller than in 1985.

Regarding the status of the domestic and offshore banking systems, the Bahraini representatives stated that the authorities continued to practice close regulation and supervision and were on guard concerning the question of nonperforming assets. None of the domestic or offshore banks had had any acute overall problems from deteriorations in asset quality. In cases of individual problem loans, the authorities ensured that the banks under their supervision undertook adequate provisioning. In the area of offshore banking, most of the recommendations of the Cooke Committee were now applied to locally incorporated offshore banks, while foreign OBUs were required to submit quarterly returns. The BMA had also continued to implement a cautious licensing policy.

The total assets of the offshore banks declined further by 10 percent during the first half of 1986. In this connection, the representatives indicated that with the slowed pace of regional commercial banking activity, the authorities had been encouraging the offshore banks to move toward fee-generating investment services in order to maintain their vitality and had suggested that smaller OBUs merge with the objective of enhancing their competitive position through economies of scale.

3. Oil sector and balance of payments prospects and policies

Bahrain's crude oil output is expected to remain at about 110,000 b/d in 1986. With regard to oil sector prospects for the medium term, the Bahraini representatives explained that the current production level from Bahrain's onshore field was satisfactory given that only a few years ago a decline in output seemed unavoidable. Studies were now underway to evaluate the feasibility of additional secondary recovery techniques to increase the extraction of heavy oil. However, the prospects for higher production were not bright, and the authorities would be satisfied if present production levels were sustained over the next few years. The present level of onshore reserves was estimated at 13-14 years production at the 1985 rate. Offshore oil exploration had been undertaken without success, and further exploration was being postponed due to the weakening of world oil prices. Production decisions for the Abu Saafa field were taken by Saudi Arabia, but the Bahraini authorities expected output levels in 1986 and possibly 1987 to be about 140,000 b/d unless major new investments were undertaken. The Government intended to focus on Bahrain's role as an oil refiner, and in this context explained that a new financial arrangement between Bahrain and Saudi Arabia had been concluded in March 1986, under which Saudi Arabian oil would be processed in the domestic refinery on a fee and netback payment basis. This new arrangement had allowed a sharp recovery in refinery throughput to near full capacity in 1986, and this level of operations was expected to be sustained over the medium term. The Government did not intend to expand the refinery's capacity, but was studying the prospects for a shift in its output mix toward lighter products which were expected to be in greater demand in the future.

For 1986 the Bahraini authorities expected that the balance of payments would record deficits in both the current account and overall positions in contrast to the large surpluses which emerged in 1985. This assessment was based on provisional actual data for the first six to nine months. In the current account, net oil exports earnings were expected to decline to US$900 million (or by nearly 20 percent), with this estimate representing a 35 percent weakening in prices for exports of refined petroleum products, but a volume increase of 25 percent. Following the August 1986 agreement among OPEC members, moderate increases were anticipated in petroleum prices for the last quarter, which would result in an average refined oil price level for the year comparable to a crude oil price of US$14.60 per barrel. Lower non-oil imports were expected to offset about half the loss in net oil export earnings and to help contain the deterioration in the current account position to a deficit of about US$100 million (or 3 percent of GDP). Remittance outflows which had reached US$300 million over the first six months were projected at about US$480 million for the year as a whole. On the capital account, a surplus of only US$75 million was anticipated, representing a deterioration of about US$190 million due essentially to a turnaround of approximately equal magnitude in private sector capital flows. Taken together, these factors were expected to result in an overall external deficit of US$30 million.

The staff commented that, while the authorities' average petroleum export price and volume assessments appeared feasible, the projections for non-oil imports and workers' remittances seemed optimistic. The official budget estimates for the year as a whole had forecast an unchanged level of government expenditures, while the credit data for the first half suggested a less contractionary impact than in 1985. These considerations suggested that domestic aggregate demand could remain at about the same level as in 1985 and that as a result non-oil imports might remain unchanged. Moreover, an extrapolation of the growth rate of workers' remittances from the first half of 1986 suggested that outflows on this account might also be higher. Under these circumstances, the current account and overall deficits could be about US$130 million larger than forecast. The Bahraini representatives responded that the worker remittance projection assumed that these outflows would slow in the second half of the year as the number of departing workers was believed to have reached a plateau in midyear, and that net capital inflows could be higher than presently forecast. Thus, while the overall deficit could be higher than officially forecast, it was unlikely to be as large as suggested by the staff.

In view of the uncertainties surrounding oil price prospects and the ongoing review of Bahrain's medium-term economic strategy, the authorities considered the quantification of external sector prospects for 1987 and beyond as tentative. The official balance of payments projections for 1987-88 envision an average crude oil price of US$15.00-US$15.50 per barrel, unchanged oil production, and refined export and import levels, a moderate gain in non-oil export earnings, small annual declines in non-oil imports, substantially lower worker remittance payments, and unchanged net service receipts (see Appendix I). On this basis, the current account deficit was projected to widen to US$150 million in 1987, but would narrow to US$80 million in 1988. 1/ As net capital inflows of US$125 million were expected for both years, the 1987 overall balance of payments deficit would be contained to about the level of US$30 million forecast for 1986, but in 1988 a surplus of US$50 million would emerge.

The staff assessment of the medium-term forecasts was that the oil sector projections were within a reasonable range, given unsettled world oil markets prices, but that the expected reductions in non-oil imports

1/ The current account deficit would change by about US$40 million for every US$1 per barrel variation in the underlying crude oil price assumption.

and remittance payments implied a further strengthening of demand management policies. On a general policy level, the staff commented that over the medium term Bahrain would likely continue to be confronted with oil price uncertainties, while prospects for expansions in domestic oil output were not promising. Under these circumstances, Bahrain would need to take a cautious approach to macroeconomic policy formulation to ensure that firm demand management policies were implemented with the objective of containing pressures on official reserves. A tight fiscal policy would play a particularly major role in this regard, but would need to be supported by appropriate domestic monetary and credit policies. This objective would be assisted by allowing greater flexibility for domestic interest rates in order for these rates to better reflect financial market forces. In this context, the staff observed that the September fiscal and monetary measures, rather than representing a tightening of demand management policies, were expansionary and directed at stimulating private sector activity. These measures could well put new pressures on the balance of payments which could continue into 1987-88. The Bahraini representatives explained that the authorities generally concurred with the need for a tight demand management stance and indicated that along with fiscal developments interest rate policies would be kept under review.

On exchange rate policies, the staff observed that despite the diversification of the domestic manufacturing sector in recent years and the real depreciation of the dinar since March 1985, manufactured exports, apart from aluminum, appeared to be making only a small contribution to the balance of payments. In this connection, the staff asked if the current exchange rate was presenting a problem to domestic producers. To provide help in the further diversification of Bahrain's exports, it might be necessary to review the appropriateness of the exchange rate so that domestic producers were provided with a sufficient competitive edge. An appropriate exchange rate would also reflect the real cost of imports to the economy and help contain import demand.

The Bahraini representatives stated that the authorities had indicated they did not intend to change the exchange rate for the dinar. The country's foreign exchange position was comfortable; the external current account had continued to be in surplus; and the overall position was expected to be broadly in balance over the medium term. Moreover, only a small segment of exports would benefit from a change in relative prices due to an exchange rate change, since the prices of Bahrain's two major exports (oil and aluminum) were fixed in U.S. dollars. Regarding industries other than aluminum, foreign demand constraints were the primary factor for their weak performance. In particular, tariff protection by some importing industrial countries was an important constraint. The services sector was unlikely to benefit from an adjustment in the exchange rate due to structural reasons, and thus new employment opportunities were unlikely to be generated. Moreover, an adjustment could contribute to undermining confidence in the stability of the offshore banking market. Finally, an adjustment would have an adverse impact on domestic prices, and the authorities were not prepared to consider an action which would adversely affect lower income groups. However, the authorities would keep exchange rate policy under review, and remained committed to an exchange and trade system free of controls. In the implementation of industrial policies, they would not resort to trade barriers, but in special circumstances, the Government might consider tariff protection for some infant industries on a temporary basis.

4. Growth, prices, and medium-term planning

The Bahraini authorities expected nominal non-oil GDP to evidence an 8 percent decline in 1986 compared with the 11 percent contraction experienced in 1985. Both the industrial and services sectors were forecast to experience lower levels of value added, with the largest losses expected in the construction and real estate subsectors. With lower world petroleum prices, the decline in nominal value added in the crude oil sector was projected at about 40 percent, and this was expected to be the major factor underlying a 15 percent decline in nominal GDP. The authorities have not yet estimated real national product for 1986. However, the Bahraini representatives indicated that in their view domestic prices would remain relatively stable in 1986 despite the nominal depreciation of the dinar. They expected the impact of higher import prices to be contained by shifts in the pattern of imports away from countries with appreciating currencies and by rundowns of domestic inventories of imported goods. The staff had estimated that Bahrain's import price index might rise by 10-12 percent in 1986 due largely to exchange rate movements, and expected that with Bahrain's high import dependency there would be upward pressures on domestic prices.

Regarding economic diversification policies, the Bahraini representatives indicated that the authorities were satisfied with the performance of the aluminum smelting industry, which represented half of value added in non-oil manufacturing, and its downstream companies. In 1986 aluminum sales receipts were expected to attain record levels as a result of the recovery of world prices and sales of stocks accumulated in 1985. Current policy was to encourage the further development of downstream aluminum industries. For example, it had been decided to establish an aluminum foil facility, and a number of other new downstream projects were also under consideration. For this reason, plans had been approved for the expansion and modernization of the smelting facility during 1987-90. Outside the aluminum industry, initiatives had also been taken to redress the weak performances of the petrochemical, iron and steel, and shipyard companies. As a general policy, the authorities intended to direct future investments in the manufacturing sector toward the development of small- and medium-scale operations which could utilize the output of the country's existing large-scale industries and benefit from the national infrastructure. Greater industrial integration among the GCC countries was also a policy objective, and to this end participation from GCC member countries was being sought for new projects, including the expansion of the aluminum smelting industry.

Economic ties among the GCC countries and economic opportunities for Bahrain were expected to be strengthened by the opening of the causeway with Saudi Arabia in November 1986. The authorities' assessment was that except in a few cases the causeway would benefit the economy. Given the small size of the Bahraini market, most manufacturing industries were already oriented toward the Saudi Arabian market and would be competitive; the causeway was also expected to facilitate establishing new joint ventures. Prospects also appeared particularly bright for service sectors, such as tourism, transportation, and insurance. Some agricultural producers would not benefit, and the Government would have to adopt policies to sustain investment in agriculture and fisheries. However, domestic consumer prices for some commodities were expected to decline with the opening of the causeway due to lower prices in Saudi Arabia.

In the area of medium-term planning and macroeconomic policy formulation, the Bahraini representatives explained that toward the end of 1985 the authorities had perceived the need to review Bahrain's economic strategy and to effect major policy changes. As a result, a Strategic Choices Committee, representing the major government ministries and the private sector, had been established to generate proposals. The Committee's lower world oil price scenario assessment had been that, if prices averaged US$18 per barrel over 1986-91 and assuming no change in policies, Bahrain would experience low rates of real economic growth over the medium term. Consequently policy recommendations were formulated with the objective of maintaining real growth at a level sufficient to prevent a decline in the average standard of living. A first round of recommendations had been made in April 1986 which had been accepted in principle by the Cabinet. The Committee's recommendations had been the basis for the September 1986 measures. With the greater than anticipated weakening in world oil prices, the report of the Committee is undergoing revision to reflect the changed situation and macroeconomic developments in 1985-86.

IV. Staff Appraisal

The Bahraini authorities for some time have been undertaking efforts to diversify the economy through promoting a regional financial and services center as well as manufacturing activities and have met with considerable success in these endeavors. This development strategy has been undertaken in response to the limited prospects for expansion in the country's crude oil output capacity. The opening of the causeway linking Bahrain with Saudi Arabia is a further step forward in this development strategy and is expected to have a beneficial impact on diversification and growth.

Despite the country's success with diversification, oil sector receipts continue to dominate budgetary revenues and foreign exchange earnings, and in view of this, the weakening of world oil prices after 1982 contributed to erosions in the country's fiscal and external sector positions. The authorities responded to these developments by introducing adjustment policies which focused on restraining the growth of budget outlays and expanding non-oil revenues. As a result, the fiscal position improved considerably in 1984-85, and a small two-year surplus was achieved. Lower world petroleum prices have been reflected in the external sector in a decline in oil sector foreign exchange earnings, and as import payments continued to rise, the current account surplus fell sharply in 1983-84. For 1985 the official balance of payments data showed an improvement in the current account and large private capital inflows, resulting in a surplus of over US$500 million in the overall external position. Bahrain's gross official reserves position is comfortable, and its external public debt is small and mostly on concessional terms. The country has continued to maintain a liberal exchange and trade system, and the staff believes that continuing these policies will benefit the objectives of diversification and growth. With the weakening of the U.S. dollar since early 1985, Bahrain's real effective exchange rate index has declined to a level which has nearly reversed the large real appreciation of earlier years.

The sharp fall of world petroleum prices during 1986 is expected to have resulted in a further erosion in Bahrain's fiscal and balance of payments positions. Budgetary oil revenues are estimated to have declined by over 35 percent, and although commendable efforts were taken to further expand domestic nontax revenues and reduce spending, it appears that the policy of expenditure restraint began to move into areas involving more difficult decisions. A sizable overall fiscal deficit in the range of 10 percent of GDP was expected for 1986, and the authorities were seeking to contain the overall external deficit to about US$30 million. The staff assessment is that an unchanged level of budget expenditures in 1986 and an accommodative interest rate policy may have sustained domestic aggregate demand at near its 1985 level. As a result, the actual current account and overall external deficits could be substantially higher than officially estimated. The policy stance implied by the fiscal and monetary measures taken in September appears to move away from the adjustment policies of 1984-85 and early 1986. Policies directed at stimulating domestic aggregate demand during a period of weak world oil prices are likely to place stronger pressures on the external position.

For 1987 and the medium term, the staff view is that with unsettled oil prices and limited prospects for expansions in official external transfers and other capital inflows, firm domestic demand management will need to be a key policy focus. The authorities are currently undertaking a review of the 1987 budget estimates and are aiming at a cautious expenditure stance. A careful assessment of the prospects for oil sector receipts will be needed and should be accompanied by measures to further curtail budget spending and increase non-oil revenues. In this connection, nondevelopment current and capital outlays should be closely scrutinized, in particular those outlays with the least adverse effect on prospects for efficient export or import-substituting projects. Spending allocations under the economic and social investment program should be subject to examination in terms of rates of return and their impact on the balance of payments. To expand domestic revenues, the programs to move user prices for public utilities toward levels which cover their full costs of production should be accelerated, while given the large gains in real incomes over the past decade, there is substantial scope for increases in domestic taxation. In this area, the staff urges early initiation of a medium-term program along the lines of the recommendations of the recent Fund technical assistance report, including in particular the introduction of sales taxes and a re-basing of property taxes on current market values. Since administrative preparation will take time, in the interim domestic revenue performance would benefit from raising import duties on consumer goods. A further strengthening of fiscal policy will inevitably result in a lowering of the impetus to economic growth from public sector spending. However, in recent years the authorities have recognized that with the altered circumstances in world oil markets, an expanded reliance on the private sector for economic growth and development will be needed. To facilitate fiscal policy evaluations and prescriptions, it would be beneficial to incorporate into the official budget most of the public finance operations presently treated as extra-budgetary transactions. With regard to the financing of budget deficits, the staff would caution that reliance on the domestic banking sector will need to be integrated into an overall approach to the management of aggregate demand.

Efforts to contain pressure on the balance of payments through fiscal adjustment will need to be supported by appropriate domestic credit and interest rate policies. In this area, the recent decision to require a lowering of domestic loan rates in order to stimulate the private sector is of concern. Private demand in Bahrain has a high import content, while the lowering of deposit rates below the level required to induce the private sector to hold dinar-denominated financial assets could contribute to private capital outflows. Therefore, an independently expansionary private credit policy could undermine fiscal policy efforts aimed at limiting pressures on the external position. It would therefore be desirable to review the recent changes in domestic interest rate policy and to consider allowing rates to move freely in response to market forces. A more flexible interest rate policy would also facilitate the role of the domestic banks in mobilizing domestic resources to finance private investment in line with the authorities' intention that medium- and small-scale private sector undertakings assume expanded responsibilities for economic development.

In the area of exchange rate policy, the staff believes that the past real appreciation of the dinar may have had the effect of limiting external competitiveness and the scope for new viable export and import diversification projects. While this real appreciation has now been essentially reversed, at the same time balance of payments prospects have weakened. A more flexible approach to exchange rate management would help mitigate pressures on the external position through enhanced competitiveness and favorable capital flows.

Regarding statistical data, while improvements have been made, there remain important areas where enhanced data quality would contribute to improved economic policy formulation. Early attention needs to be given to better fiscal, monetary, and balance of payments accounting. In the latter two areas, implementation of the Fund technical assistance recommendations would be beneficial.

The authorities have requested and the staff recommends that Bahrain continue an 18-month consultation cycle.

Table 2. Bahrain: Balance of Payments Summary for 1981-85
and Projections for 1986-88

	1981	1982	1983	1984	Prov. 1985	Official Projections 1986	1987	1988
	(In millions of U.S. dollars)							
Trade balance	222	320	-66	-276	-211	-314	-469	-395
Oil exports, f.o.b.	3,879	3,144	2,585	2,825	2,552	1,976	1,760	1,816
Non-oil domestic exports	165	235	307	243	160	178)	372	372
Re-exports and exports from bonded areas	133	314	227	136	184	173)		
Oil imports	-2,536	-1,881	-1,455	-1,674	-1,449	-1,072	-1,085	-1,120
Non-oil imports for domestic use	-1,094	-1,139	-1,350	-1,540	-1,271)	-1,569	-1,516	-1,463
Non-oil imports into bonded areas	-235	-353	-380	-266	-387)			
Services and private transfers, net	13	62	101	356	355	210	316	316
Services receipts, net	331	384	399	688	757	689	688	688
Worker remittance payments	-318	-322	-298	-332	-402	-479	-372	-372
Current account balance	235	382	35	80	144	-104	-153	-79
Nonmonetary capital inflows, net	107	151	209	117	266	74	125	125
Official capital, net	65	18	131	134	52	114	101	101
Of which: official transfers	(194)	(190)	(143)	(124)	(120)	(100)	(101)	(101)
Short-term oil trade credit, net	-60	94	34	72	41	-27	27	27
Private capital, net	102	39	44	-89	173	-13	-3	-3
Errors and omissions, net 1/	610	-504	-121	-128	112	--	--	--
Overall balance	952	29	123	69	522	-30	-28	46
Net foreign assets	-952	-292	-123	-69	-522	30	28	-46
Government	-323	-35	102	-47	-148	...	...	...
Bahrain Monetary Agency	-266	39	7	6	-33	...	...	...
Commercial banks	-363	-33	-232	-28	-341	...	...	...
Memorandum items:								
Net oil trade receipts	1,343	1,263	1,130	1,151	1,103	904	675	696
Gross official reserves	1,599	1,568	1,480	1,430	1,724	1,694	1,660	1,712
(In months of following year's imports, c.i.f.) 2/	17	14	12	14	17	19	18	18
	(In percent)							
Net oil trade/GDP	31	27	23	23	24	23	...	...
Current account/GDP	6	8	1	2	3	-3	...	...
Debt service payments/current receipts 3/	8	8	1	1	3	1	2	2
Growth rates:								
Net oil trade receipts	16	-6	-11	2	-4	-18	-25	3
Non-oil domestic exports	-18	42	73	-21	-34	11	...	...
Non-oil domestic imports	-5	4	19	14	-17	-5	...	...
Worker remittance payments	12	1	-7	11	21	19	-22	--

Source: Bahrain Monetary Agency.

1/ For 1981-83 includes valuation changes relating to net foreign assets of the Government and the Bahrain Monetary Agency.
2/ Non-oil imports for domestic use.
3/ Defined as receipts from net oil trade, non-oil exports of domestic origin, and services.

Assumptions Underlying the Official Balance of Payments Projections for 1987-88

1. The average import price for crude oil is projected to be US$15.00 per barrel in 1987 and US$15.50 per barrel in 1988, compared with an estimate of US$14.60 for 1986. The prices for crude oil in 1987-88 also apply to Bahrain's revenue share in Abu Saafa output. The per barrel price for exports of refined petroleum products is assumed to be US$2.00 per barrel higher than the average price of imported crude oil.

2. Domestic crude oil production, Bahrain's share of output from the Abu Saafa field, crude oil imports, and refined exports are maintained at the same levels as in 1986, namely, at 41,960 b/d, 66,860 b/d, 192,800 b/d, and 237,710 b/d respectively.

3. Total non-oil exports, including re-exports and exports from bonded areas, are assumed to rise by 6 percent in 1987 and to remain unchanged in 1988.

4. Total non-oil imports, including imports into bonded areas, are assumed to decline annually by 3 percent over 1987-88.

5. Net services receipts, excluding worker remittances, in both 1987 and 1988 are forecast to remain at the 1986 level, with higher tourism receipts from the opening of the causeway offsetting in part expected declines in investment income and earnings of offshore banking units.

6. Worker remittances are assumed to fall by 22 percent in 1987, reflecting a large departure of expatriate workers in 1986, and are projected to stabilize in 1988.

7. Net nonmonetary capital inflows are projected to return to about the 1984 level. Official transfers in both 1987 and 1988 are assumed to be at the same level as in 1986, and a reversal of the 1986 net short-term oil debit is assumed. No foreign commercial borrowing is assumed.

Bahrain: Fund Relations

(As of November 30, 1986)

I. Membership Status

a.	Date of membership:	September 7, 1972.
b.	Status:	Article VIII.

A. Financial Relations

II. General Department

a.	Quota:	SDR 48.9 million.
b.	Total Fund holdings of Bahrain dinars:	SDR 22.9 million or 46.9 percent of quota.
c.	Fund credit:	None.
d.	Reserve tranche position:	SDR 26.0 million.
e.	Current operational budget:	Not included.
f.	Lending to the Fund:	None.

III. Current Stand-by or Extended Arrangement and Special Facilities

None.

IV. SDR Department

a.	Net cumulative allocation:	SDR 6.2 million.
b.	Holdings:	SDR 14.1 million or 228.0 percent of net cumulative allocations.
c.	Current Designation Plan:	Not included.

VII. Use of Fund Resources

Bahrain has not used Fund resources to date.

B. Nonfinancial Relations

VIII. Exchange Rate Arrangement

The Bahrain dinar (BD) is in principle pegged to the SDR at BD 0.476190 = SDR 1 with margins of 7.25 percent. However, since December 1980, the dinar/U.S. dollar rate has remained unchanged at BD 1 = US$2.66. As a result, the dinar/SDR exchange rate in some periods moved substantially outside the wider margins. At end-November 1986, the dinar/SDR rate was within the wider margins at BD 0.455073 = SDR 1.

IX. Last Article IV Consultation

November, 1984. The Staff Report (SM/85/45) was discussed by the Executive Board on March 4, 1985.

X. Technical Assistance

A CBD statistical advisor has been assigned to the Bahrain Monetary Agency since May 1978. The FAD technical assistance program on budget management, which was initiated in September 1982, was completed in March 1986. A FAD technical assistance mission visited Bahrain in February 1984 to advise the authorities on measures to mobilize non-oil revenues; the report was submited in August 1984. Staff members from STAT visited Bahrain in December 1983 and September-October 1985 to provide technical assistance in the fields of balance of payments accounting and monetary statistics. The related reports were provided to the authorities in June 1984 and August 1986.

Bahrain: Relations with the World Bank Group

The World Bank Group's involvement with Bahrain in recent years has been through economic and sector work and technical assistance. The Bank has not engaged in any project lending to Bahrain. The Bank carried out a general economic review of the Bahraini economy in 1979. Subsequently, two special economic studies were conducted--a Basic Needs Study in 1982 and an Energy Demand Policies Study in 1983. An economic mission visited Bahrain in November 1984 and a technical assistance mission on housing in September 1986.

The economic mission of 1984 reviewed recent economic developments and focused on Bahrain's long-term prospects. The mission noted that, despite the decline in oil production since the late 1970s, Bahrain's non-oil economy had shown remarkable resilience which had helped sustain a satisfactory rate of overall GDP growth. However, this growth was not accompanied by an adjustment in aggregate demand, in particular consumption. Public consumption had grown at a rate three times that of GNP. The mission therefore emphasized the need to adopt demand management policies in order to restore equilibrium and to aid long-term growth within a stable financial environment. It recommended that these policies focus on curbing public consumption through curtailment of government expenditures. At the same time government revenues should be increased through a combined program of increased public services fees and introduction of more traditional revenue measures.

A major finding of the mission was that Bahrain's growth prospects lay essentially in the expansion of its exportable surplus from tradable services and small- and medium-scale industries. On the basis of labor market projections the mission concluded that Bahrain would continue to be a labor-deficit country, and as the economy moved toward a greater services orientation, the workforce would need to adapt to the increased demand for labor in the services sectors. The mission recommended the promotion of private enterprise and a "free market philosophy". The mission also noted the effective appreciation of the dinar over the 1980-84 period and pointed to the need for a flexible exchange rate policy as part of the strategy for growth and an improved balance of payments position.

Bahrain - Statistical Issues

1. National accounts

Bahrain provides data on gross domestic product in both current and constant prices which are in most instances of good quality. At present, these data are not published in IFS. Clearance for publication has been sought from the authorities.

2. Oil sector

For 1985 an inconsistency exists between Abu Saafa oil output and price data and the entries for receipts from this source as recorded in the budget, the balance of payments, and the current price national income accounts. As a result, real oil sector value added is not consistent with published information on the volume data.

3. Prices

A new consumer price index, based on a household expenditure survey during 1983-84, was introduced in May 1985. The new index is a marked improvement over the old index as it is more representative of current expenditure patterns and covers a wider basket of goods and services.

4. Money and credit

Since July 1984, monetary statistics have been compiled on the basis of a new set of monthly commercial bank returns. A problem with the new returns is that the commercial banks were instructed to include transactions with nonfinancial public enterprises as part of transactions with the Government. Because of this reclassification, major data items of the monetary survey in the new series are not comparable with those of the old series. Since the magnitude of nonfinancial public sector enterprise transactions is sizable, the reclassification precludes accurately calculating monetary and credit movements in 1984. Moreover, the reconciliation of the monetary and fiscal accounts has become more difficult for years after 1983. An August 1986 technical assistance report prepared by the Fund's Bureau of Statistics made the following recommendations to rectify major deficiencies in the monetary data: (a) claims on Government by, and government deposits with, the banking system should be separately identified, by excluding the accounts relating to public enterprises; (b) central government accounts should include those of the General Organization for Social Insurance; (c) Treasury bills held by banks and currently reported as investments should be shown as claims on Government; (d) borrowings by nonfinancial public enterprises should be treated separately in claims on the private sector, and deposits of such enterprises should be included in money and quasi-money; and (e) foreign currency deposits of residents with the domestic banking system should be treated as part of quasi-money. Subsequent to the mission, the Bahrain Monetary Agency notified the Bureau that it was in broad agreement with the general framework of the technical assistance report and, as a starting point, had called for separate statistics in respect of government and public sector enterprises transactions with full commercial banks to be supplied from January 1987 onwards. The authorities also indicated that other suggestions in the report would be examined and suitable action would be taken in due course.

Data on actual interest rates are not available, and economic analysis would benefit from collecting such information.

5. Government finance

Comprehensive data on the transactions of the official budget are made available to consultation missions and for publication in the Government Finance Statistics Yearbook. However, information on the relatively large and fluctuating extrabudgetary transactions is inadequate, making it difficult to quantify and analyze accurately the overall fiscal position. Extrabudgetary operations, conducted largely through a Reserve Fund Account, include interest receipts from the Government's domestic and foreign deposits, income from the Government's investments in domestic and international enterprises, expenditure on such participations, and drawings and repayments of foreign nonconcessional loans. Some transactions relating to defense and security also form part of extrabudgetary operations. Information is made available only on expenditure on participations. Incorporation of as many as possible of the above transactions into the official budget would facilitate a better understanding of overall fiscal developments. The separate provision of information on above-the-line items on a gross basis and on their financing would be a minimum analytical improvement.

6. Balance of payments

The balance of payments estimates are based on reports of foreign exchange transactions of commercial banks and the Bahrain Monetary Agency, supplemented by reports on the foreign exchange transactions of a number of large enterprises and on the balance sheets and accounts of offshore banking units (OBUs). Substantial gaps in the information on balance of payments transactions and inadequate information from the commercial banks on the nature of foreign exchange transactions result in inaccurate classification of transactions and sizable errors and omissions. A Bureau of Statistics technical assistance report of June 1984 made several important recommendations for improvements: (a) the reporting of foreign exchange transactions of the commercial banks should be redesigned to obtain more detail on the nature of transactions and to avoid doublecounting of transactions on which data are collected from other sources; (b) the number of supplementary entities reporting their balance of payments transactions should be expanded; (c) the reporting of transactions by OBUs should be improved to obtain more information on their transactions with residents and on their domestic assets and liabilities; and (d) the valuation of exports of petroleum products should be made on the basis of actual sale prices.

While the authorities have partially implemented recommendations (b) and (c) above, implementation of other suggestions in the report has been tardy, and sizable errors and omissions persist. Better analytical use of existing data would also be of help in improving estimates for the external accounts.

7. External debt

The official foreign debt and debt service payments data provided to consultation missions are believed to be comprehensive.

8. International liquidity

The data on total official foreign assets which are used in the consultation reports have the same coverage as those in the international liquidity section in IFS. However, these data exclude foreign assets held by the Government in the Reserve Fund Account, information on which is not available.

9. Coverage, currentness, and reporting of data in IFS

The table below shows the currentness and coverage of data published in the country page for Bahrain in the December 1986 issue of IFS. The data are based on reports sent to the Fund's Bureau of Statistics by the Bahrain Monetary Agency, which during the past year have been provided on a fairly regular basis.

Status of IFS Data

		Latest Data in October 1986 IFS
Real Sector	- National Accounts	n.a.
	- Prices	December 1985
	- Production: (Refined Petroleum)	April 1986
	- Employment	n.a.
	- Earnings	n.a.
Government Finance	- Deficit/Surplus	1984
	- Financing	1984
	- Debt	1984
Monetary Accounts	- Monetary Authorities	June 1986
	- Deposit Money Banks	March 1986
	- Other Financial Institutions	n.a.
Interest Rates	- Discount Rate	n.a.
	- Bank Lending/Deposit Rate	July 1986
	- Bond Yields	n.a.
External Sector	- Merchandise Trade: Values	December 1985 1/
	Prices	March 1986
	- Balance of Payments	1985
	- International Reserves	October 1986
	- Exchange Rates	October 1986

1/ Aluminum exports through March 1986.
2/ Unit value of aluminum exports only.

Bahrain: Basic Data

Population 399,500 (1985 estimate)
GDP per capita US$11,679 (1985 estimate)

	1981	1982	1983	1984	1985	Official Proj. 1986
			(In percent)			
National income						
Real growth rates						
GDP	2.8	6.4	7.0	5.6	-4.9	...
Crude oil 1/	-11.9	-8.2	2.8	10.4	15.1	...
Non-oil GDP	6.4	9.4	7.7	4.8	-8.3	...
Industry	(1.5)	(0.7)	(9.2)	(13.2)	(-12.0)	(...)
Services	(8.7)	(13.5)	(7.5)	(1.2)	(-6.7)	(...)
			(In thousands of barrels per day)			
Oil sector						
Crude oil production 1/	99.6	91.4	94.5	109.1	107.2	108.8
Crude oil exports 2/	53.4	47.3	52.6	67.2	65.3	66.9
Refined product exports	250.2	188.6	177.4	197.7	179.0	236.2
Crude oil imports 3/	213.0	150.3	133.6	156.8	138.9	195.0
Average unit values of refined product exports (US$ per barrel)	(36.19)	(37.59)	(32.53)	(31.28)	(30.18)	(19.36)
			(In percent)			
Prices						
Changes in						
Non-oil GDP deflator	12	4	2	-1	-3	...
Consumer price index	11	9	3	1	-3	...
Non-oil import price index 4/	1	-4	-4	-1	-2	12 4/

Bahrain - Basic Data (continued)

	1981	1982	1983	1984	Prov. Actual 1985	Official Proj. 1986
			(In millions of Bahrain dinars)			
Government finance						
Revenues, of which:	482.3	498.4	437.1	473.9	493.8	378.2
Oil and gas revenues	(398.5)	(401.9)	(328.6)	(354.5)	(374.0)	(235.4)
Grants	58.3	56.4	47.0	37.6	37.6	37.6
Current expenditure	231.4	296.1	309.0	319.3	333.2	351.6
Capital expenditure	150.2	174.4	222.0	210.0	164.3	145.0
Official budget surplus/ deficit	159.0	84.3	-46.9	-17.8	33.9	-80.8
Extrabudgetary operations (net)	37.5	-173.1	-78.4	10.9	-18.7	-52.0
Overall surplus/deficit	196.5	-88.8	-125.3	-6.9	15.2	-132.8
Financing	-196.5	88.8	125.3	6.9	-15.2	132.8
Domestic banking system	(-193.5)	(71.4)	(-15.4)	(12.1)	(20.9)	(...)
Domestic nonbank borrowing	(2.0)	(-9.4)	(15.0)	(19.7)	(--)	(35.0)
Concessional foreign borrowing (net)	(4.2)	(11.1)	(-1.7)	(6.6)	(-22.7)	(...)
Discrepancy	(-9.2)	(15.7)	(127.4)	(-31.5)	(-13.4)	(...)
			(In percent)			
Rates of change:						
Total revenue	21.1	3.3	-12.3	8.4	4.2	-23.4
Oil and gas revenue	24.6	0.9	-18.2	7.9	5.5	-37.1
Total budgetary expenditure	20.3	23.3	12.9	-0.3	-6.0	-0.2
Current expenditure	(20.8)	(28.0)	(4.4)	(3.3)	(4.4)	(5.5)
Capital expenditure	(19.6)	(16.1)	(27.3)	(-5.4)	(-21.8)	(-11.8)
As percent of GDP:						
Official budget surplus/ deficit (-)	9.8	4.8	-2.6	-1.0	1.9	-5.4
Overall surplus/deficit (-)	12.2	-5.1	-6.9	-0.4	0.9	-8.9
Total revenue	29.9	28.5	24.0	25.3	28.2	25.5
Oil and gas revenue	24.7	23.0	18.0	18.9	21.4	15.9
Current expenditure	14.3	17.0	17.0	17.0	19.1	23.7
Capital expenditure	9.3	10.0	12.2	11.2	9.4	9.8

Bahrain - Basic data (continued)

	1981	1982	1983	1984	Prov. Actual 1985	Official Proj. 1986
			(In millions of Bahrain dinars)			
Changes in monetary aggregates						
Net foreign assets	357.8	11.0	45.8	6.5	232.3	54.0 6/
Net domestic assets	-158.4	30.4	9.9	... 5/	-182.7	-25.5 6/
Claims on Government (net)	(-193.5)	(71.4)	(-15.0)	(...) 5/	(-72.7)	(-4.1) 6/
Claims on private sector	(52.6)	(57.2)	(62.2)	(...) 5/	(-41.8)	(-17.2) 6/
Other items (net)	(-17.5)	(-98.2)	(-37.3)	(41.2)	(-68.2)	(-4.2) 6/
Money and quasi-money	199.4	41.4	55.7	... 5/	49.6	28.5 6/
			(In percent)			
Rates of change:						
Money and quasi-money	35.5	5.4	6.9	... 5/	5.7	3.1 6/
Claims on Government (net)	-79.9	16.4	-4.1	... 5/	-16.3	-0.8 6/
Claims on private sector	12.1	11.7	11.4	... 5/	-6.5	-2.9 6/
			(In millions of U.S. dollars)			
Gross official reserves	1,598.7	1,567.6	1,480.1	1,430.1	1,724.3	1,656.5 7/
Government	(733.8)	(768.6)	(667.0)	(687.0)	(884.1)	(811.2) 7/
Bahrain Monetary Agency	(864.9)	(799.0)	(813.1)	(743.1)	(840.2)	(845.3) 7/
Balance of payments						
Trade balance	222	320	-66	-276	-211	-314
Oil exports, f.o.b.	3,879	3,144	2,585	2,825	2,552	1,976
Of which: refined products	(3,311)	(2,595)	(2,113)	(2,264)	(1,977)	(1,670)
Oil imports, c.i.f.	-2,536	-1,881	-1,455	-1,674	-1,449	-1,072
Of which: crude oil	(-2,487)	(-1,845)	(-1,426)	(-1,645)	(-1,424)	(-1,045)
Non-oil domestic exports, f.o.b.	165	235	307	243	160	178
Re-exports	133	314	227	136	184	173
Non-oil imports for domestic use, c.i.f.	-1,094	-1,139	-1,350	-1,540	-1,271)	) -1,569
Imports into bonded area, c.i.f.	-325	-353	-380	-266	-387)	
Services and private transfers (net)	13	62	101	356	355	210
Of which: workers' remittances, outward	-318	-322	-298	-332	-402	-479
Current account balance	235	382	35	80	144	-104

Bahrain: Basic Data (concluded)

	1981	1982	1983	1984	Prov. Actual 1985	Official Proj. 1986
			(In millions of U.S. dollars)			
Nonmonetary capital account balance 8/	107	151	209	117	266	74
Errors and ommissions	611	-517	-128	-128	112	--
Overall balance	952	29	123	69	522	-30
Change in reserves and net foreign assets (increase -)	-952	-29	-123	-69	-522	30
Bahrain Monetary Agency	-323	-35	102	-47	-148	...
Change in holdings	(-323)	(-35)	(102)	(-20)	(-197)	(...)
Valuation adjustment	(...)	(...)	(...)	(-27)	(49)	(...)
Government	-266	39	7	6	-33	...
Change in holdings	(266)	(39)	(7)	(30)	(-73)	(...)
Valuation adjustment	(...)	(...)	(...)	(-24)	(40)	(...)
Commercial banks	-363	-33	-232	-28	-341	...
Memorandum item:						
Net oil trade	1,343	1,263	1,130	1,151	1,103	904
			(In percent)			
Rates of change						
Net oil trade	16	-6	-11	2	-4	-18
Non-oil domestic exports	-18	42	73	-21	-34	11
Non-oil imports for domestic use	-5	4	19	14	-17	-5
Workers' remittances	12	1	-7	11	21	19
Nominal effective exchange rate (depreciation -)	11	11	8	11	-12	-8 9/
Real effective exchange rate (depreciation -)	12	13	6	3	-17	-11 9/

Source: Data provided by the Bahrain authorities.

1/ Domestic onshore production plus Bahrain's half share in production from the offshore Abu Saafa field.

2/ Corresponds to Bahrain's half share in production from the offshore Abu Saafa field.

3/ For refining and export of petroleum products.

4/ Partner countries' unit export values for non-oil trade; staff estimates.

5/ Data for 1984 and subsequent years are not comparable with data for years prior to 1984 due to a reclassification of the nonfinancial public sector enterprises from the private sector to inclusion with Government.

6/ Actuals for the first half of 1986.

7/ As of September 30, 1986.

8/ Includes official grants.

9/ Change from December 1985 to September 1986.