April 8, 2020
Approval: 4/15/20

INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 19/31-2

11:35 a.m., April 29, 2019

2. Kingdom of Bahrain—2019 Article IV Consultation

Documents: SM/19/63 and Supplement 1

Staff: Joshi, MCD; Gemayel, SPR

Length: 19 minutes

Executive Board Attendance

T. Zhang, Acting Chair

Executive Directors	**Alternate Executive Directors**
	A. Tivane (AE), Temporary
M. Raghani (AF)	
	J. Di Tata (AG)
	G. Johnston (AP)
	A. Maciá (BR), Temporary
	Y. Liu (CC), Temporary
	J. Rojas (CE), Temporary
	C. Williams (CO), Temporary
	S. Benk (EC)
	A. Castets (FF)
S. Meyer (GR)	
	P. Dhillon (IN), Temporary
	T. Persico (IT), Temporary
	N. Komura (JA), Temporary
	K. Badsi (MD), Temporary
	S. Geadah (MI)
	T. Manchev (NE), Temporary
	J. Sigurgeirsson (NO)
	L. Palei (RU)
	F. Rawah (SA), Temporary
	R. Pandit (ST), Temporary
	P. Trabinski (SZ)
	R. Masood (UK), Temporary
	P. Pollard (US), Temporary

G. Tsibouris, Acting Secretary
V. Sola, Summing Up Officer
A. Lalor/E. Mannefred, Board Operations Officers
M. McKenzie, Verbatim Reporting Officer

Also Present
Legal Department: I. Luca. Middle East and Central Asia Department: M. Alnasaa, T. Koranchelian, S. Roudet, V. Stepanyan, M. Zaher, L. Zhu. Monetary and Capital Markets Department: J. Alwazir. Strategy, Policy, and Review Department: E. Gemayel, M. Saito. Western Hemisphere Department: A. Husain. Senior Advisors to Executive Directors: W. Abdelati (MI), Y. Danenov (SZ), S. Potapov (RU), E. Rojas Ulo (AG), M. Sidi Bouna

(AF). Advisors to Executive Directors: F. Al-Kohlany (MI), P. Al-Riffai (MI), M. Bernatavicius (NO), S. Buetzer (GR), G. Khurelbaatar (AP), A. Olhaye (AF), P. Rozan (FF).

2. KINGDOM OF BAHRAIN—2019 ARTICLE IV CONSULTATION

Mr. Geadah and Ms. Merhi submitted the following statement:

The Bahraini authorities thank staff for a constructive and open dialogue and look forward to continuing the close engagement and candid policy discussion with the Fund. They appreciate staff's valuable policy advice and, while they broadly concur with staff's assessment of the current economic conditions, they are more optimistic about the rebound in non-oil growth in 2019 and projections in the medium-term on the basis of expectations for infrastructure projects and private sector activity. The authorities also expect the planned fiscal adjustment to have a minimal impact on economic activity.

Fiscal Policies

Fiscal consolidation efforts continue to address imbalances and put public debt on a sustainable path. After the first set of fiscal consolidation measures during 2015-2017[1], in response to the decline in oil prices, the government launched the second set of measures with the adoption of the Fiscal Balance Program (FBP)[2] in October 2018. The FBP aims to achieve a balanced budget by 2022, in a manner that helps to restore fiscal sustainability without compromising growth objectives. This is being supported by financial assistance from the Kingdom of Saudi Arabia, the United Arab Emirates, and Kuwait[3]. Market reaction to the FBP and its support package has been favorable, with long-term government bond spreads declining by about 260 basis points following its announcement.

The FBP consists of six initiatives: (i) reduce government operational expenditures by 20 percent; (ii) balance the Electricity and Water Authority's expenditures and revenues by 2022; (iii) introduce a voluntary retirement scheme for government employees; (iv) streamline the distribution of cash subsidies to citizens in need; (v) improve the efficiency of government expenditures; and (vi) simplify government processes and increase non-oil

[1] The measures included streamlining government expenditures, increasing government revenues, and redirecting government subsidies. They resulted in a decline in non-oil primary balance in percent of non-oil GDP from 34.5 percent in 2015 to 26.5 percent in 2017.

[2] The FBP aims to achieve annual savings of 800 million Bahraini dinars over the coming years, equivalent to about 5.5 percent of 2019 GDP, with the objective of balancing the budget by 2022. https://www.mofne.gov.bh/fbp.aspx

[3] The support package consists of a US$10 billion loan at zero interest, with a maturity of 30 years and a grace period of 7 years. It will cover one half of Bahrain's financing requirements under the FBP through 2022.

revenues to lower the dependence of fiscal revenues on the hydrocarbon sector. The government is fully committed to the effective implementation of the FBP. Progress has been made on the voluntary retirement scheme[4] for government employees, with around 19 percent of the civil service workforce having applied to it. The authorities estimate the associated reduction in the wage bill to be around BD122 million (about one percent of GDP) in 2019.

Public finances will also benefit from the introduction of the VAT in January 2019. Because of the large number of small businesses, the authorities cautiously and temporarily set the minimum threshold for business registration at an elevated level to ensure high compliance. They plan to reduce the threshold by the end of 2019.

The authorities are undertaking structural fiscal reforms. The Ministry of Finance and National Economy established a debt management office to strengthen its fiscal financing and debt management strategy, a central internal audit unit, as well as a central procurement unit, while efforts to have a macro-fiscal unit are ongoing. In addition, many initiatives were launched to improve public service delivery for citizens, including online services and e-government applications.

Monetary Policy and Financial Sector Stability

Monetary policy remains anchored by the exchange rate peg, which has served Bahrain well and has been an important element of macroeconomic stability for decades. The Central Bank of Bahrain (CBB) has adjusted its policy rate in 2018 in line with US rates. The CBB key policy interest rate (on the one-week deposit facility) is currently 2.75 percent.

The financial sector continues to perform strongly. The banking sector remains well capitalized and profitable and has benefited from a robust regulatory and supervisory regime. The CBB closely monitors the banking system. It has made impressive progress in implementing the 2017 FSAP recommendations and plans to complete the remaining recommendations in a timely manner. In this regard, the CBB has established a joint committee on crisis management with the Ministry of Finance and National Economy. The CBB also introduced new quantitative prudential liquidity requirements and liquidity risk management guidelines for banks in line with international standards and best practices; developed a comprehensive bank risk assessment

[4] 8025 applicants were accepted for the voluntary retirement scheme for government employees, and the transition to retirement will consist of 4 phases with the last two phases being on June 30, 2019 and August 31, 2019.

framework; and adopted a risk-based supervisory approach that takes into account banks' risk profile and systemic importance.

Bahrain remains at the forefront of financial innovation in the Middle East. Significant progress has been made in fintech development. The number of participants in the regulatory sandbox has increased, and some start-ups have already graduated. The Bahrain Fintech Bay, which was launched last year, provides a collaborative platform for cooperation in the region. The CBB has recently joined the Global Financial Innovation Network[5]. It has also introduced regulations[6] related to Crypto-assets services and open banking aimed at ensuring that the related activities are brought within the regulatory perimeter and are subject to comprehensive regulatory and supervisory measures.

Structural and Regulatory Reforms to Boost Inclusive Growth

In line with Bahrain Economic Vision 2030—which focuses on competitiveness and job opportunities for nationals—the authorities continue to take measures to support private sector-led growth. These measures include initiatives to support SMEs through several government entities, such as Tamkeen[7] and the Bahrain Development Bank. The strategy for SME development has initiatives to improve access to finance, facilitate access to overseas markets, as well as fostering innovation and skill development. To further improve access to finance, the authorities recently established the Bahrain Investment Market, which will help SMEs raise capital from the Bahrain Bourse at a lower cost. Export Bahrain was established to train SMEs on export processes and procedures and raise awareness of potential export opportunities.

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[5] The Global Financial Innovation Network (GFIN), which spurred from a 2018 proposal by the Financial Conduct Authority to create a global sandbox, was formally launched in January 2019 by an international group of financial regulators and related organizations to act as a network of regulators to collaborate and share experience of innovation in respective markets, including emerging technologies and business models, and to provide accessible regulatory contact information for firms.

[6] The CBB Crypto-asset rules deal with licensing, governance, minimum capital, control environment, risk management, AML/CFT, standards of business conduct, avoidance of conflicts of interest, reporting, and cyber security for crypto-asset services. They also cover supervision and enforcement standards, including those provided by a platform operator as a principal, agent, portfolio manager, adviser and as a custodian within or from the Kingdom of Bahrain. In addition, for those licensed by the CBB as crypto-asset exchanges, the regulatory framework also contains rules relevant to order matching, pre and post trade transparency, measures to avoid market manipulation and market abuse, and conflicts of interest.

[7] Tamkeen provides financial assistance and training to private-sector businesses and individuals in order to promote a vibrant private sector and enhance productivity of the national workforce.

Bahrain is undergoing an extensive digital transformation with the aim to enhance public sector efficiency and provide promising investment opportunities. This includes the introduction of a 5G network and strengthening the digital infrastructure to promote cloud computing. Many e-government solutions were also recently introduced to simplify government procedures and facilitate the delivery of services to citizens. These include Tawasul, which enables citizens and residents to submit their suggestions and complaints to any government entity easily at any time and from anywhere; Sijilat 2.0, which is a commercial registry platform that simplifies business registration processes and works 24/7; and Benayat[8], which is a new streamlined process for issuing building permits.

Mr. Di Tata and Mr. Rojas Ulo submitted the following statement:

We thank staff for the well written paper and Mr. Geadah and Ms. Merhi for their informative buff statement.

In recent years the economy of Bahrain has been affected by the decline in oil prices, which has led to a weakening of the country's fiscal and external positions. Economic growth slowed in 2018 owing to lower crude production from the onshore Bahrain field and a deceleration in non-oil activity; average inflation increased slightly; the current account deficit widened mainly because of higher remittances abroad; and gross international reserves declined to about one month of prospective non-oil imports. Real GDP growth is projected to recover moderately over the medium term.

Although some improvement in the fiscal position took place in 2018, the overall fiscal deficit remains high. Higher oil prices and some consolidation measures lowered the deficit in 2018, but the overall financing needs exceeded 30 percent of GDP. The public debt is estimated at 93 percent of GDP at end-2018 and is projected to continue rising under the baseline scenario. The announcement of the support package of US$10 billion from the Kingdom of Saudi Arabia, the United Arab Emirates, and Kuwait has alleviated immediate financing constraints, with a favorable market reaction. We note that off-budget spending and the statistical discrepancy were on average equivalent to 5 percent of GDP in 2015-2018. Could staff comment if there are any plans to integrate off-budget spending into the budget?

We welcome the adoption of the Fiscal Balance Program (FBP) in October 2018, which seeks to achieve a balanced budget by 2022. The FBP

[8] Benayat reduced time it takes for building permits from 6 months to 5 days.

constitutes an important effort by the authorities to strengthen the medium-term fiscal position, but we believe that additional fiscal measures will be needed to support the currency peg and ensure a sustainable fiscal position over the medium term. The non-oil primary balance is expected to improve by 12 percentage points of non-oil GDP by 2024 due to the FBP, mainly because of the introduction of the VAT and lower budgeted expenditures. However, extrabudgetary spending plans are not considered in the FBP and the expected yields from the announced measures could be optimistic. We concur with staff that, under the current oil assumptions, a significant additional fiscal effort would be required to put the public debt on a downward trajectory. In this regard, the authorities could consider reviewing the list of zero-rated and exempted items under the VAT, introducing a well-designed direct taxation system, and implementing the planned additional energy and water subsidy reforms, as well as other expenditure measures, while ensuring that the most vulnerable are adequately protected.

We welcome the authorities' ongoing efforts to strengthen debt management, as well as their plans to create a macro-fiscal unit. At the same time, we encourage them to further improve fiscal transparency, including by reporting general government data and publicly disseminating the key elements of the FBP. We take positive note of the progress that has been made under the Voluntary Retirement Scheme (VRS) for government employees, which is expected to result in a significant reduction in the wage bill in 2019. However, we agree with staff on the need to consider contingent liabilities arising from the VAR and to obtain adequate financing to avoid placing further stress on the pension fund.

The peg to the US dollar has served Bahrain well by providing a credible monetary anchor and should be maintained. We agree with staff that the CBB should continue to match US monetary policy adjustments to avoid increases in capital outflows. Moreover, it is of critical importance that the CBB continue unwinding its credit to the government to preserve the currency peg.

We note that the banking sector remains well capitalized and loan provisioning has increased. However, profitability remains low and there are some vulnerabilities, including banks' exposure to the government and the real estate and construction sectors. We welcome the recent introduction of new quantitative prudential liquidity requirements and liquidity risk management guidelines for banks, as well as the adoption of a risk-based supervisory approach. We encourage the authorities to continue with their efforts to implement the 2017 FSAP recommendations and to press ahead

with their plans to add financial stability as a legal mandate for the CBB, complete the development of a macroprudential framework, and develop a well-defined emergency assistance scheme. Promptly addressing remaining gaps in the AML/CFT framework is also important. Could staff comment on the size and characteristics of the Islamic banking sector in Bahrain?

As noted in the buff statement, Bahrain remains at the forefront of financial innovation in the Middle East and has made significant progress in fintech development. In this regard, we welcome the Bahrain Fintech Bay launched last year and the CBB's participation in the Global Financial Innovation Network to coordinate promotion and regulation of fintech.

We agree that structural reforms should aim at supporting inclusive private sector-led growth. In this regard, we welcome that the reform agenda focuses on easing the cost of doing business and encourage the authorities to move ahead with their plans to privatize the logistics sector. We also support the staff's call for an overarching public-private partnership law and the authorities' ongoing efforts to enhance the role of SMEs in invigorating the private sector. In addition, facilitating broad-based growth requires addressing gaps in welfare indicators and implementing well-targeted education and labor market reforms, including through vocational training and initiatives to increase female labor participation.

With these comments, we wish the Bahraini authorities every success in their future endeavors.

Mr. Sigurgeirsson and Mr. Bernatavicius submitted the following statement:

We thank staff for their informative report and Mr. Geadah and Ms. Merhi for their useful buff statement. We broadly concur with the thrust of staff's appraisal. The extension of financial support from regional partners provides a good opportunity to proceed with much needed reforms. Fiscal and current account deficits remain elevated and official reserve coverage remains well below the median for emerging markets economies. We urge the Bahraini authorities to reinforce their fiscal adjustment plan, enact policies to improve the environment for the private sector, and continue to unwind central bank lending to the government.

We welcome the recently announced Fiscal Balance Program (FBP) as a step in the right direction. Nevertheless, we share the staff's view, that the FBP may ultimately prove to be insufficient to meet the balanced budget target by 2022. Without further policy efforts, public debt will continue to

rise, even with the assumption of effective implementation of the FBP's revenue measures. There is also room for higher public sector efficiency, as the public wage bill constitutes more than a third of all public expenditures. Given the close link between external and fiscal balances in Bahrain, the steadfast implementation of fiscal consolidation beyond the current plan is important as the external position is substantially weaker than what would be implied by fundamentals and official reserves remain low by any reserve adequacy metrics.

The Central Bank of Bahrain (CBB) should continue to unwind its direct credit to the government to support the currency peg. As the CBB's financing of the government remains elevated, the recent uptick in the extension of central bank credit sends a worrying signal. The authorities' commitment to maintain the peg should be anchored in a gradual unwinding of central bank financing and fiscal consolidation.

Subsidies should be gradually replaced by targeted social transfers. While we welcome the introduction of the VAT at the start of 2019, Bahrain has exempted a broader set of goods and services than neighboring countries. The removal of exemptions would generate additional public revenue and enable the provision of more targeted means-based support to the poorest.

Fiscal and monetary frameworks would benefit from higher transparency. Publicly accessible budget execution reports issued at regular frequency would boost Bahrain's fiscal policy credibility. The monetary policy framework could also be strengthened by clearly defined emergency liquidity assistance rules for conventional and Islamic banks.

We urge the authorities to consent with the publication of the Article IV report.

Ms. Levonian, Ms. McKiernan and Mr. Mooney submitted the following statement:

We thank staff for their comprehensive report and Mr. Geadah and Ms. Merhi for their informative buff statement. We note the more optimistic view of authorities regarding non-oil growth in 2019 and into the medium term, despite the deceleration in growth in this sector in 2018. Having overestimated non-oil growth in 2018, can staff explain how they are factoring this into their forecasts for 2019? Despite the recent easing of near-term financing constraints, risks remain on the downside including a tightening of global financial conditions, possible intensification of global geopolitical

tensions and delays in fiscal reforms. We broadly concur with staff's findings and add the following points for emphasis.

We agree with staff that the Fiscal Balance Program (FBP) represents a notable advance. The initiatives in the areas of VAT, the increase of utility prices, improved procurement practices and the voluntary retirement scheme for civil servants should aid in stabilizing the debt level. In addition, we support staff's view that a well-designed direct tax system would be effective in mobilizing substantial non-oil sources of revenue. We welcome the progress made by authorities in upgrading the fiscal governance framework and echo staff's call for further fiscal transparency in order to enhance Bahrain's fiscal policy credibility. We note the progress to date in the CBB's decreasing of its credit to government and agree that this should be done in a gradual manner to prevent large liquidity shocks.

We welcome the work undertaken by the authorities to date in the implementation of the 2017 FSAP recommendations, via enhanced regulation and supervision of the banking sector. We note the exposure of the banking sector to the real estate and construction sectors and welcome the development of a macroprudential framework, which should go some way to containing banks' exposure to these sectors. We welcome the ongoing work of the authorities in strengthening the AML/CFT framework. The work undertaken by the authorities to date in the promotion and development of fintech is also to be welcomed.

We agree that structural reforms remain necessary to support continued diversification and non-oil growth. We note the positive business environment for SMEs in Bahrain and welcome the contribution of the SME Development Board (SDB) in this regard, as outlined in Box 4 of the report. The 2023 KPIs for SMEs should further enhance the development of the sector and consequently increase employment opportunities. We agree with staff that a more active privatization plan could encourage further private investment, while targeted labor market and education reforms would improve productivity. We welcome authorities' efforts to strengthen the judicial system and improve the e-governance framework.

Ms. Pollard and Mr. Vitvitsky submitted the following statement:

We thank staff for the interesting Article IV report and Mr. Geadah and Ms. Merhi for their buff statement. Bahrain's economy faces significant challenges amid wide external and internal imbalances and very low reserve coverage. We are therefore encouraged that the Bahraini authorities have

begun to adopt a Fiscal Balance Program (FBP)—with the support of regional peers—to reduce imbalances. The ability of the authorities to maintain the exchange rate peg will also depend on robust fiscal consolidation. We broadly agree with the staff appraisal and offer a few comments for emphasis.

The FBP appears to be a solid fiscal adjustment package, with several elements aimed at smoothly reducing the government wage bill and improving spending efficiency. At the same time, we noticed wide divergence between staff and the authorities on the 2019 growth projection and on the medium-term fiscal and debt path. Mr. Geadah and Ms. Merhi's buff statement also noted that the $10 billion regional financing assistance will cover one half of Bahrain's financing requirements under the FBP through 2022. Annex V in the report on the FBP and Adjustment Needs and the DSA were very helpful in explaining some of the differences, but we would still appreciate greater elaboration from staff. On page 39, staff assumptions on higher interest payments and capital spending appear to be the largest points of divergence.

Relatedly, has staff engaged with the authorities that provided financial assistance, including whether there are any other economic conditions tied to the loan other than the FBP? While the regional financing does not appear to fall under Fund guidance on collaboration with regional financing arrangements (RFAs), we think it is important that Fund staff engage and share information in both directions, including under surveillance, with multilateral and bilateral creditors.

Additionally, we agree with staff's message on the need for structural reforms to support diversification and non-oil economic growth. We encourage the authorities to accelerate the process of scaling back the government's role in the economy and supporting private sector development, including through improving the business environment and the judicial system.

Finally, we strongly echo staff's call to further enhance fiscal transparency in Bahrain. While the Article IV may include some non-public information on the terms of the financial assistance program, we still encourage the authorities to consent to publish the report. Enhanced transparency will ultimately help improve investor sentiment toward Bahrain.

Mr. Villar and Mr. Rojas Ramirez submitted the following statement:

We welcome this Art. IV report for the Kingdom of Bahrain and thank the staff for its reports and Mr. Geadah and Ms. Merhi for their illustrative buff statement.

After a period of low oil prices with high impact on the economy, the Bahraini authorities are committed to achieving fiscal consolidation, a sound debt administration framework and preserving financial soundness. Still, the Kingdom of Bahrain is facing difficult challenges for its economic stability, financial soundness, and sustainable economic growth.

Fiscal policy aims to assure fiscal sustainability and underpin the external position. Authorities are committed to the success of the Fiscal Balance Program (FBP). We welcome advances in the introduction of the value-added tax, actions included on FBP for targeting subsidies and for more efficient government operations. We also welcome the authorities' efforts on debt management and for promoting fiscal transparency thru the Public Debt Management Directorate. Nevertheless, we note staff's remarks that additional efforts would be necessary to secure fiscal and external sustainability and to support the currency peg regime. We concur with staff's proposal for promoting a fiscal management framework underpinning equity and promoting reforms throughout a direct taxation system for improving non-oil revenues and removing exemptions on the VAT. We also agree with staff's proposals, aiming at controlling budgetary and extrabudgetary spending and reducing financing needs. This would require civil servants wage restraint and improving service provision in the water, sanitation and power supply sectors, eliminating subsidies and strengthening social safety nets.

The authorities are committed to improving the external position by rebuilding foreign reserves and supporting the currency peg and underpinning external stability through fiscal measures. We welcome CBB efforts to unwind its credit to the government and agree with staff that such process of unwinding should continue to maintain the peg to the US dollar.

The banking sector seems sound and the country's leadership in Fintech is commendable. However, the system shows low profitability and some vulnerabilities that need attention. We concur with staff that introduction of macroprudential policy instruments such as loan-to-value ratios and higher risk weights could be considered to contain banks' exposure to the real estate and construction sectors. We also welcome the authorities'

commitment to address the gaps identified in Bahrain's AML/CFT framework.

Structural reforms and non-oil inclusive growth are essential for the Bahraini economy. We agree with staff on the need for promoting private sector participation, invigorating SMEs, improving governance, scaling back government's participation in the economy and improving the business environment.

With these remarks, we wish the authorities of the Kingdom of Bahrain success in their endeavors.

Mr. Johnston and Mr. Khurelbaatar submitted the following statement:

We thank staff for their report and Mr. Geadah and Ms. Merhi for their informative buff statement. Lower oil prices since 2014 have eroded Bahrain's fiscal and external positions. The regional support package has helped reduce financing pressures and the authorities have made considerable progress in mapping out a path of fiscal consolidation. Nonetheless, economic growth remains subdued, the country is vulnerable to oil price and external shocks, and the currency peg and large fiscal deficit make it difficult to build up foreign reserves to adequate levels.

The Fiscal Balance Program is a welcome development since last year's Article IV. The introduction of VAT, energy and water subsidy reforms, pension reforms and other fiscal adjustment measures will help lower the fiscal deficit. While the authorities do not currently anticipate the need for further measures, these might prove to be necessary if public debt cannot be stabilized. Staff's suggested revenue and expenditure measures are therefore helpful. We encourage the authorities to consider these suggestions. It is a pity, however, that the VAT was introduced with so many exemptions as removing these in the future would be difficult.

Progress has been made in implementing the 2017 FSAP recommendations. However, we would also encourage the authorities to develop the emergency liquidity assistance framework which would enhance the soundness of the banking sector.

We agree that a more dynamic private sector, employing a greater proportion of Bahrainis, would help facilitate broad-based growth. Generous public employment has been one way to share the benefits of oil revenues amongst Bahraini citizens. Changing that approach over time, with more of a focus on the private sector, would seem to us a significant task, and we look

forward to seeing how well the National Employment Program does in achieving it.

Finally, we would encourage the authorities to agree to the publication of the staff report.

Mr. Gokarn and Ms. Dhillon submitted the following statement:

We thank staff for the informative report and Mr. Geadah and Ms. Merhi for their insightful buff statement.

Growth in Bahrain has slowed to 1.8 percent in 2018, driven by a decline in oil production and reduced activity in retail, hospitality, and financial services. In the medium-term, staff has projected a growth of around 1¾ percent even as the authorities are more optimistic about the rebound in non-oil growth in 2019 and, consequently, projected growth. However, delays in fiscal adjustment, global financial conditions and geopolitical tensions pose downside risks. Going forward, the authorities must continue to take effective steps on the twin deficits and strengthening of reserves. We broadly agree with the recommendations of the staff report and encourage authorities to consent to its publication.

We concur with staff that Bahrain needs additional reform for ensuring fiscal sustainability with a transparent medium-term framework. The six core measures targeted in the Fiscal Balance Program, including on expenditure rationalization, simplifying of government processes and increase in non-oil revenues, are reassuring. Similarly, introduction of VAT is a constructive step and we would urge the authorities to reflect on the progressive tax system suggested by the staff, given the overarching requirement of financing juxtaposed with rising debt. Assistance from the region of US$10 billion loan at zero interest meets one half of Bahrain's financing requirements under the FBP through 2022 and the buff highlights the favorable market reaction to this and the FBP. Alongside, staff has highlighted extra-budgetary spending plans. In this context we would like to know more on a) whether the assistance is tied to the achievement of specific targets? b) Could staff elaborate on the scale of the extra budgetary support and the underlying impediments to its integration in the budget?

Monetary policy, anchored by the exchange rate peg, has served Bahrain well.

The banking sector remains stable, well capitalized and profitable. We welcome the implementation of the 2017 FSAP recommendations, with the heightened regulation and supervision of both conventional and Islamic banks. We also join staff in urging continued vigilance on exposures emanating from the real estate sector and banks' low profitability. Notably, Bahrain's lead in fintech and its related regulations and collaborations, is admirable, including the introduction of regulations related to Crypto-assets services. Could staff offer some implementation experiences of these regulations? Beyond this, we would urge the authorities to address the gaps in Bahrain's AML/CFT framework swiftly.

We agree with staff recommendations for structural reforms to support private- sector led growth and diversification. Initiatives to develop the business climate and improve access to finance, especially for small and medium enterprises are positively noted. Moving forward, education and labor market reforms could be game changers for employment and productivity and become the pivot for sustainable and inclusive growth.

With these comments, we wish the authorities the best in their endeavors.

Mr. Daïri and Mr. Badsi submitted the following statement:

We thank staff for the well-written report and Mr. Geadah and Ms. Merhi for their informative buff statement. Bahrain's economy continues to cope with highly volatile oil markets that have generated significant macroeconomic imbalances. Compared with the two previous years, growth has slowed down significantly in 2018 and is expected to remain subdued in 2019 and 2020, mainly driven by poor performance of the oil sector. Notwithstanding a slight increase in 2018, inflation is low but remains subject to pressures in 2019 due to the introduction of VAT. Although still high, the fiscal deficit continues its rapid decline in 2018, including from improved oil prices and fiscal adjustments, at a time when the rising current account deficit through 2018 is projected to moderate going forward. However, the reserve position has weakened significantly, adding to the pressures from the high and rising public debt. Moreover, the highly uncertain outlook poses downside risks to the baseline, stemming from delays in fiscal adjustment, a sharp tightening of global financing conditions, and lower oil prices. The announcement of substantial assistance from the region in support of the Fiscal Balance Program adopted in October have helped alleviate these pressures and improve confidence, as evidenced by declining spreads and

inclusion of Bahrain in the EMBI. We concur with the thrust of the staff appraisal.

We commend the authorities for the progress made on the implementation of the Fiscal Balance Program. However, given the still high fiscal breakeven oil price, additional fiscal adjustments are needed to ensure fiscal sustainability, set public debt on a firm downward path, and help build foreign reserves. We welcome the recent introduction of the value added tax and the planned additional reforms of energy and water subsidies, as well as efforts to improve the targeting of subsidies. On the voluntary retirement scheme, we call for caution and selectivity to avoid loss of capacity and expertise, and for careful consideration of the impact on the pension system. Further measures are needed to increase revenue mobilization, including through a well-designed direct taxation system. Authorities' efforts to improve debt management and strengthen the budgetary framework are encouraging, and we support staff call for improving fiscal policy transparency.

The banking sector is assessed as being stable and well capitalized but suffers from low profitability and tight liquidity conditions. Progress made in implementing 2017 FSAP recommendations, in particular in the area of regulatory and supervisory vigilance, and in promoting Fintech, where Bahrain plays a leading role, should be commended. We welcome the authorities' commitment to maintaining the currency peg to the US dollar, which serves the economy well, and the Central Bank of Bahrain (CBB) should continue to follow changes in US monetary policy. The CBB agreement to continue unwinding its credit to government while guarding against liquidity shocks goes in the right direction.

Like other hydrocarbon exporting countries affected by high oil market volatility, Bahrain's needs to implement comprehensive structural reforms aimed at diversifying the economy and ensuring sustained and inclusive growth. In line with Bahrain Economic Vision 2030, commendable efforts have been made to support private sector-led growth, as mentioned by Mr. Geadah and Ms. Merhi. We welcome the authorities' initiatives on vocational training and increasing female labor participation. However, growth is expected to remain sluggish in 2019-20, in a context where the share of Bahrainis working in the private sector has been declining. Could staff elaborate on the impact of slower growth on unemployment?

We wish the authorities all the success in their endeavors.

Mr. Palei and Mr. Potapov submitted the following statement:

We thank staff for the insightful report and Mr. Geadah and Ms. Merhi for their informative buff statement. The Bahraini authorities continue to deal with significant challenges stemming from the decline in oil prices since 2014. Bahrain's large twin deficits, low international reserves, and worsening debt dynamics present downside risks to the outlook. The recently announced financial support package from the regional partners will help to meet near-term financing needs, mitigate pressures on the exchange rate peg, and support the implementation of the authorities' Fiscal Balance Program (FBP). We broadly agree with staff's recommendations in the report and limit our comments to the following points.

Last year, economic activity in Bahrain has been subdued. Both oil output and non-oil growth decelerated in 2018. Public debt is estimated to have reached 93 percent of GDP. The external position remains under pressure, with the current account deficit at 5.8 percent of GDP and international reserves at around 15 percent of the IMF's ARA metric. Financing needs, including rollover of short-term debt, remain high, at around 30 percent of GDP. Although the banking system remains sound, the government-banking sector nexus raises additional concerns. The financial support package from the regional partners was timely, helping to compress government bond spreads. We would appreciate additional elaborations on conditionality, if there is any, included in the financial support package provided by the regional partners.

We agree with staff that large-scale fiscal consolidation is required to restore fiscal and external sustainability. The FBP is an important step in addressing Bahrain's fiscal challenges over the medium term. At the same time, we note substantial differences between staff's and the authorities' assessments of the FBP fiscal outcomes. The discrepancy can be attributed to differences in projections and assumptions regarding potential yields from the envisioned fiscal measures, as well as oil prices, growth rates, and financing cost.

Staff advocate further fiscal adjustments of 10.7 percent of non-oil GDP over the next five years to stabilize public debt and rebuild buffers. These include phasing out the remaining subsidies and containing the wage bill in nominal terms, while eliminating VAT exemptions, introducing new taxes, such as CIT, PIT, and property taxes. While we noticed the authorities' reservations about additional measures, we would encourage them to closely monitor the FBP's implementation and develop a contingency plan in case

fiscal outcomes from this program fall short of expectations. At the same time, could staff elaborate on the political and social feasibility of their preferred very large total fiscal adjustment amounting to around 23 percent of non-oil GDP?

We support staff's recommendation to further strengthen fiscal transparency and public debt management. The use of extrabudgetary funds to cover the costs of the voluntary retirement scheme (VRS) creates additional fiscal risks and can undermine the credibility of the budget process. We encourage the authorities to conduct the IMF's Fiscal Transparency Evaluation (FTE) that can be instrumental in strengthening fiscal governance. At the same time, we would be interested in more details on how the upfront costs of the VRS will be financed.

While a more flexible exchange rate could have helped to adjust to external shocks, we agree with staff and the authorities that the exchange rate peg to the U.S. dollar remains broadly appropriate for Bahrain. We welcome the CBB's plans to unwind its credit to the government as fiscal consolidation proceeds. We also welcome the authorities' progress in the implementation of the 2017 FSAP recommendations, as well as their efforts to address the remaining gaps in the AML/CFT framework.

Advancing the structural reform agenda is critical for strengthening private sector development, improving the business environment, and facilitating diversification. We welcome the authorities' efforts to encourage private-sector employment of Bahrainis, reduce costs of doing business, and support SME development. We also welcome the authorities' plans to make Bahrain a regional fintech hub. Further on the VRS, could staff elaborate on how to address the risks of disruptions in service delivery, especially in the health and education sectors where a bulk of retirements is expected?

Mr. Tan and Ms. Pandit submitted the following statement:

We thank staff for their well-presented paper and Mr. Geadah and Ms. Merhi for their informative buff statement. Given sizeable financing needs and a large budget deficit, Bahrain's public debt is estimated to reach 114 percent of GDP by 2024, while external position is expected to remain weak from rising borrowing costs and remittances. Against this backdrop, we take positive note of the regional partners' financial support in alleviating the near-term financing needs, as well as the authorities' efforts in introducing the Fiscal Balance Program (FBP) to address the fiscal challenge over the medium term. In line with staff's call for further attention to focus on

fostering macroeconomic sustainability and supporting private sector-led economic growth and diversification in the longer term, we would like to raise the following comments for emphasis.

Additional fiscal reforms are warranted to build market resilience and secure longer term fiscal and external sustainability. While measures under the FBP would serve to improve fiscal fundamentals and the introduction of VAT as well as other fees and excise taxes would boost non-oil revenue, we concur with staff that additional fiscal reforms in the form of direct taxes on corporate income, reduction in VAT exemptions and phasing out of untargeted subsidies are essential to strengthening Bahrain's long term fiscal and external sustainability. This is particularly critical considering the underlying vulnerabilities in the country's elevated fiscal deficit and weak current account position, as well as the potential downside risks from tightening of global financing conditions. In this regard, we welcome the authorities' efforts to improve debt management with the establishment of the Public Debt Management Directorate at the MOFNE and to institutionalize the fiscal framework within the MOFNE. Furthermore, we support greater fiscal transparency for better public financial management and enhanced credibility of the government's reform plans.

The Central Bank of Bahrain (CBB) should continue efforts to unwind its credit to government and strengthen financial stability. Staff saw merit in the current peg to the US dollar providing a well-functioning monetary anchor and keeping inflation at a manageable level. Correspondingly, there is a need for the CBB to gradually unwind its credit to government in tandem with the fiscal consolidation to rebuild foreign reserves. We are glad that the banking system remains stable with high capital adequacy ratios and stable NPL levels. Given remaining pockets of vulnerabilities, we are also encouraged by the authorities' progress in implementing the 2017 FSAP recommendations and addressing the gaps identified in the joint FATF/MENAFATF assessment of Bahrain's AML/CFT framework. We take positive note on the country's promotion of fintech, continuing efforts on enhancing financial stability, introduction of macroprudential framework, and launch of the global financial innovation network as forward-looking steps and in the right direction to strengthen financial stability.

Structural reforms to support continued diversification and inclusive non-oil growth should be prioritized. Private sector-led diversification from oil dependency is essential for Bahrain's long-term economic sustainability. As rightly pointed out by staff, structural reforms should be geared on enhancing the business environment to further develop a vibrant private

sector, attracting foreign investment, and increasing employment opportunities, while transforming the government's role in relation to necessary public services. We note that Bahrainis participation in the private sector is declining whereas outward remittance is growing and pressurizing the external sector. In this vein, we agree with staff that targeted education and labor market reforms are essential to promoting opportunities and improving productivity. The authorities' plan to privatize the logistics sector and efforts to ease the cost of doing business and enhance the SMEs' contribution to the economy are much appreciated.

With these comments, we wish Bahrain and its people success in their future endeavors.

Mr. Alkhareif and Mr. AlHafedh submitted the following statement:

We thank staff for an informative report and Mr. Geadah and Ms. Merhi for their insightful buff statement. Bahrain's economic performance remains generally strong despite recent economic pressures. Financing from regional partners and the implementation of GCC-funded infrastructure projects are expected to yield favorable outcomes in the medium-term. Therefore, we share the authorities' optimistic view of the expected rebound in non-oil growth in 2019 and over the medium-term. Indeed, continued implementation of fiscal measures and reforms is needed to ensure fiscal and external sustainability. Against this background, we are in broad agreement with staff's policy recommendations and would like to emphasize the following points.

We commend the authorities for launching their second Fiscal Balance Program (FBP) with the aim to balance the budget by 2022. Here, we take positive note of the favorable market reactions to the announcement of the FBP and the support package from neighboring countries, i.e. Saudi Arabia, UAE, and Kuwait. This was reflected in a substantial decline in long-term government bond spreads. The introduction of the VAT, VRS, and spending efficiency and non-oil revenue measures will help contain the fiscal deficit and support sustainability. Furthermore, we welcome Bahrain's substantial progress in upgrading its fiscal governance framework and encourage continued efforts to further advance fiscal transparency and debt stabilization measures as recommended by staff. In this context, we are encouraged by the authorities' firm commitment to maintain fiscal prudence and to implement the needed measures.

On the monetary side, we agree with staff and the authorities that the exchange rate peg has served Bahrain well and should be preserved. As staff has rightly noted, the peg provides a credible monetary policy anchor and helps keep inflation low and stable. In this context, we welcome the rate adjustments following the Fed raising policy rates in 2018 and concur with staff that the CBB needs to continue to match the US monetary policy adjustments. Going forward, the focus should be on implementing credible fiscal adjustment, coupled with growth-enhanced reforms, to help steadily improve external balances, boost investor confidence, and rebuild reserves.

On the financial sector, we are comforted to note that the banking system remains liquid, profitable, and well capitalized, with stable NPLs. We welcome the progress made in implementing the 2017 FSAP recommendations, including the newly introduced quantitative prudential liquidity requirements and liquidity risk management guidelines for banks that reflect a comprehensive risk assessment framework considering banks' risk profile and systemic importance. On the same note, we are encouraged by the progress being made in promoting fintech, particularly through the introduced and revision of relevant regulations by the CBB and its global collaboration to launch the Global Financial Innovation Network (GFIN).

On structural reforms, we welcome the initiatives to promote private sector growth and public sector digital transformation, which would enhance public sector efficiency and provide investment opportunities. In this regard, we agree with staff that more active privatization efforts and well-designed labor market reforms could encourage additional private investment, promote opportunities, and improve productivity.

With these comments, we wish the authorities all the success.

Mr. Meyer, Mr. Rashkovan, Mr. Buetzer and Mr. Manchev submitted the following joint statement:

We thank staff for the well-focused report and broadly agree with their assessment and recommendations. Mr. Geadah and Ms. Merhi's buff statement also provides helpful insights to better understand the authorities' position. Bahrain's financial sector is resilient, and we welcome the authorities' continuous progress with the implementation of the FSAP and FATF/MENAFATF recommendations, the increasing effectiveness of the AML/CFT framework, and the active promotion and regulation of the fintech sector. However, economic activity is likely to remain subdued in the medium term while fiscal and external imbalances persist. International reserves

remain low, the external position is weaker than implied by fundamentals and desirable policies, and public debt has been rising rapidly. The front-loaded and highly concessional regional financial support provides a good opportunity for Bahrain to accelerate the long-awaited fiscal and structural reforms while putting the economy and public finances on sustainable footing.

Fiscal Policy and Debt Management

Public debt has risen to very high levels and is projected to increase further, warranting swift and far reaching fiscal consolidation beyond the recently adopted Fiscal Balance Program (FBP). The introduction of VAT earlier this year with a low rate in line with the Gulf Cooperation Council (GCC) agreement has been a small step in the right direction. However, we strongly support staff's call to remove the broad set of exemptions and to lower the minimum threshold for business registration, which is substantially higher than the GCC-agreed threshold. We welcome Annex V of the staff report, which underscores the need for additional fiscal measures in order to stabilize debt over the medium term. We agree with staff that the authorities should consider the introduction of a well-designed direct taxation system to effectively mobilize non-oil revenues, reduce reliance on distortive fees, and strengthen the business environment. This should be accompanied by well-tailored expenditure measures to reduce financing needs.

The development of transparent debt management and financing strategies should be among the key priorities of the recently established Debt Management Office at the Ministry of Finance (MOFNE). It will help the authorities to strengthen long-term debt sustainability and efficiently rebalance the composition of the existing debt stock, including by making use of the current low interest rate environment. At the same time, the authorities should remain cognizant of refinancing risks and strive to rebuild the low level of reserves. The contingent financing plan, as suggested by the Fund staff in para 19, could be helpful in this regard. A proper debt management strategy design would also contribute to the development of the domestic bond markets.

We strongly second staff's call that the Central Bank of Bahrain (CBB) should unwind its credit to the government as fiscal consolidation measures proceed. As staff rightly notes, this should be done in a gradual manner to avoid large liquidity shocks. We welcome the recent establishment of a joint MOFNE-CBB crisis management group and the authorities' plan to institutionalize the medium-term fiscal framework through creating a new macro-fiscal unit at the MOFNE, supported by Fund TA. If properly staffed

and trained, these units can help the authorities to better understand and manage macro-financial risks.

Structural Reforms and Sustainable Development

The authorities should speed up the implementation of structural reforms to enhance private sector development and diversify the economy. As Annex IX of the staff report demonstrates, a growing population and rapid technological advances pose challenges to the labor market and Bahrain's society more generally. We encourage the authorities to make further progress with targeted education and labor market reforms, including measures to reduce gender inequality and to increase female labor participation. We welcome the recently adopted National SMEs Development Strategy and encourage the authorities to further reduce the cost of doing business by improving governance. Moreover, steps to narrow the public-private sector wage gaps and skill-mismatches would also be needed to be brought in line with staff's recommendations.

Public Communication and Policy Transparency

We would highly appreciate a change towards greater transparency in the authorities' communication strategy. It is regrettable that the authorities consistently do not consent to the publication of IMF reports. Disseminating information in a timely and transparent manner would help to better explain the objectives of the needed reforms and seek broad public support for the painful fiscal consolidation and inevitable energy price hikes in the medium term. It would also contribute to improve the credibility of the authorities' policies. Similarly, a timely disclosure of important macro-financial information should be regarded as an opportunity to give more traction to the already launched education and labor market reforms. Moreover, it would be helpful if details on the regional financial support would be released to the public.

Mr. Benk and Mr. Harvan submitted the following statement:

We thank staff for their comprehensive report and Mr. Geadah and Ms. Merhi for their informative buff statement. Bahrain's economic activity has been subdued in 2018, in both the oil and non-oil sectors and slow growth is expected to continue also in 2019 in the context of fiscal adjustments and remaining structural weaknesses. The authorities' Fiscal Balance Program (FBP) and the accompanying regional concessional financial support are projected to alleviate pressures on Bahrain's public finances, lowering the

average interest rate, and improving market confidence. However, with continued deficits in the primary balance, public debt is expected to gradually increase in the coming years to very high levels. We broadly support staff's call on the authorities to proceed with the needed adjustments and reforms to improve fiscal sustainability, enhance financial sector resilience, and foster a more diverse and inclusive growth.

Stepping up credible fiscal consolidation efforts and reforming the public finance management framework are imperative. As public debt is projected to increase under all staff scenarios, further consolidation measures beyond the FBP would help secure fiscal and external sustainability, reducing the debt overhang and financing needs. We see careful monitoring of implementation essential to ensure that the projected expenditure savings materialize. We welcome the introduction of the value added tax (VAT) at the beginning of 2019 and are encouraged by the authorities' intention to revisit the exemptions as well as the applicable threshold. Given the experience in other countries and possible challenges, vigilant administration of the new VAT is warranted. Moreover, a well-designed direct taxation system could provide long-lasting dividends and allow for a progressive better targeted tax and benefits system. On the expenditure side, the priorities should be streamlining inefficient subsidies; containing current expenditure, particularly the high wage bill; and addressing actuarial imbalances in the pension system. We welcome the efforts to strengthen public finance management, in particular the improvements in debt management. However, more work is needed to increase transparency in public finances, including by introducing more frequent reporting on fiscal developments and by reducing the role of extrabudgetary funds.

Notwithstanding recent efforts to improve the regulatory framework, more needs to be done to address remaining gaps in the financial supervisory framework, including through implementing the Financial Sector Assessment Program's recommendations. Once financial stability becomes the legal mandate of the CBB, introduction of macroprudential policy instruments should be considered as private sector credit growth picked up in 2018. Further, continuing to unwind central bank credit to the government would also strengthen the institutional mandate of the CBB and expand its policy space. We are concerned about the adequacy of the reserve buffer in view of possible bouts of external stress. Therefore, while noting that the currency peg regime has served the Bahrain economy broadly well, a gradual move toward a more flexible exchange rate system could appropriately constitute a first line of defense. Given the evolving monetary policy stance in the US, could staff elaborate more on the implications on Bahrain's monetary policy?

Further momentum to implement structural reforms is needed to support diversification of the economy as well as overall economic welfare. The government should accelerate efforts to scale back its role in the economy. The announced plan to privatize the logistics sector is welcome as are the initiatives in the education system and labor market reforms to induce greater participation by nationals in the private sector. In reference to the respective 2018 Article IV recommendation on female labor force participation, could staff comment more on the progress made?

Finally, as Bahrain aims to become a regional fintech hub, it is crucial for the authorities to expeditiously address remaining gaps identified in their AML/CFT framework as identified by the joint 2018 FATF/MENAFATF assessment.

Mr. Sun and Ms. Zhao submitted the following statement:

We thank staff for the comprehensive report and Mr. Geadah and Ms. Merhi for the helpful buff statement. The regional support has eased Bahrain's immediate financing constraints. Nevertheless, significant challenges remain, which call for steadfast reform efforts to ensure fiscal and external sustainability. We broadly agree with the thrust of staff's appraisal and would like to make the following comments for emphasis.

A strong and credible fiscal adjustment is necessary for fiscal and external sustainability. We take positive note of the recent parliament's approval of the Fiscal Balance Program (FBP) that should help contain the fiscal deficit. Given the elevating fiscal deficit and rising public debt, we share staff's concern that the FBP alone may not be enough to stabilize the debt level. We therefore encourage additional reform efforts, including reducing VAT exemptions and phasing out untargeted subsidies, supported by a transparent medium-term fiscal framework. Such measures would be helpful in putting the public debt on a downward path and bolstering economic resilience and market confidence. Meanwhile, social safety net measures should not be hampered in protecting the vulnerable groups.

We encourage continued efforts in strengthening the regulatory and supervisory frameworks. Given Bahrain's role as a financial center for the Gulf Cooperation Council region, the stability of its financial system is of critical importance. We welcome the implementation of the 2017 FSAP recommendations, notably the placement of the deposit insurance scheme funds with the Central Bank of Bahrain (CBB). Developing a comprehensive

macroprudential framework can further enhance risk control. We share staff's view that a clearly defined emergency liquidity assistance framework needs to be developed. Unwinding the CBB's credit to the government should also be continued, and we look forward to the addition of financial stability as a legal mandate for the CBB. Meanwhile, we welcome the authorities' promotion of financial innovation, in particular Fintech, and their continued efforts in addressing the gaps following the assessment of the country's AML/CFT framework.

We support efforts to promote broad-based growth and economic diversification. We encourage the authorities to improve the education system and continue their efforts with labor market reforms, including greater emphasis on vocational training, increased female labor participation, and higher SME growth. We welcome the plan to privatize the logistics sector and ease the cost of doing business by improving e-governance and the judicial system. We agree that a better business environment is instrumental for inclusive and sustainable growth.

With these remarks, we wish the authorities every success in their policy endeavors.

Mr. Trabinski and Mr. Danenov submitted the following statement:

We thank staff for an insightful report and Mr. Geadah and Ms. Merhi for their informative buff statement. Lower oil prices have further weakened the fiscal and external positions, and growth has slowed markedly. The Fiscal Balance Program (FBP) launched late 2018 and the accompanying regional financial support led to a decline in borrowing costs and will reduce the fiscal deficit. We share staff's appraisal on the need for further adjustment to rebuild reserves, as well as for forceful structural reforms, including to increase fiscal transparency and develop a medium-term debt management strategy. We note the differences between staff and the authorities on the economic outlook and the necessity for further consolidation.

We welcome the recent improvements in the fiscal position, but more efforts are needed to ensure fiscal and external sustainability. We commend the authorities for the set of initiatives envisaged within the FBP focused on achieving a balanced budget by 2022. The reduction in governmental operational expenditures, the introduction of the VAT and the Voluntary Retirement Scheme for civil servants, as well as the increase of utility prices and improved procurement practices should all contribute to putting debt on a downward path. However, as the staff report makes clear, further adjustment

measures are needed. We also encourage the authorities to further improve fiscal transparency in order to enhance the credibility of Bahrain's fiscal policy, and to strengthen public financial management. In that regard, it would be important to align the general government data reporting with best practice, and public dissemination of the key elements of the FBP would be a critical step. Could staff provide more information on whether the authorities requested or are planning to request further technical assistance from the Fund on structural fiscal issues?

We welcome the progress in implementing the 2017 FSAP recommendations and take note of the overall stability of the financial sector. While the regulation and the supervision of the banking sector have been enhanced, there are some vulnerabilities related to the sector's exposure to government, real estate and construction sectors, which calls for attention. While we take note of the overall low profitability of the financial sector, we would appreciate some further elaboration by staff. Moreover, we encourage the authorities to implement pending FSAP recommendations. It will also be important to address the existing gaps in the AML/CFT framework. The ongoing comprehensive efforts to promote fintech solutions, as well as the cross-border regulatory collaboration, are commendable.

Structural reforms to promote private sector-led growth are key in ensuring more inclusive growth. We encourage the authorities to make progress in their privatization agenda, improve the business environment and labor market, and continue to support the development of SMEs. These reforms would contribute to the further diversification of the economy that is needed to reduce its dependence on oil markets and to increase long-term potential growth.

We encourage the authorities to consent with the publication of the Article IV report.

Mr. Raghani and Mr. Sidi Bouna submitted the following statement:

We thank staff for the informative report and Mr. Geadah and Ms. Merhi for their insightful buff statement.

Fiscal and debt challenges, coupled with a weakened external position, continue to weigh on Bahrain's economic prospects, and we encourage the authorities to steadfastly tackle these issues through adequate fiscal policy and reforms. Economic activity slowed down in 2018 due mainly to a contraction in the oil sector and low performance in some tertiary sectors. Public debt

remains high while rising interest payments on external debt as well as increased remittances outflows continue to put pressure on Bahrain's external position. We welcome the authorities' policy response to Bahrain's recent economic slowdown. Their medium-term Fiscal Consolidation Program (FBP) along with regional financial support have helped reassure markets about their determination to address high debt levels and the decline in foreign exchange reserves. Nevertheless, growth is projected to be moderate over the medium-term and public debt is expected to remain high. Therefore, we encourage the authorities to consider additional fiscal reforms to alleviate the pressure on the external position and help build reserve buffers. This will also help contain capital outflows while supporting the pegged exchange rate.

More specifically, regarding the FBP, we welcome the authorities' full commitment to this plan and encourage them to consider contingent measures. The introduction of the VAT should contribute to broadening the tax base and enhancing fiscal revenues. We share the view that additional fiscal consolidation measures may be needed to reduce the non-oil primary deficit more rapidly and accelerate the decline in public debt. Staff has made valuable recommendations in this regard, including the proposal to introduce a 15-percent corporate income tax. Could staff elaborate on the potential difficulties to impose such a corporate income tax? We also encourage the authorities to consider fiscal consolidation measures on the expenditure side, including initiatives to contain the wage bill, such as the Voluntary Retirement Scheme (VRS). Another stated aim of the VRS is to incentivize labor movement of nationals from civil sector to the private sector. We echo the importance of linking to the VRS, job retraining, job placement, and even job apprentice programs that are strongly aligned with the private sector hiring firms and supported with effective communication.

We welcome the overall assessment that Bahrain's financial system remains stable and resilient, thanks in part to high capital adequacy ratios, and stress the importance of addressing the credit concentration risk, AML/CFT weaknesses and crypto-related challenges. The authorities have made noteworthy progress in strengthening regulation and supervision and are currently developing a macroprudential framework. We encourage them to tackle remaining vulnerabilities in the financial system, in particular banks' relatively high exposure to a limited number of sectors, notably real estate, government and construction. To this effect, the central bank's gradual removal of credit to the government is a step in the right direction. We urge the authorities to finalize the work underway to address the gaps in the AML/CFT framework. Furthermore, we commend the authorities' recent developments in fintech which is positively reflected by the increased number

of participants in the sandbox, hence fostering an environment of increasing innovation in this space. We also take note of the authorities' adoption of blockchain technology as means to reduce the cost of the national vehicle registration system and to utilize the process as a learning experience. Can staff provide further details on this program, and what are the early takeaways? Have the authorities reflected on the risks associated with these fintech developments and on how to mitigate them?

Regarding structural reforms, we welcome the encouraging efforts to diversify the economy and promote the development of the private sector while highlighting the need for additional transformative measures. The authorities' decision to privatize the logistics sector is a step in the right direction, as are the planned reforms in healthcare. We commend them for the adoption of their national SME development strategy which could play a major role in bolstering the private sector. However, further progress is needed to ease the cost of doing business. In addition, it will be important to reform the education system with a view to meeting the needs of the domestic labor market and increase employment of Bahraini nationals in the private sector. Finally, we share the call for a public-private partnership (PPP) law which would help create a fair risk-sharing environment.

With these remarks, we wish the Bahraini authorities success in their endeavors.

Mr. de Villeroché, Mr. Castets and Mr. Rozan submitted the following statement:

We would like to thank staff for their report, as well as Mr. Geadah and Ms. Merhi for their insightful buff statement. We support its main conclusions and wish to offer the following comments.

The regional support, as well as the government's Fiscal Balance Program, have been useful to alleviate financing constraints, given the very sizeable fiscal deficits. While debt is elevated and steady fiscal consolidation is warranted, we commend the authorities for the measures already taken, for instance on the voluntary retirement scheme, the reduction of operational expenditures and the increase in non-oil revenues notably through a new VAT. We note that under staff assumptions, public debt would continue to increase over the medium term, along with financing needs. We therefore encourage the authorities to further improve the non-oil primary balance, through new revenue generation and expenditure measures. We wonder whether staff's objective of reducing this balance by 20,2 percent of non-oil GDP over six years can realistically be implemented. In this regard we would

welcome staff comments on the reform priorities, keeping in mind the need to protect the most vulnerable. Going forward, we encourage the authorities to enhance public financial management, through public disclosures, inclusion of extra budgetary funds into the regular fiscal framework, and capacity building within the MOFNE. We would welcome staff comments on current and tentative technical assistance activities in the country.

We share staff assessment that the peg to the US dollar serves Bahrain well and provides a credible monetary anchor. We note that reserves are relatively low; the ongoing fiscal adjustment should help reduce downward pressure and boost investor confidence. In addition, we encourage the authorities to gradually reduce Central Bank credit to the government. Regarding the outward remittances, which have increased in 2018, we would welcome staff comments as to trends for 2019, and underlying assumptions.

We note the progress made to support the financial regulatory and supervisory frameworks, and encourage authorities to complement the framework with macroprudential capabilities as well emergency liquidity assistance tools. Authorities should address the gaps identified in the recent AML/CFT assessment. Finally, we note that the real estate sector represents a point of vulnerability for the economy – we would welcome staff comments on the level of vulnerability this generates for the financial sector.

We encourage the authorities to renew their effort to diversify the sources of growth, as well as to make growth more inclusive. We share staff's conclusions regarding the needed education and labor market reforms, to better address firms' needs and induce greater participation. Reducing dependency to the oil sector will require private sector development as well as a competitive SME environment. Recent efforts, on the logistics sector, as well as on the SME strategy, go in the right direction. We would welcome staff comments regarding reform priorities to develop a vibrant SME environment. We would also welcome staff comments on current efforts to support greater female labor force participation, and whether there is scope for greater ambition in this regard.

The Acting Chair (Mr. Zhang) made the following statement:

Last year, the Article IV consultation for Bahrain ended up with Directors calling for a comprehensive package of reforms to put public finances in order. Since then, the authorities have announced their Fiscal Balance Program (FBP), an ambitious effort aiming to reduce the deficit. This is the step that many Directors' gray statements welcomed. This is a step that

is jointly supported by regional partners, including Kuwait, Saudi Arabia, and the United Arab Emirates (UAE). I believe this is a very positive step forward.

But as Directors suggested in their gray statements, further efforts are needed to secure fiscal and external sustainability. In particular, structural reforms would also be necessary to promote private sector-led growth and increase the diversification of the economy.

Mr. Geadah made the following statement:

I would like to express the appreciation of the Bahraini authorities, as well as my own, for Mr. Joshi and his team for their excellent work and collaboration, constructive engagement, and valuable policy advice. I also thank Directors for their gray statements and their views, which will be conveyed to my authorities.

The staff has done a very good job in responding to the questions raised in the gray statements. I would like to add a few comments.

On the fiscal reforms and financial support, the authorities are aware of the substantial challenges that they are facing. They have taken significant measures in the Fiscal Balance Program to eliminate the budget deficit by 2022. This has been supported by Kuwait, Saudi Arabia, and the UAE; and this support is conditional on the implementation of this program, which will be monitored by the Arab Monetary Fund, which will be issuing progress reports every six months.

On the Voluntary Retirement Scheme and whether there is a risk of disruptions in service delivery, especially in the health and education sectors, which will have the bulk of retirements. The staff's response is clear and comprehensive. The authorities do not expect the vacated positions to be filled. They can use outsourcing or train the remaining employees so as to avoid the risk of disruption, if needed. All ministries have been requested to develop, by the end of this year, a restructuring plan for the ministries so as not to refill positions. As an example of the extent of restructuring the health sectors, the authorities have a program to transform the role of the Ministry of Health from an operator to a regulator.

We received from the central bank some updates on the implementation of the Financial Sector Assessment Program (FSAP) recommendations, which they appreciated, and on the Anti-Money Laundering and Combating the Financing of Terrorism (AML/CFT)

framework, which we shared with the staff. These relate to the macroprudential policy framework, where the draft has been prepared, and internal consultations have started on the legislative and institutional structure, as well as on a procedure to deal with systemic risks.

An amendment of the central bank law, which will give it explicit mandate for financial stability, has also been prepared and is now being reviewed by the relevant bodies before it is issued.

Finally, on the AML/CFT, the authorities are now focusing on implementing the key recommendations in preparation for their discussion in the Middle East and North Africa Financial Action Task Force (MENAFATF) plenary in November 2019.

Mr. Rawah made the following statement:

We thank the staff for its work and Mr. Geadah and Ms. Merhi for their buff statement and for the introductory remarks. We issued a detailed gray statement; therefore, I will be brief and focus my remarks on a few issues for emphasis.

We commend the authorities for their consolidation efforts under the FBP. We are confident that the FBP will help in mitigating fiscal risks and placing public debt on a sustainable path. In this regard, we are encouraged by the authorities' firm commitment to maintain fiscal prudence.

We also take positive note of the progress made in enhancing the resilience and the innovation of the financial sector. We are also encouraged by the progress made in the implementation of the national small- and medium-sized enterprise (SME) development strategy, including the issuance of crowdfunding regulations, and the allocation of 20 percent of government procurement to SMEs. Indeed, faster SME development is a key priority for Bahrain, as well as for our region.

Given the structure of Bahrain's economy, we agree that the exchange rate peg has served the economy well and should be preserved. Going forward, the focus should be on implementing credible fiscal adjustments, coupled with growth-enhancing reforms to help steadily improve the external balance, boost investor confidence, and rebuild reserves.

Finally, we would like to emphasize that the financial support by Saudi Arabia, Kuwait, and the UAE aims to ensure fiscal sustainability and

strengthen Bahrain's international reserves, while helping in accelerate structural reforms.

The staff representative from the Middle East and Central Asia Department (Mr. Joshi), in response to questions and comments from Executive Directors, made the following statement:[9]

The staff has provided written responses to the questions raised by Directors in their gray statements. I will update the Board on developments since the staff report was issued and focus on a few key themes.

First, regarding some differences between the authorities and the staff on data issues, some Directors noted the divergence in terms of our growth forecasts, which we also noted in the staff report. Since the issuance of the staff report, the statistical agency has released its official estimate for GDP in 2018. I am pleased to note that it is almost identical to the estimate we have in the staff report. Furthermore, since the mission, the authorities have also submitted a budget for 2019 and 2020. While discussions on that are still ongoing and the budget has not yet been made public or enacted, the submitted version has macroeconomic assumptions and an outcome that are very similar to what we have in the staff report.

In addition to the nominal GDP for 2019 and 2020, the central government deficits for the covered years are also very similar to the staff's baseline. We believe that this represents, as we have discussed with the authorities and as policies have been identified, a shared understanding of yields of various measures.

Turning to the issue of regional support, where Directors have a few questions, the support is in concessional terms, with a long repayment period. By the time of the Article IV mission, the Bahraini authorities had signed formal agreements with two of the three regional partners, Saudi Arabia, and the UAE. The authorities had made available to us disbursement schedules for both of them. Since then, in early April, the authorities have also signed the remaining agreement with Kuwait. We hope to get that agreed disbursement schedule soon.

As we understand it, while the support is based on the FBP being on track, there are no specific quantitative targets governing each disbursement.

[9] Prior to the Board meeting, SEC circulated the staff's additional responses by email. For information, these are included in an annex to these minutes.

One can think of this as, in Fund terminology, review-based conditionality, with funds being released after a semiannual review of progress by the Arab Monetary Fund.

We remain engaged, not only with the Bahraini authorities but also with those that have provided financial assistance. We have underscored to the authorities the need for fiscal transparency, not the least before Bahrain has to approach the market later this year to meet its residual financing needs. We have been assured that further details on the support would be publicly released over time.

Finally, as most Directors have observed, fiscal policy has remained at the heart of our discussion. This is why we underscored fiscal consolidation as a necessary step to ensure that the fixed exchange rate regime in Bahrain continues to remain appropriate. Their FBP is a sizable step in ensuring sustainability, but more needs to be done.

In terms of the technical feasibility of measures, as noted in our answers, an additional adjustment seems feasible. Politically and socially, however, it may face some headwinds, not the least in parliament. So in our discussions this year, we drew on the analytical work done for the last year's Article IV consultation and tried to identical steps that would go in the right direction in terms of adjustment while ensuring equity and protecting the most vulnerable. Getting public support for reform would require a good communications strategy, of which the FBP is a notable first step. We continue to be available to the authorities at their request, including via technical assistance, to help them design such programs.

I thank the authorities for their constructive engagement and hospitality, as well as Mr. Beblawi, Mr. Geadah, and Ms. Mehri, for their support.

Mr. Meyer asked the staff to update the Board on the authorities' decision to publish the staff report in the interest of transparency.

The staff representative from the Middle East and Central Asia Department (Mr. Joshi) responded that the staff had not received any additional information on consent to publication.

Mr. Geadah, in a brief concluding statement, remarked that he was waiting for the authorities to make their plans clear with regard to publication.

The Acting Chair (Mr. Zhang) noted that the Kingdom of Bahrain is an Article VIII member, and no decision was proposed.

The following summing up was issued:

Executive Directors agreed with the thrust of the staff appraisal. They commended the authorities for their recent efforts to address Bahrain's fiscal and external vulnerabilities and acknowledged the medium-term budget support received from regional partners to assist in this adjustment. Nevertheless, macroeconomic challenges persist and risks, including from potential tightening in global financial conditions and delays in fiscal adjustment, remain tilted to the downside. Directors called for additional fiscal and structural reform efforts to strengthen the fiscal and external positions and to promote inclusive and sustainable growth, while preserving financial stability.

Directors welcomed the authorities' Fiscal Balance Program that aims to reduce the fiscal deficit by increasing non-oil revenue and improving spending efficiency. They commended the introduction of the value-added tax (VAT) and welcomed the Voluntary Retirement Scheme as a tool to help contain the wage bill, but noted the need to monitor possible contingent liabilities. To further ensure fiscal and external sustainability, Directors saw merit in additional fiscal consolidation measures, including introducing direct taxes, reducing VAT exemptions, and phasing out untargeted subsidies, while protecting the vulnerable. They welcomed the ongoing efforts to strengthen debt management and institutionalize the fiscal framework and encouraged the authorities to promote greater data transparency to enhance the credibility of their fiscal reform plans.

Directors agreed that the exchange rate peg has served Bahrain well and has delivered low and stable inflation. They emphasized that gradually unwinding central bank lending to the government and continued fiscal adjustment will be instrumental in supporting the peg. Directors underscored the need to rebuild international reserves amid external sector pressure.

Directors welcomed continued progress in implementing the 2017 FSAP recommendations. They commended recent measures to enhance the supervision and regulation of banks, ongoing efforts to develop a macroprudential framework, and Bahrain's leadership in promoting fintech. Directors encouraged the authorities to monitor banks' profitability and exposure to the real estate sector and highlighted the need for a clearly-defined emergency liquidity assistance framework. They also

emphasized the need to address the remaining gaps in the AML/CFT framework.

Directors encouraged further structural reforms to support diversification and private sector-led inclusive growth. They welcomed the announced plans to increase female labor participation, ease the cost of doing business, and enhance SMEs' contribution to the economy. Directors also called for a more active privatization plan and overarching public-private partnership legislation to further encourage private investment. They emphasized that targeted education and labor market reforms will be important to promote opportunities and improve productivity.

It is expected that the next Article IV consultation with the Kingdom of Bahrain will be held on the standard 12-month cycle.

APPROVAL: April 15, 2020

JIANHAI LIN
Secretary

Annex

The staff circulated the following written answers, in response to technical and factual questions from Executive Directors, prior to the Executive Board meeting:

Outlook and Risks

1. Having overestimated non-oil growth in 2018, can staff explain how they are factoring this into their forecasts for 2019?

- Non-oil growth in 2018 turned out to be lower than the forecast in the 2018 Article IV Staff Report mainly due to unexpected declines in retail and hospitality sectors, given weaker growth in discretionary income in the region. We expect a gradual recovery over the medium term, as discretionary income grows. While estimating non-oil growth for 2019, we have also taken into account the impact of planned fiscal consolidation, while cognizant of continued support from GCC-funded projects.

2. *Could staff elaborate on the impact of slower growth on unemployment?*

- We expect much of the adverse impact of slower economic growth on unemployment to be absorbed by expatriate workers, as employment of nationals continues to be encouraged via, *inter alia*, the newly introduced National Employment Program. The adverse impact on employment of nationals will thus likely be limited.

Fiscal Policy

3. *Could staff comment if there are any plans to integrate off-budget spending into the budget?*

4. Could staff elaborate on the scale of the extra budgetary support and the underlying impediments to its integration in the budget?

- The authorities currently do not report extra-budgetary expenditure; the Ministry of Finance and National Economy (MOFNE) focuses only on the central government budget approved by parliament. Calculated as the difference between financing and central government balance above the line for the purposes of staff analysis, off-budget expenditure, which could include statistical discrepancy, has averaged around 5 percent of GDP. The authorities have expressed interest in revisiting the budgetary process before the next budget cycle, to improve the budget preparation process, coverage, and transparency.

5. Annex V in the report on the FBP and Adjustment Needs and the DSA were very helpful in explaining some of the differences, but we would still appreciate greater elaboration from staff.

To expand on the discussion in Annex V, differences between the FBP and staff projection comprise:

(i) *Growth*. The FBP estimated non-oil growth in 2018 at 4.4 percent. Recently official data release puts it at 2.5 percent, in line with staff forecast in the Staff Report. Furthermore, despite the sizeable fiscal consolidation, the FBP assumes a minimal impact on growth.

(ii) *Financing needs*. The authorities' financing needs cover only the on-budget fiscal outcome. Staff estimates, however, encompass financing of estimated off-budget spending and statistical discrepancy, resulting in higher borrowing needs and public debt levels compared to the FBP.

(iii) *Interest costs*. Compared to staff's baseline, the FBP assumed significantly lower interest payments. The authorities' draft budget currently being discussed in parliament, however, comes much closer to matching staff's estimates of interest payments in 2019 and 2020.

(iv) *Wages and salaries*. The FBP assumed retirement of around 10,000 civil servants under the VRS. The actual number has been lower. That, in addition to further clarity on the profile of retirees, has allowed staff to refine its estimate, to around 80 percent of FBP-targeted savings.

- While capital spending may look different, this was mostly due to staff's practice of including in it spending via the GCC Development Fund. The impact of this difference on the overall budget is neutral, as staff also record the Fund receipts on the revenue side as grants.

6. We wonder whether staff's objective of reducing the non-oil primary balance by 20.2 percent of non-oil GDP over six years can realistically be implemented. In this regard we would welcome staff comments on the reform priorities, keeping in mind the need to protect the most vulnerable.

- As noted in staff's responses to technical questions on the 2018 Article IV Staff Report, a large consolidation is not unusual in GCC countries; such adjustments have historically been implemented in response to fiscal pressures stemming from declines in oil prices. The non-oil primary balance declined, between 2014 and 2018, by 26 percentage points of non-oil GDP in Kuwait, 21 percentage points in Oman, and 22 percentage points in Qatar, and 24 percentage points in Saudi Arabia. Given the fiscal challenges, fiscal adjustment of a large magnitude continues to be needed to put public finances on a more sustainable footing. The receipt of regional support permits

space to take measures to contain costs of public borrowing and to reassure markets, while enacting measures to protect the most vulnerable. Annex XI of SM/18/165 explored various ways in which fiscal consolidation measures could be made more equitable.

7. Could staff elaborate on the potential difficulties to impose such a corporate income tax?

- The authorities are concerned about the impact of a corporate income tax (CIT) on Bahrain's business environment. Given recent fuel and electricity subsidy reforms, introduction of the VAT, and the imposition of various business fees, they argue that a CIT would increase the cost of doing business in Bahrain, thus adversely affecting competitiveness and FDI inflows. For now, they would prefer to focus on increasing collection from the VAT. However, since the CIT has been implemented in some form in most other GCC countries, staff consider such experience to be helpful in the design of a CIT regime in Bahrain, to close the fiscal gap while limiting risks to competitiveness. As noted last year, institutional underpinnings now in place for the VAT could be used to develop a CIT framework. The mandate of the newly established National Bureau of Revenue (NBR) could be expanded to collect such taxes. In fact, the unit dealing with enterprise taxation issues within the MOFNE has been transferred, along with the VAT unit, to the NBR. As done in the case of the VAT, a CIT could initially be targeted to a few big corporations (such as those listed at the Bahrain Bourse).

8. Could staff provide more information on whether the authorities requested or are planning to request further technical assistance from the Fund on structural fiscal issues?

9. We would welcome staff comments on current and tentative technical assistance activities in the country.

- The information annex (SM/19/63, Supplement 1) contains details on technical assistance provided to Bahrain in recent years. At end-2018, Fund staff provided technical assistance to the MOFNE on developing a medium-term debt management strategy. More recently, support has been provided to the statistical agency to rebase the consumer price index, with likely follow-up missions in the future (including to develop a producer price index). While there are no outstanding requests, discussions are ongoing to help the authorities as needed on the implementation of the GFSM 2014 framework. Fund staff have also been in communication with senior MOFNE officials on budget institutions assessments and best practices on fiscal transparency.

10. We would be interested in more details on how the upfront costs of the VRS will be financed.

- Since staff's discussion during the Article IV mission, the authorities have confirmed that the Unemployment Insurance Fund (noted in ¶18 of SM/19/63) would cover the upfront costs of the VRS. This Fund currently has assets of around BD 800 million (5½ percent of GDP). The parliament has recently approved a one-time withdrawal of BD 230 million to cover the costs.

Monetary Policy

11. Given the evolving monetary policy stance in the US, could staff elaborate more on the implications on Bahrain's monetary policy?

- To support the fixed exchange rate regime, Bahrain's monetary policy will have to continue to reflect changes in monetary policy in the U.S. Following the March FOMC meeting, staff expect the more gradual outlook for monetary policy normalization in the U.S. to provide a more accommodative monetary environment for the planned fiscal consolidation in Bahrain.

External Sector

12. Regarding outward remittances, which have increased in 2018, we would welcome staff comments as to trends for 2019, and underlying assumptions.

- The large increase in remittances in 2018 was described by the authorities as being in response to heightened perceived risks in the economy earlier in the year (when spreads were rising, before the regional support package was announced). Given the decline in perceived risks since then, staff share the authorities' view of the 2018 increase being temporary, with remittances returning to trend in 2019 and beyond.

Financial Sector

13. Could staff comment on the size and characteristics of the Islamic banking sector in Bahrain?

- The Islamic banking sector in Bahrain has become increasingly important: its assets as a share of total banking sector assets has increased from 6 percent in 2005 to 15 percent by end-2018, equivalent to 74 percent of GDP. Islamic retail banks have tended to have lower capital adequacy ratios and higher NPL ratios than conventional retails banks, in part due to their larger exposures to real estate and construction sectors. Following the 2017 FSAP, the CBB has significantly enhanced its regulation

and supervision of Islamic banks, employing a more comprehensive and investigative approach to the supervision of Islamic banks, and increasing prudential requirements to account for excessive risk concentration. This has resulted in a decline in exposure to the real estate and construction sectors.

14. While we take note of the overall low profitability of the financial sector, we would appreciate some further elaboration by staff.

- Profitability of the banking sector has been low: the return on assets has been at around one percent, slightly below that in the U.S. as well as the GCC average (both of which were at 1.3 percent in 2018). The low profitability reflects weak loan growth: annual growth in business loans averaged 3 percent since 2011, much lower than that for the US (at almost 10 percent annual growth). A continued slowdown in the economy could lead to consolidation in the banking sector, which would help improve profitability.

15. We would welcome staff comments on the level of vulnerability the real estate sector generates for the financial sector.

- Real estate and construction sectors account for around 30 percent of the exposure of the retail banking sector. Despite this sizable exposure, banks generally have large capital buffers to absorb losses. Staff expect the CBB's push for risk-based regulation and supervision to continue to limit and reduce banks' exposures to the real estate sector. The Real Estate Regulatory Authority, which was established last year, has been compiling data on the sector, which should allow better macroprudential monitoring of debt using credit, price, and affordability indicators.

16. Notably, Bahrain's lead in fintech and its related regulations and collaborations, is admirable, including the introduction of regulations related to Crypto-assets services. Could staff offer some implementation experiences of these regulations?

17. We also take note of the authorities' adoption of blockchain technology as means to reduce the cost of the national vehicle registration system and to utilize the process as a learning experience. Can staff provide further details on this program, and what are the early takeaways? Have the authorities reflected on the risks associated with these fintech developments and on how to mitigate them?

- Fintech in Bahrain is still at an early stage and the authorities are taking a careful approach, introducing necessary rules and regulations in a timely manner. The CBB has relied on its experience with its regulatory sandbox, established in 2017, to develop its rules and regulations. Some of the participants in the sandbox have specialized in crypto-asset services, which helped shape the rules on such services

that were introduced in February 2019, making Bahrain one of the first countries to introduce such rules. A project to utilize blockchain technologies in the national vehicle registration system was announced in May 2018, with the government offering a tender for implementation in April 2019. The authorities expect the project to reduce the cost and improve efficiency of services. However, given such recent reforms, it may be a bit premature to make a definitive assessment in either case.

Structural Reforms

18. In reference to the respective 2018 Article IV recommendation on female labor force participation, could staff comment more on the progress made?

19. We would also welcome staff comments on current efforts to support greater female labor force participation, and whether there is scope for greater ambition in this regard.

- Staff have continued their dialogue with Bahrain's Supreme Council of Women (SCW) on measures to support female labor force participation. Progress since the 2018 Article IV consultation, as highlighted by the SCW, comprises: (i) a significant increase in the number of women doing business; (ii) increased focus by the CBB on female access to financial services, including in its Financial Stability Report; and (iii) establishment of an Equal Opportunity Committee in the banking sector. Specialized training is also being provided to women retiring under the VRS to equip them with skills required to become entrepreneurs. Continuation of these initiatives would help further empower women and facilitate higher female labor force participation. However, challenges remain, including on: auditing and monitoring progress, building a national gender-balance database, and encouraging a more active participation of the private sector in these initiatives.

20. We would welcome staff comments regarding reform priorities to develop a vibrant SME environment.

- The priority areas that the government has identified (noted in Box 4 of the Staff Report) are in line with reforms required to create an enabling environment for SME development. They include: improving access to finance, facilitating access to markets, developing skills, and streamlining the business environment. Staff note the importance of estimating and balancing the cost and contingent liabilities of SME support initiatives against targeted benefits, to ensure these are in line with fiscal consolidation plans.

21. Further on the VRS, could staff elaborate on how to address the risks of disruptions in service delivery, especially in the health and education sectors where a bulk of retirements is expected?

- In the short term, the government may have to adopt some flexible employment arrangements: secondment of education and health staff from agencies and areas with excess capacity to those experiencing shortages, approval of overtime where possible, and outsourcing service delivery to private-sector service providers in healthcare. However, it may not be feasible to address service-delivery concerns in a budget-neutral manner, a concern noted in the Staff Report. Over the medium and longer term, the restructuring plans that ministries have been requested to develop by end 2019 need to take into account the strategic objectives and Key Performance Indicators that they are targeting and identifying modalities to reach them. Again, this could involve outsourcing (through partnerships with the private sector) and capacity development for remaining public sector employees.