

# COUNTRY REVIEW

## Brunei



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**EULER HERMES COUNTRY RISK GRADE: BB**

Country Risk Grades are on a scale of AA, A, BB, B, C, D  
where AA is the lowest and D the highest risk.

## Strengths

- Low risk of political instability or social unrest despite the absence of democratic mechanisms.
- Oil and gas production will remain a calculable income basis and, together with considerable investment income from abroad, serve to maintain Brunei's status as a high income country at least over the medium term.
- Huge current account surpluses.
- Exchange rate peg of the Brunei dollar to the Singapore dollar ensures low inflation.
- Public and external debt are nil, net creditor position.

## Weaknesses

- High dependence on the oil and gas sector, thus vulnerability to global prices.
- Very high level of government intervention in the economy.
- Modest long-term contraction of real GDP per capita.
- Large budgetary shortfalls since 1992 (though covered by transfers from the Brunei Investment Agency).

## KEY RISKS

- **Collapse in oil prices for a sustained period**

## Country Risk Assessment

Ratings	Brunei		Median Grade BB	Bahrain	Peers	
	Latest	Previous			Kuwait	Qatar
<b>Systemic Political Risk:</b>	<b>P2+</b>	<b>P2+</b>	<b>P2+</b>	<b>P2-</b>	<b>P2-</b>	<b>P2-</b>
<b>Systemic Economic Risk:</b>	<b>E3</b>	<b>E3</b>	<b>E3</b>	<b>E3</b>	<b>E3</b>	<b>E3</b>
ME rating:	ME3	ME3	ME3	ME3	ME3	ME3
<i>Structure</i>	5.0	5.0	3.3	5.7	5.0	5.7
<i>Policy</i>	4.6	3.6	4.2	3.8	5.6	4.2
<i>Solvency</i>	1.0	1.0	1.9	1.3	1.0	1.9
<i>External Liquidity</i>	2.8	2.8	3.3	2.3	1.7	2.3
SBE rating:	SBE3	SBE3	SBE2	SBE2	SBE2	SBE2
<b>COUNTRY GRADE:</b>	<b>BB</b>	<b>BB</b>		<b>BB</b>	<b>BB</b>	<b>BB</b>

**Nomenclature:**

Political Risk Ratings are on a scale of P1 (lowest risk), P2+, P2-, P3+, P3-, P4 (highest risk).

Economic Risk Ratings are on a scale of E1 (lowest risk), E2, E3, E4, E5, E6 (highest risk).

ME (Macro-Economic) ratings are on a scale of ME1 (lowest risk), ME2, ME3, ME4, ME5, ME6 (highest risk).

The constituent parts of the ME rating are on a scale of 1.0 (best) to 6.0 (worst).

SBE (Structural Business Environment) ratings are on a scale of SBE1 (best), SBE2, SBE3, SBE4, SBE5, SBE6 (worst).

Country Grades are on a scale of AA, A, BB, B, C, D where AA is the lowest and D the highest country risk.

Source: Euler Hermes Country Risk Unit

## ECONOMIC STRUCTURE

<b>Country Profile</b>	
Capital city:	Bandar Seri Begawan
Population:	392000 mn (2008)
GDP:	USD 14553 mn (2008)
Currency:	Bruneian dollar (BND)
Form of state:	Constitutional Sultanate
Head of government:	Sultan and Prime Minister Sir HASSANAL Bolkiah
Next elections:	none

<b>Major Industries (% of GDP at market prices, 2007)</b>	<b>Global Assumptions</b>	2009	2010
Oil and gas sector	Real GDP grth (% yr/yr) *	-3.9	0.9
Oil and gas mining	Inflation (% , av) *	-0.1	1.3
Manufacture of LNG	Dated Brent (USD/b)	61	72
Non-oil and gas sector	* Major economies		
Private sector			

<b>Main Exports (% of total, 2007)</b>		<b>Main Imports (% of total, 2007)</b>	
Crude oil	66.0%	Machinery & transport equipment	38.5%
Natural gas	30.2%	Manufactured goods	24.9%
Garments	1.5%	Food & live animals	13.7%
Machinery & transport equipment	1.4%	Miscellaneous manufactured articles	8.8%
Manufactured goods	0.3%	Chemicals	8.2%
<b>Lead Export Markets (% of total exports, 2008)</b>		<b>Lead Import Markets (% of total imports, 2008)</b>	
Japan	44.1%	Singapore	34.4%
Indonesia	22.7%	Malaysia	19.4%
Australia	12.0%	Japan	7.7%
South Korea	10.3%	China	6.2%

## Basic indicators

<b>Selected economic indicators</b>	2006	2007	2008	2009f	2010f
Nominal GDP (USD mn)	11,470	12,284	14,553	14,336	15,235
Population	377,000	385,000	392,000	400,076	408,146
GDP per capita (USD)	30,424	31,906	37,125	35,833	37,326
Real GDP growth (% yr/yr)	4.4	0.6	-1.7	-0.5	1.4
Inflation (% , eop)	0.5	0.3	2.7	1.2	1.2
Fiscal balance (% of GDP)	18.9	21.1	29.1	16.0	18.0
Current account balance (% of GDP)	56.3	50.7	50.6	36.1	37.0
Foreign exchange reserves (USD mn)	460	625	708	600	650
Import cover (months)	2.0	2.3	2.2	2.1	2.1
Exchange rate assumption, BND:USD (av)	1.59	1.51	1.42	1.45	1.40
f: CRU central forecast					

Sources: National sources, IMF, ADB, World Bank, Euler Hermes Country Risk Unit

## Political Stability

The Sultanate of Brunei has been ruled by emergency decree since 1962. In 1984, it attained independence from Britain, and Sultan Hassanal Bolkiah—in power since 1967—assumed absolute power. The Sultan is assisted and advised by several councils, the most important of which are the Religious Council and the Council of Cabinet Ministers. The Sultan espouses a national ideology, Melayu Islam Beraja (Malay Islamic Monarchy, or MIB), a fusion of Islamic values and Brunei Malay culture, which seeks to justify absolute monarchy. The MIB focuses exclusively on the ethnic-Malay and Muslim majority—accounting for about 70% of the population—though there is no room for Islamists. Minorities—ethnic-Chinese, indigenous groups, Christians, guest workers from India and the Philippines—play a negligible role in politics, although many, particularly the Chinese, are important to the economy. There have been no elections since 1962. The Brunei Legislative Council (Legco), an appointed legislature, was suspended for 20 years before it was briefly reconvened in September 2004 to amend the constitution to allow the introduction of a 45-member legislature, 15 of which would be elected by popular vote. The convening of a new 30-member Legco, with five indirectly elected members representing village councils, in September 2005—which has met occasionally since—was thought to be an initial step towards partial democratisation, but no timetable for an election has been announced yet. We expect political liberalisation to be only gradual and limited.

The September 2004 constitutional amendments also put the Sultan's powers on a firmer legal footing. Further, a cabinet reshuffle in May 2005 included the appointment of Crown Prince Billah Bolkiah, the Sultan's son, as senior minister, ranked immediately after the Sultan. Although there is some potential for social discontent owing to rising unemployment, perceived bureaucratic shortcomings and economic mismanagement, the risks of social unrest or popular pressure for greater democracy appear very limited as substantial fiscal revenues from oil and gas production have generated a large public sector that provides generous, tax-free remuneration and an extensive welfare system.

In 1984, Brunei established an exclusive fishing zone around part of the southern Spratly Islands, the possible site of oil reserves, but makes no public territorial claim to the offshore reefs, which are officially claimed also by China, Taiwan, Vietnam, Malaysia and the Philippines. Brunei's relations with China have been improving for several years and both countries appear open to the idea of jointly exploiting the disputed area in the South China Sea. In March 2009, the leaders of Brunei and Malaysia signed an accord and set up joint committees to resolve their land and maritime border disputes which include claims on offshore oil and gas fields near Borneo. A settlement could be reached in 2010 and would allow both countries to resume hydrocarbon exploration in the disputed areas. Otherwise Brunei's international relations are generally good. The country is a member of ASEAN, APEC, WTO and the IMF. In recent years the country appears to seek closer regional economic ties. Also very important is Brunei's membership in the Organisation of the Islamic Conference (OIC). In all, Brunei continues to offer a stable political environment and effective government processes.

## Economic Stability

The economy is heavily dependent on oil and natural gas, which accounted for 67% of GDP in 2007 (up from 53% in 2002) and more than 90% of government revenues and export earnings. High earnings from oil and gas have created a favourable fiscal position, a steady increase in the country's net foreign assets, an extensive welfare system, good infrastructure, and a large well-paying public sector. Most economic activities are directly or indirectly financed by the government. According to the IMF, Brunei is in a comfortable net creditor position which has helped to reduce the vulnerability to exogenous shocks and thus to maintain economic stability. Proven oil and gas reserves are substantial. In 2002, Brunei granted new licences to develop new deep sea oil and gas fields. If these fields match assumed productivity, they will ensure the current level of oil and gas production for another generation. Latest estimates put GDP per capita in Brunei at about USD37,000 in 2008—comparable to advanced economies.

Economic data for Brunei has improved, though it is still not comprehensive and not always up-to-date. The economy has benefited from continued high export prices for oil and gas until mid-2008 and again since mid-2009, in particular the external and fiscal positions have been very strong while economic growth has remained modest and, noteworthy, well below the rates achieved by other ASEAN countries, let alone the comparable oil-producing Gulf States. Following average annual growth of 0.9% in 2004-2007, real GDP contracted by an estimated 1.7% in 2008 and 0.5% in 2009, owing to declining hydrocarbon output, the fall in oil prices and lower world energy demand since mid-2008. Based on a stabilisation of global oil prices around current levels (USD70-80/barrel), a modest recovery to about 1-2% annual growth is forecast in 2010-2011. Merchandise exports have continued

to exceed imports by more than three times in 2008-2009—with both developing in line with the overall business cycle. And returns from investments held abroad, though falling somewhat in the wake of the global asset crunch, have remained substantial. The resulting large surpluses on the trade and the income accounts have continued to outweigh small deficits on the services and transfers accounts such that overall large annual current account surpluses have been maintained—estimated at 50% of GDP in 2008 and 36% in 2009. We forecast continued surpluses of around 35% in 2010-2011, providing a substantial cushion against external shocks.

The considerable investment revenues of the Sultanate are managed by the Brunei Investment Agency (BIA) and since 1992, transfers from the BIA have been used to offset large budgetary shortfalls, creating in most years an ex-post fiscal surplus. In 1998, the bankruptcy of Amedeo, a construction and real estate combine run by Prince Jefri, a younger brother of the Sultan, battered government finances and hit the image of the Sultanate, which was hit again in 2000 when the Prince was accused of misappropriating USD16bn from the BIA. Despite this, the government is debt-free and the BIA appears well funded. But Jefri's profligacy has depleted Brunei's foreign exchange reserves from estimated USD30bn in 1997 to currently about USD600mn, just slightly more than two months of import cover. There is no central bank in Brunei and monetary policy is determined by the Ministry of Finance. The Brunei dollar is pegged to the Singapore dollar at par, which together with price controls and subsidies on food and petrol has ensured low and stable inflation.

In all, while some structural issues are affecting sustainable, high economic growth, income from oil and gas and large proven reserves of both will continue to provide macroeconomic stability and low external liquidity risk in the medium term.

## Structural Business Environment

Data on the Structural Business Environment has also improved, indicating that it is generally adequate, i.e. ranking slightly above average in our assessment model. Political and macroeconomic stability together with a liberal trade environment provide quite favourable conditions for exporters to Brunei. Conditions for foreign direct investment (FDI) have been eased some years ago. New enterprises that meet certain criteria can be exempted from income tax for up to five years. FDI and foreign equity ownership is now welcomed and virtually unrestricted in most sectors, although the government encourages local participation in both shared capital and management and also continues to control 50% of the majority of companies in the oil and gas sector. Regulations have become more transparent and bureaucracy has been reduced. There are no foreign exchange controls and foreign investors may repatriate profits and capital. Nonetheless, foreign investment remains limited by other factors such as the small size of the domestic market, high labour costs and shortage of skilled labour. Moreover, the bankruptcy of Amedeo in 1998 (see above) is a reminder that doing business in Brunei is not without risk.

The Brunei government regulates the country's banking sector which consists of two local banks and six branches of foreign banks. The latter have provided for reasonable stability of the sector. Private sector credit growth has been well below the regional and global average for many years, indicating continued low financial intermediation but also limited exposure to external financing—a positive when the global financial crisis intensified in autumn 2008. Moreover, the government implemented a guarantee on local- and foreign-currency deposits in October 2008 to ensure calm in the banking sector in the wake of that crisis. The guarantee will remain in place until end-2010.

Brunei faces a range of structural problems that could inhibit sustainable growth in the long term. These problems include the high and currently increasing dependence on oil and gas exports. The Bruneian authorities formed the Brunei Darussalam Economic Council in 1998 to examine these problems. The Council's 2000 final report was hard-headed, but little has actually changed since. In 2000, the authorities announced to undertake efforts to turn Brunei into an International Financial Service Centre, but so far progress has been limited. Other non-realised plans include the privatisation of a range of public services, the construction of a 500-megawatt power plant for an aluminium smelting plant, and the establishment of a giant container hub at the Muara Port facilities.

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**Charts**

