



## Summary

After having gone through a mild recession in 2008 and 2009, the wealthy hydrocarbon-based economy of Brunei has embarked on a gradual economic recovery in recent years. Driven by rising exports of oil and natural gas, as well as improving economic conditions in the non-hydrocarbon sectors, economic growth likely reached about 2.5% to 3% last year. Amid ongoing tensions in the Middle East and increased demand for natural gas by Japan in the aftermath of that country's nuclear disaster, Brunei's short-term growth prospects are bright. Its stable political climate and the country's proximity to major Asian economies bode well in this respect. While progress on democratic reforms of Brunei's absolute monarchy have not gained traction, the country's generous welfare state continues to provide the local population with a very high standard of living and guarantees social stability going forward. As hydrocarbon deposits are expected to last for another 30 years, Brunei's government finances and its current account will continue to post sizeable surpluses and reduce the incentive for increased economic diversification.

## Things to watch:

- Volatility in global oil and natural gas prices
- Progress on economic diversification
- Gradual democratization

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Brunei Darussalam			
<b>National facts</b>		<b>Social and governance indicators</b> rank / total	
Type of government	Constitutional Sultanate	Human Development Index (rank)	33 / 187
Capital	Bandar Seri Begawan	Ease of doing business (rank)	83 / 183
Surface area (thousand sq km)	6	Economic freedom index (rank)	n.a.
Population (millions)	0.4	Corruption perceptions index (rank)	44 / 182
Main languages	Malay (official)	Press freedom index (rank)	125 / 179
	English	Gini index (income distribution)	n.a.
Main religions	Muslim (official) (67%)	Population below \$1 per day (PPP)	n.a.
	Buddhist (13%)		
	Christian (10%)		
Head of State (sultan)	Sir Hassanal Bolkiah	<b>Foreign trade</b> 2010	
Head of Government (prime-minister)	Sir Hassanal Bolkiah	<i>Main export partners (%)</i>	<i>Main import partners (%)</i>
Monetary unit	Brunei dollar (BND)	Japan 41	Singapore 19
		South Korea 16	EU 11
		China 11	Japan 10
		Australia 10	US 10
<b>Economy</b> 2010		<b>Main export products (%)</b>	
<i>Economic size</i> bn USD % world total		<i>Main import products (%)</i>	
Nominal GDP	17 0.03	Mineral fuels	96
Nominal GDP at PPP	21 0.03	Machinery and transport equipment	2
Export value of goods and services	12 0.01	Miscellaneous manufactured goods	1
IMF quatum (in mln SDR)	215 0.09		
<i>Economic structure</i> 2010 5-year av.		<i>Main import products (%)</i>	
Real GDP growth	2.6 0.0	Machinery and transport equipment	40
Agriculture (% of GDP)	1 n.a.	Manufactured goods	22
Industry (% of GDP)	53 n.a.	Food and live animals	12
Services (% of GDP)	46 n.a.		
<i>Standards of living</i> USD % world av.		<i>Openness of the economy</i>	
Nominal GDP per head	40703 411	Export value of G&S (% of GDP)	58
Nominal GDP per head at PPP	51372 434	Import value of G&S (% of GDP)	19
Real GDP per head	28952 362	Net FDI (% of GDP)	2.6

Source: EIU, CIA World Factbook, UN, Heritage Foundation, Transparency International, Reporters Without Borders, World Bank.

**Due to insufficient (reliable) data availability, the figures presented in this evaluation should be interpreted with caution.**

### Economic structure and growth

Brunei is a small, very prosperous sultanate on the northern coast of the island of Borneo. Its sole neighbor is Malaysia, with which Brunei shares a common cultural and historic background. Once an important sea power in the region, Brunei became a British protectorate in 1888, and only gained independence again in 1984. The country is richly endowed with crude oil and natural gas deposits, which have been the main source of the country's wealth since their discovery in 1929. Today, with a nominal GDP per capita of about USD 40,000 (USD 50,000 at PPP), Brunei ranks among the richest countries in Asia. Ample revenues from the exploitation of the vast crude oil and natural gas deposits enable the government to provide a generous welfare state and employ a considerable part of the local population. Reflecting the importance of the hydrocarbon industry for the local economy, more than 50% of national income is generated by the industrial sector, while agriculture and services only account for about 1% and 45%, respectively. The hydrocarbon sector also dominates Brunei's foreign trade, as oil, natural gas and methanol account for 96% (2010) of all exports, which are primarily destined for Japan, South Korea, China and Australia. Imports are dominated by machinery, transport equipment, manufactured goods and food, as Brunei lacks noteworthy agricultural and non-hydrocarbon industrial sectors, as progress on government initiatives to diversify the local economy is slow. Yet, given proven reserves that are expected to

last for up to 30 years and recurrent discoveries of new oil and gas fields, the lacking diversification should not lead to problems in the medium-term. Still, going forward, increasing economic diversification is advisable, as Brunei should not solely rely on the investment returns from its sizeable sovereign wealth fund once its oil and gas deposits are depleted.

Even though the availability of economic data has improved, the 2011 economic growth figures were not published at the time of writing of this report. Based on the released data on the first three quarters of last year, Brunei's economy likely expanded by 2.5% to 3% in 2011, following 2.5% real economic growth in the previous year. During the first half of 2011, economic growth has been mainly driven by the non-hydrocarbon sector, while growth in the hydrocarbon sector strengthened markedly in the third quarter on the back of strongly rising oil, natural gas and methanol exports. While the strong performance of the non-hydrocarbon sector indicates some success in broadening Brunei's economic base, it should be noted that the sector remains dependent on government financial support, which is derived from the hydrocarbon sector. In 2012, we expect economic growth to strengthen gradually, as the sultanate should benefit from demand shifts on the back of the oil embargo on Iran and associated elevated oil prices over the course of the year. In the medium-term, the politically stable Brunei could strengthen its position as a reliable oil and gas supplier for Asia, as it benefits from its proximity to these markets and the fact that its hydrocarbon deliveries do not have to pass the problematic Malacca Strait. Still, given the timeliness of its current natural riches, the government should not become complacent and forcefully pursue its current diversification path to ensure the long-term sustainability of the economy.

Brunei's financial sector comprises eight commercial banks, six foreign and two domestic, as well as various other financial institutions, like investment banks, trust funds and wealth management companies. The banking sector mainly focuses on the provision of personal loans, which accounted for about 65% of total lending in 2010. Partly due to stricter regulation of the banking sector, the value of outstanding loans fell from USD 4.3bn in September 2010 to USD 3.9bn in September 2011, while deposit accumulation continued. Meanwhile, asset quality in 2011 improved somewhat, as the banking sectors' non-performing loan ratio improved from 10.5% in the first quarter of 2010 to a still elevated 8.5% at the end of the same year, roughly equal to the level of 2008. Yet, as banks remain strongly capitalized with a sector-wide Tier 1-ratio of 20% as of September 2011, the relatively weak asset quality can be handled by local banks.

### **Political and social situation**

Brunei is one of the last absolute monarchies on the globe and its political system is structured according to the Melayu Islam Beraja (Malay Islamic Monarchy). This national philosophy, which was adopted on the day of Brunei's independence in 1984, defines Brunei as an absolute monarchy that esteems and practices Islamic laws and values and embraces Malay culture and traditions. Consequently, practically all political power lies with the Sultan, Hassanal Bolkiah, who currently simultaneously serves as the country's prime minister, finance minister, and defense minister. Other government posts are held by members of the Bolkiah royal family. The current Sultan, aged 65, has been in office since 1967, following the voluntary abdication of his father. He has appointed his first-born son Al-Muhtadee Billah as his Crown Prince, which should ensure political stability and policy continuity going forward.

In line with the nation's philosophy of Melayu Islam Beraja, the sultanate's policies are characterized by a moderate form of Islam, which brings with it the partial application of Shari'a

law, though British common law generally dominates. While the application of Shari'a law might increase following the Sultan's call upon the Islamic Religious Council to bring criminal law into line with Shari'a law, twin civil and religious legal systems will remain in place, provided existing law does not contradict Islam. The adherence to the Melayu Islam Beraja philosophy resonates well with the local population and provides public support for the absolute monarchy. Despite intentions to gradually introduce democratic structures, Brunei's Legislative Council merely fulfills a representative function. Plans for the addition of 15 elected representatives to the current 30 government-appointed council members have not been implemented yet. Still, some minor progress has been made recently, as the first two female representatives have been admitted following the explicit wish of the council. Notwithstanding, progress on democratization remains very slow and all political power remains with the royal family. So far, unlike in various Arab nations, there has not been any popular movement pushing for political liberalization. This has been mainly due to the generous welfare state, which provides subsidized food and housing, free education up to the university level, as well as ample employment possibilities in the public sector. Consequently, the risk of major public disenchantment with the royal family's extravagant lifestyle or the unequal distribution of wealth is minimal and we do not expect a major deterioration in the coming years.

Brunei's external relations are quite stable. Brunei is a dedicated member of the ASEAN group and recent border disputes with neighboring Malaysia, another ASEAN-member, have been resolved peacefully by the signing of an agreement for the joint exploitation of the natural resources in the disputed areas. Remaining border disputes with China over some islands in the South Chinese Sea still need to be addressed, but increasing economic ties between the two countries bode well for a solution that reflects both countries' interests. Bilateral relations with Vietnam have also strengthened early this year, following the granting of a royal pardon to Vietnamese fishermen that had been detained on the grounds of illegal fishing in Bruneian waters

### **Economic policy**

Given Brunei's dependence on the hydrocarbon sector, economic policy efforts have been directed at the broadening of the country's economic base and more private sector employment opportunities. Besides promoting the development of a domestic IT sector and Islamic Banking, the recent opening of the Brunei Agro Technology Park is intended to reduce the sultanate's dependence on imported food and thereby also reduce the incidental pass-through of food price inflation. Still, given the relatively early stage of these projects and the gradual progress being made, Brunei's heavy dependence on the hydrocarbon sector will likely remain over the medium term. Still, as recent exploration activities revealed new oil and gas deposits, lacking economic diversification should not pose any major economic problems.

Brunei's public finances are very strong, as the government shares in the revenues of the hydrocarbon sector. According to the most recent publicly available information, Brunei's primary surplus declined to 4% of GDP in 2009 from 30% in the previous year on the back of declining oil and gas revenues during the global economic downturn. As primary surpluses have been between 10% and 30% of GDP since 2004, we expect that the 2010 and 2011 primary surpluses recovered strongly amid the global economic recovery. Owing to recurrent primary surpluses, Brunei does not have any government debt and government savings have been accumulating in the country's sovereign wealth fund, which had a net asset value of about USD 40bn (about 320% of GDP) in late 2011.

Brunei's currency, the Brunei dollar, is pegged to the Singapore dollar at parity, which has helped in containing inflation and, in combination with the sovereign wealth fund, limit the risk of Dutch disease effects for the non-oil sector. Since 2011, the Monetary Authority of Brunei Darussalam (AMBD) is in charge of managing the exchange rate peg and financial supervision. Its creation followed calls for improvements in financial sector supervision and does not indicate a deviation from the current exchange rate regime. Due to the beneficial effect of the fixed exchange rate, Brunei managed to keep headline inflation at a low 2% during the period January-November 2011, while food price inflation reached a still moderate level of 2.5%.

### **Balance of Payments**

Owing to substantial oil and gas exports and, to a minor extend, due to investment returns from the sovereign wealth fund, Brunei's current account generally posts very large surpluses, averaging about 50% of GDP during the period 2004 -2009. Even when oil and natural gas prices plummeted during the 2009 global economic downturn, the current account surplus still reached a level of 40% of GDP, reflecting the resilience of Brunei's balance of payments. As local hydrocarbon deposits will likely last throughout the coming 30 years, similar surpluses can be expected in the future. While no recent current account data is available, we expect that Brunei's current account surplus surged in 2010 and 2011 on the back of the global economic recovery and rising oil and gas prices. Also, Japan's need for alternative energy sources in the aftermath of the Fukushima Daiichi nuclear disaster should boost Brunei's exports in the short- to medium-term. While Brunei does not have any external financing needs, its hydrocarbon sector continues to attract sizeable FDI inflows.

### **External position**

Thanks to its beneficial balance of payments situation, Brunei's external position is very strong. As the country does not have any external financing needs, its total foreign debt is limited to a small 10% of GDP in 2010 and is entirely owed by the private sector. Despite the large current account surpluses, Brunei's foreign exchange reserves only cover about 2.4 months of imports, as financial troubles of a member of the royal family in the late 1990's and early 2000's led to a marked decline of Brunei's once strong reserves position. Still, given ample foreign asset holdings in Brunei's sovereign wealth fund, of which the net asset value covers total 2009 goods imports 20-fold, the low level of foreign exchange reserves is not worrisome.

Brunei Darussalam							
Selection of economic indicators	2004	2005	2006	2007	2008	2009	2010
<i>Key country risk indicators</i>							
GDP (% real change pa)	0.5	0.4	4.4	0.2	-1.9	-1.8	2.5
Consumer prices (% change pa)	-0.9	-1.1	-0.2	0.3	2.1	1.1	0.0
Current account balance (% of GDP)	47.7	52.8	56.4	51.1	54.3	40.2	n.a.
Gross foreign exchange reserves (mln USD)	489	492	514	667	751	1357	1563
<i>Economic growth</i>							
GDP (% real change pa)	0.5	0.4	4.4	0.2	-1.9	-1.8	2.6
Energy sector	-1.0	-2.6	4.3	-6.9	-6.2	-4.6	2.2
Non-energy sector	2.5	4.1	4.5	8.5	2.4	0.9	3.0
Gross fixed investment (% real change pa)	2.8	0.5	1.4	26.5	13.2	-0.3	-3.5
Private consumption (real % change pa)	12.3	-0.6	3.7	2.0	1.8	4.7	2.1
Government consumption (% real change pa)	4.1	-1.1	12.8	15.8	-0.8	5.3	3.5
Exports of G&S (% real change pa)	-0.7	-1.3	3.7	-9.6	-6.2	-5.3	-7.8
Imports of G&S (% real change pa)	-3.1	10.2	4.1	13.2	11.0	-0.8	-0.3
<i>Economic policy</i>							
Overall primary balance (% of GDP)	10	28	22	15	30	4	n.a.
Nonenergy overall primary balance (% of GDP)	-26	-23	-21	-23	-19	-28	n.a.
Consumer prices (% change pa)	-0.9	-1.1	-0.2	0.3	2.1	1.1	0.0
Exchange rate LCU to USD (average)	1.7	1.7	1.6	1.5	1.4	1.5	1.4
<i>Balance of payments (mln USD)</i>							
Current account balance	3827	5032	6472	6254	7835	4320	n.a.
Trade balance	3721	4836	6039	5700	7840	4890	n.a.
Export value of goods	5057	6249	7627	7692	10698	7170	n.a.
Exports of oil and gas	4624	5886	7346	7396	10321	6890	n.a.
Import value of goods	1336	1413	1588	1992	2858	2280	n.a.
Services balance	-530	-494	-469	-503	-535	-520	n.a.
Income balance	944	1067	1308	1488	950	390	n.a.
Transfer balance	-309	-376	-405	-430	-420	-450	n.a.
Net direct investment flows	155	175	105	258	222	330	n.a.
Net portfolio investment flows	-45	22	-90	358	88	140	n.a.
Change in international reserves	14	3	22	153	84	606	206
<i>External position (mln USD)</i>							
Total foreign debt	463	582	645	846	915	1040	1390
Short-term debt	142	180	201	267	291	360	470
Gross foreign exchange reserves	489	492	514	667	751	1357	1563
<i>Key ratios for balance of payments, external solvency and external liquidity</i>							
Trade balance (% of GDP)	28.0	30.5	33.1	30.9	38.4	31.3	n.a.
Current account balance (% of GDP)	47.7	52.8	56.4	51.1	54.3	40.2	n.a.
Net FDI (% of GDP)	1.2	1.1	0.6	1.4	1.1	2.1	2.6
Foreign debt (% of GDP)	6	6	6	7	6	10	10
Foreign debt (% of XGSIT)	7	7	7	8	7	12	n.a.
FX-reserves import cover (months)	2.3	2.1	1.9	1.9	2.4	2.4	n.a.

Source: IHS Global Insight, IMF, Brunei Department of Economic Planning and Development (JPKE). (Data for 2011 is not yet available)

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