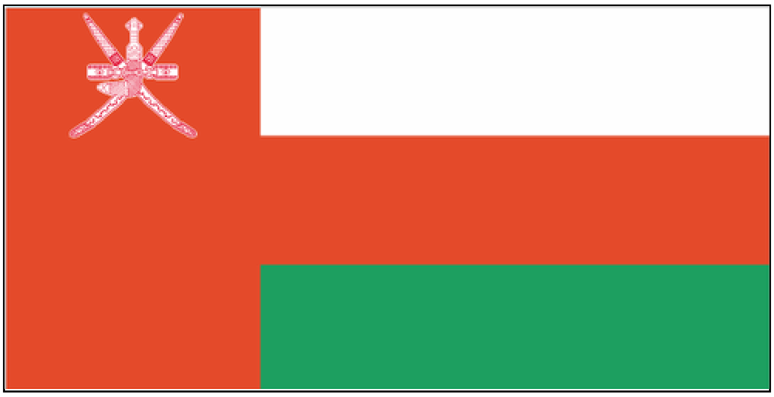
Rabobank

Country update **OMAN**



Summary

Oman is a middle-income economy that is heavily dependent on its dwindling oil resources. Because of declining oil reserves and a rapidly growing labour force, the government is actively pursuing a development plan that focuses on diversification, industrialization, and privatization. However, last year investment spending was crowded out by social and defense spending, in response to the social unrest. Due to continuous large revenues from the country's oil and gas exports, Oman's external position remains in very healthy shape. Economic growth is forecast at around 4.9% in 2012, buoyed by domestic demand and external demand for the country's oil and gas exports. A downside risk to this forecast is the uncertain global economic environment. Most notably the impact of the eurozone peripheral debt crisis and slowing growth in China, Oman's largest export partner. Also, the effect of the global economic uncertainty and the regional unrest on global oil prices are important factors for Oman's economy.

Author:	**Ashwin Matabadal** Country Risk Research Economic Research Department Rabobank Nederland
Contact details:	P.O.Box 17100, 3500 HG Utrecht, The Netherlands +31-(0)30-21- 61601 A.R.K.Matabadal@rn.rabobank.nl

Oman

National facts			Social and governance indicators	rank / total
Type of government	Monarchy		Human Development Index (rank)	89 / 187
Capital	Muscat		Ease of doing business (rank)	49 / 183
Surface area (thousand sq km)	212		Economic freedom index (rank)	47 / 179
Population (millions)	3.2		Corruption perceptions index (rank)	50 / 183
Main languages	Arabic		Press freedom index (rank)	117 / 178
	English		Gini index (income distribution)	n.a.
Main religions	Ibadhi Muslim (75%)		Population below $1.25 per day (PPP)	n.a.
	Other (25%)			

		Foreign trade			2011
		Main export partners (%)		*Main import partners (%)*	
Head of State (president)	Sultan Qaboos bin Said	China	30	UAE	26
Head of Government	Sultan Qaboos bin Said	South Korea	11	Japan	16
Monetary unit	Rial (OMR)	Japan	11	US	6

Economy		2011		
			UAE 11	India 5
Economic size	*bn USD*	*% world total*	*Main export products (%)*	
Nominal GDP	73	0.11	Crude oil	59
Nominal GDP at PPP	85	0.11	Non-oil exports	17
Export value of goods and services	49	0.22	Re-exports	12
IMF quotum (in mln SDR)	237	0.11	LNG (liquefied natural gas)	8
Economic structure	*2011*	*5-year av.*	*Main import products (%)*	
Real GDP growth	5.2	6.8	Machinery & transport equipment	42
Agriculture (% of GDP)	2	2	Manufactured goods	17
Industry (% of GDP)	51	50	Food & live animals	9
Services (% of GDP)	48	50	Beverages & tobacco	1
Standards of living	*USD*	*% world av.*	*Openness of the economy*	
Nominal GDP per head	22219	206	Export value of G&S (% of GDP)	67
Nominal GDP per head at PPP	25928	209	Import value of G&S (% of GDP)	41
Real GDP per head	13813	170	Inward FDI (% of GDP)	3.3

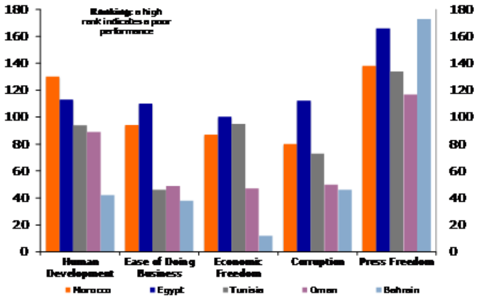
Source: EIU, CIA World Factbook, UN, Heritage Foundation, Transparency International, Reporters Without Borders, World Bank.

Introduction and update

Our economic growth forecast for 2012 remains unchanged at 4.9%. Domestic demand is expected to remain robust and external demand for the country's oil and gas exports will also contribute significantly to economic growth. A downside risk to this growth forecast is the uncertain global economic environment. Most notably the impact of the Eurozone peripheral debt crisis and slowing growth in China, Oman's largest export partner. Oman's external position remains in very healthy shape, due to continuous large revenues from its oil and gas exports, which are estimated to last for the next couple of decades at least. Economic diversification away from the hydrocarbon sector is necessary, but investment spending has been crowded out by social and defense spending, in response to the social unrest.

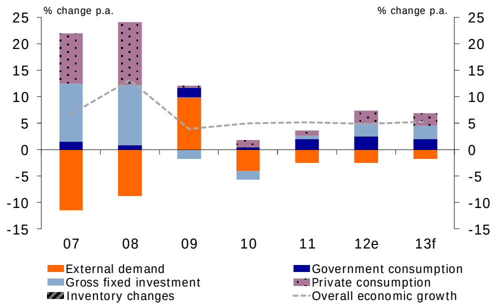
One year after the initial social unrest (Arab Spring) hit Oman, the country's political structure remains largely intact. Increased spending appears to have worked to appease Omanis in 2011, but keeping the population content with just these policies will be challenging, although fiscal strains are insignificant. In this update, we describe the social unrest and its implications and we analyze the fiscal challenges of the country in the longer term.

Figure1: Social & governance indicators



Source: See factsheet

Figure 2: Growth performance



Source: EIU

Political and social situation

A year after the Arab Spring protests hit Oman, the country's political structure remains largely intact. Increased spending appears to have successfully appeased Omanis in 2011, but keeping the population content with just these policies will be challenging, although fiscal strains are insignificant. In early 2011, the population took to the streets, protesting against the government and demanding socio-economic change. In response, Sultan Qaboos bin Said al Said announced and implemented a raft of reforms, which appear to have stabilized his rule. The most important measure was to grant legislative powers to the Majlis al-Shura (parliament) by amending the Basic law of State in October 2011. This means parliament not only has an advisory role, it can now also question ministers, propose laws and suggest changes to government regulations. In March 2012, the Supreme Judicial Council was reconstituted to make the judicial system independent from the executive branch. The cabinet was also reshuffled for the third time in one year, bringing in new faces to key ministries including information, justice, and commerce and industry. Even prior to the Arab Spring, the sultan solidified his position by intermittently adopting new and more liberal policies compared to his Gulf Country Council (GCC) counterparts. As a result, when demonstrations broke out last year, protesters' demands included greater accountability, increased efforts to combat corruption, and economic empowerment, but not a regime overhaul.

The government has also introduced pay rises to appease Omanis. In the immediate aftermath of the 2011 demonstrations, Sultan Qaboos ordered the creation of 50,000 government jobs, the introduction of social security payments, an increase of the minimum wage in the private sector, and a plan to reform the education sector so that the skills of Omani youth are more in line with the needs of the market. Later that year, the government also pledged to create an additional 36,000 jobs for Omanis, primarily in the public sector.

Despite the raft of reforms, the unrest has not disappeared. In July 2012, up to 200 young Omanis staged peaceful demonstrations in Sohar demanding jobs, an end to corruption and improved living conditions, as they did 18 months ago. The protests came after a recent resurgence of unrest, such as a strike by Omani workers in the oilfields in June. One of the most notable gains of the 2011 demonstrations was greatly improved freedom of expression, but the arrest in June of a number of bloggers and writers is threatening this. There is also skepticism about the enhanced powers awarded to the parliament last October, with many Omanis feeling that little has changed.

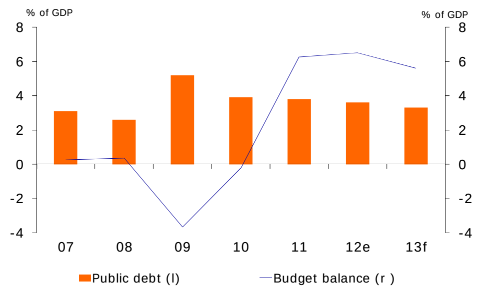
Going forward, we believe the Sultan can continue his rule relatively unthreatened. Especially since he still commands wide popular support, shored up by the loyalty of the security services and the strength of the country's traditional social structures. However, we do not expect protests to vanish either, as it will be difficult to fully address the population’s grievances, regarding the labor market in particular. The authorities are battling with the effects of forty years of reliance on cheap Asian (non-Omani) labor. Although this brought undoubted benefits for the country economically, it has created a major problem of unemployment (estimated at more than 24% by the IMF in 2011) and unrealistic expectations among the growing numbers of young Omanis, who are only interested in white-collar jobs. Meanwhile, businesses are understandably keen to hang on to expatriate employees as they are cheaper to employ and easier to fire.

Fiscal sustainability

Another challenge for the government is the costs of the reforms as government expenditure increases, mostly a problem for the longer term. This year, the budget surplus has grown nearly eightfold to USD 4.2b. The growth comes despite a 38% hike in public expenditure in the first six months of this year compared to the same period in 2011. For 2012, a budget deficit of USD 3.15bn was forecast by the government, but this was on the assumption of an average oil price of only USD 75 per barrel. The higher average oil price and subsequent budget surplus so far will be a relief to the government, who are perfectly aware that a healthy economy is an important defence against political instability. The oil export revenues have ensured deep pockets for the Omani government, and this makes current expenditures affordable. However, we are concerned about the impact of the current policies on the longer term. Investment spending, which is required to foster greater economic diversification, declined in the first five months of 2012. Furthermore, if increases in spending on defence and public sector salaries continue to crowd-out productive investments, this will be detrimental to the long-term health of the economy. In both areas spending has risen in response to countrywide demonstrations in early 2011, but the government allowed investment spending to decline. This is contrary to projections in the eighth five-year plan, which came into force at the beginning of 2011 and envisaged an increase of more than 110% in investment expenditure compared to the previous five-year plan.

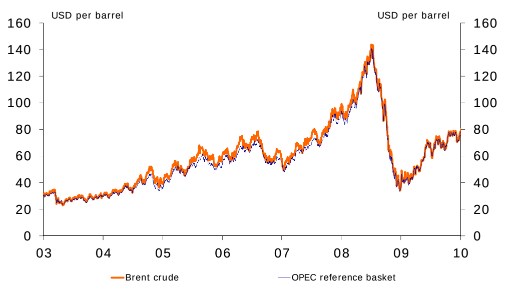
Getting the balance right will be the key challenge for the government to ensure both political and economic stability in the longer term. It is seeking to diversify the economy away from oil and gas and to promote non-oil exports. The five-year plan was designed with this in mind and included increasing allocations for infrastructure projects, including the development of the tourism sector and ports. The government also plans to keep investing in expansion of crude oil production through enhanced oil recovery techniques, but diversification of the economy will become increasingly important as the growth of oil production slows. It is also important to reduce Oman's reliance on high oil and gas prices and to help to improve job creation.

Figure 3: Public finances



Source: EIU

Figure 4: Oil prices



Source: Reuters EcoWin

Oman

Selection of economic indicators	2007	2008	2009	2010	2011	2012f	2013f
Key country risk indicators							
GDP (% real change pa)	6.7	13.1	3.9	5.0	5.2	4.9	5.3
Consumer prices (average % change pa)	6.0	12.5	3.5	3.2	4.1	4.0	3.8
Current account balance (% of GDP)	5.9	8.3	-1.2	8.6	14.7	13.7	9.2
Total foreign exchange reserves (m USD)	9523	11582	12203	13024	14365	15860	16510
Economic growth							
GDP (% real change pa)	6.7	13.1	3.9	5.0	5.2	4.9	5.3
Gross fixed investment (% real change pa)	36.9	29.8	-4.0	-4.1	2.0	7.0	7.0
Private consumption (real % change pa)	23.5	25.3	0.8	2.8	2.0	5.0	5.0
Government consumption (% real change pa)	5.8	3.5	7.5	1.8	8.0	10.0	7.6
Exports of G&S (% real change pa)	6.2	5.2	-8.6	3.5	5.0	6.3	7.0
Imports of G&S (% real change pa)	35.5	21.6	-24.6	13.3	10.0	10.6	9.0
Economic policy							
Budget balance (% of GDP)	0.3	0.4	-3.7	-0.2	6.3	6.5	5.6
Public debt (% of GDP)	3	3	5	4	4	4	3
M2 growth (% change pa)	35	23	5	11	12	10	11
Consumer prices (average % change pa)	6.0	12.5	3.5	3.2	4.1	4.0	3.8
Exchange rate LCU to USD (average)	0.4	0.4	0.4	0.4	0.4	0.4	0.4
Balance of payments (m USD)							
Current account balance	2463	5016	-603	5097	10672	10360	7300
Trade balance	10349	17012	11600	18727	25737	25170	23580
Export value of goods	24692	37719	27652	36601	47087	48440	49770
Import value of goods	14343	20707	16052	17874	21349	23270	26190
Services balance	-3412	-4055	-3868	-4764	-6425	-5620	-6150
Income balance	-804	-2760	-3019	-3162	-2823	-2880	-3190
Transfer balance	-3670	-5181	-5316	-5704	-5818	-6300	-6930
Net direct investment flows	3332	2952	1509	2333	2380	2470	2530
Net debt flows	1075	1675	-597	708	1037	750	990
Other capital flows (negative is flight)	-2360	-7585	312	-7316	-12748	-12080	-10170
Change in international reserves	4510	2058	621	822	1341	1500	650
External position (m USD)							
Total foreign debt	5965	7780	7172	7961	9033	9730	10650
Short-term debt	2835	4093	3173	3533	4220	4600	5180
Total debt service due, incl. short-term debt	2579	3376	4573	3636	4019	4830	5330
Total foreign exchange reserves	9523	11582	12203	13024	14365	15860	16510
Key ratios for balance of payments, external solvency and external liquidity							
Trade balance (% of GDP)	24.7	28.0	24.0	31.6	35.4	33.4	29.6
Current account balance (% of GDP)	5.9	8.3	-1.2	8.6	14.7	13.7	9.2
Inward FDI (% of GDP)	8.0	4.9	3.1	3.9	3.3	3.3	3.2
Foreign debt (% of GDP)	14	13	15	13	12	13	13
Foreign debt (% of XGSIT)	21	19	24	20	18	19	20
Debt service ratio (% of XGSIT)	9	8	15	9	8	9	10
Interest service ratio incl. arrears (% of XGSIT)	1	1	1	1	1	1	1
FX-reserves import cover (months)	5.9	5.2	6.8	6.4	5.8	6.1	5.6
FX-reserves debt service cover (%)	369	343	267	358	357	328	310
Liquidity ratio	149	149	134	151	164	161	149

Source: EIU

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