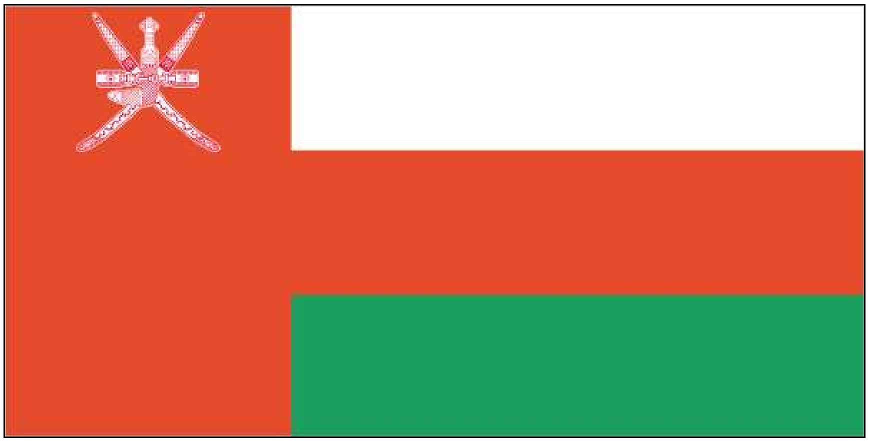
Country report **Oman**



Summary

Oman is an oil based economy, with structural policies aimed at diversification for several decades. So far these policies have attained very limited success: oil is replaced by natural gas and energy-intensive semi-processed raw materials. Tourism has been on the rise. Liberalization and privatization are the policy buzzwords, but state interference remains strong.
Politically, the sultanate escaped the violent scenes seen during the Arab Spring in fellow Gulf state Bahrain and in other Arab countries. Modest political reforms and social spending were promised and satisfied the protesters. External threats from Iran, al-Qaida or pirates have not increased.
The country’s and the sovereign’s solvency is comfortably assured by at least a decade of (often substantial) current account and fiscal budget surpluses, although the value of external assets are not provided. We consider official and hidden reserves to be sufficient to cover for unlikely current account deficits. They are also large enough to defend the fixed exchange rate to the USD.

Things to watch:

- Implementation of promised political democratization
- Succession of childless sultan Qaboos

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Oman

National facts		
Type of government	Monarchy	
Capital	Muscat	
Surface area (thousand sq km)	212	
Population (millions)	3.2	
Main languages	Arabic	
	English	
Main religions	Ibadhi Muslim (75%)	
	Other (25%)	
Head of State (president)	Sultan Qaboos bin Said	
Head of Government	Sultan Qaboos bin Said	
Monetary unit	Rial (OMR)	

Economy		2010
Economic size	*bn USD*	*% world total*
Nominal GDP	58	0.09
Nominal GDP at PPP	76	0.10
Export value of goods and services	37	0.20
IMF quotum (in mln SDR)	194	0.09
Economic structure	*2010*	*5-year av.*
Real GDP growth	4.5	6.0
Agriculture (% of GDP)	2	2
Industry (% of GDP)	51	51
Services (% of GDP)	48	50
Standards of living	*USD*	*% world av.*
Nominal GDP per head	17557	178
Nominal GDP per head at PPP	23072	196
Real GDP per head	12591	157

Social and governance indicators	rank / total
Human Development Index (rank)	n.a. / 169
Ease of doing business (rank)	57 / 183
Economic freedom index (rank)	34 / 179
Corruption perceptions index (rank)	41 / 178
Press freedom index (rank)	124 / 178
Gini index (income distribution)	n.a.
Population below $1.25 per day (PPP)	n.a.

Foreign trade			2010
Main export partners (%)		*Main import partners (%)*	
China	27	UAE	24
South Korea	12	Japan	15
Japan	12	US	6
UAE	11	India	6
Main export products (%)			
Crude oil			59
Non-oil exports			14
Re-exports			14
LNG (liquefied natural gas)			9
Main import products (%)			
Machinery & transport equipment			49
Manufactured goods			17
Food & live animals			10
Beverages & tobacco			1
Openness of the economy			
Export value of G&S (% of GDP)			64
Import value of G&S (% of GDP)			46
Inward FDI (% of GDP)			4.3

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

Economic structure and growth

Oman is a small high income economy that is heavily dependent on oil resources. It is a small member of the OPEC oil-cartel with a share of 0.4% of the world's proven oil stocks and 1% of world production. Aware of dwindling oil reserves (less than 19 years of 2009 oil production), the government actively pursued a development plan that focuses on industrialization, privatization and diversification away from oil, with the overall objective of reducing the oil sector's contribution to GDP to 9% by 2020, ambitious as the value of oil produced in 2010 amounted to USD 20bn or 30% of GDP. However, oil is gradually being replaced by natural gas, which was discovered in large quantities since the late 1980s. Diversification plans now are de facto limited to stimulate the export of liquefied natural gas (LNG) and gas-based industries, such as petrochemicals. However, by shifting oil for gas, the dependence on external demand for hydro-carbons in China and other Asian markets (two thirds of all exports) is unlikely to be reduced in the coming decade. Moreover, gas may run out soon as well. Reserves equal 0.4% of world resources and 40 years of Oman's 2009 production, but with high ambitions to increase production volumes (in 2009 at 1% of world total), this ratio could fall steeply. Agriculture is not a priority in terms of diversification efforts, it contributes only 2% to GDP in spite of its vital role played in employment. Among services, tourism is being promoted and is a successful key component of the diversification strategy.
Using technologically more advanced oil recovery techniques, oil production is still on the rise (3-5% p.a.), giving the economy more funds in the short run, but depletes the available oil resources

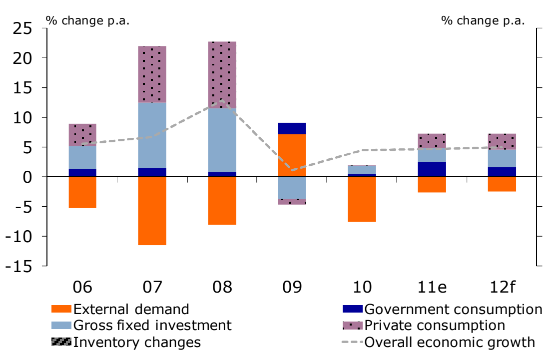
faster. The high global oil prices during 2010 (averaging USD 75 pb) and 2011 (around USD 110 during first half) more than compensate for increasing exploration and exploitation costs and thus provide additional external financial resources to invest in non-oil sectors.

Just 40 years ago, Oman was almost totally isolated from the global economy. But over the years, the sultanate encouraged foreign involvement, particularly in tourism, higher education, information technology and manufacturing to speed up economic growth. Late 2010, plans for expansion of tax-free trade and manufacturing zones and ports targeted foreign investors. The efforts to liberalize the business environment faces the desire to protect national interests via programs such as "Omanization" of ownership and the labor market. Thus, the business environment is far from ideal, but in line with that of other Gulf states: red tape, slow decision making and political interference in the legal system and corruption are facts of life, but at lower levels than in most Arab countries.

The open economy (goods and services exports amount to 55% of GDP; G&S imports to 40%) is highly dependent on demand from Asian countries. The membership of the more western-style World Trade Organization (WTO) plus a free-trade agreement (FTA) with the United States (since 2009), have both contributed to further improvements of the overall investment climate, more privatization and to more transparency in the legal system.

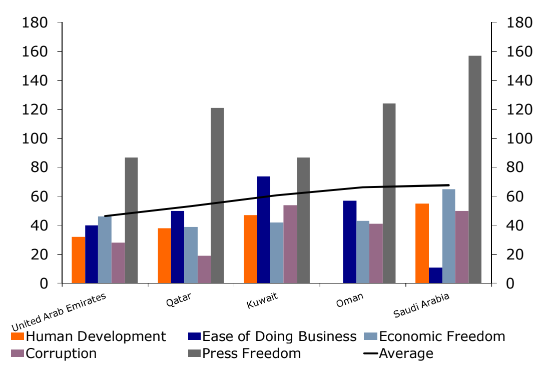
As chart 1 shows, overall growth prospects remain positive. There was a slight consumption and investment growth dip during the global financial crisis of 2009, but the Arab Spring of 2011 appears to have had no impact on economic activity. Growth in 2012 is projected to be at about 5%, driven by hydro-carbon output (oil + 4%; gas + 12%), steady growth in infrastructure construction, manufacturing and tourism.

Chart 1: Growth drivers



Source: EIU

Chart 2: Governance indicators



Source: EIU

Stringent monetary policies and emergency liquidity injections contained systemic contagion from the global financial crisis of 2008 and 2009. The sultanate's young banking sector is considered well capitalized and liquid, but banks continue to make provisions and thus will be reluctant to lend. Moreover, despite liberalization efforts, current private sector investment initiatives remain modest.

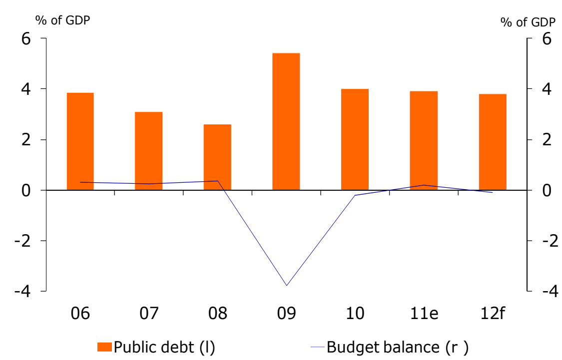
Political and social situation

The present sultan Qaboos bin Said came to power in 1970 through a bloodless coup against his father. He can be considered to be an enlightened despot as he seeks to transform the isolated country into a modern, forward-looking state and liberalizing the economy. Political modernization is lagging: political parties are not allowed, the parliament can discuss but not legislate and decision-making is still heavily influenced by tribal considerations. This has not evolved in line with the increasing level of education and political awareness of the Omani youths. Demands for changes were expressed on the streets in several cities during the Arab Spring of 2011, but met initially with police force. However, soon also key figures in the government were replaced and legislative powers for the consultative council were promised. In addition, plans for 50,000 new government jobs were announced and social allowances and minimum wages -for Omani only- were raised. This apparently satisfied the protesters as the social unrest and protests subsided. Political stability was reasonably assured, but that may be for the time being. The Sultan enjoys widespread popularity and legitimacy among the public and is not known for nepotism vis-à-vis his close family or tribe as is often the case in other Arab states. A major domestic political risk remains as the ageing ruler lacks an obvious successor. The ongoing Omanization program should in theory add to domestic political and social stability as it favors nationals over expatriates, but faces the structural problem that skills of Omani often do not match local job requirements. Externally, Oman faces limited threats from the current unrest in Yemen and al-Qaida's presence there, and from Iran's theocratic and nuclear ambitions. Also, there are Somali-led piracy gangs off the Omani coast. But, despite the government's openly pro-Western stance and tight co-operation with the United States, the support for radical forms of Islam in Oman has been limited and terrorist incidents are rare. Oman is a respected member within the Gulf Cooperation Council, and maintains friendly relations with all Islamic countries –including Iran- and has close strategic relationships with the United States, the UK and other EU countries. Relationships with Asian trading partners and sources of labor (India) are increasingly important.

Economic policy

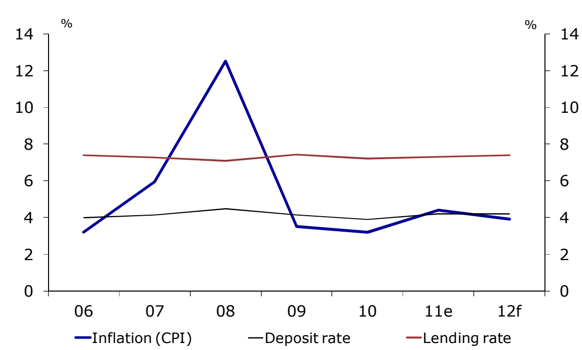
The current overall structural economic policy was already outlined in 1995 in the policy document Vision 2020. Policies will aim at diversification away from hydro-carbons, and the promotion of non-oil exports derived from new industrial projects. Tourism should play a key role in diversifying GDP and taxation and regulation efforts will entice the private sector (including foreign-based) in large-scale projects. Macroeconomic policies have over the past decades been conducive for these objectives, which however, still need to be reached.

Chart 3: Public finances



Source: EIU

Chart 4: Inflation and interest rates



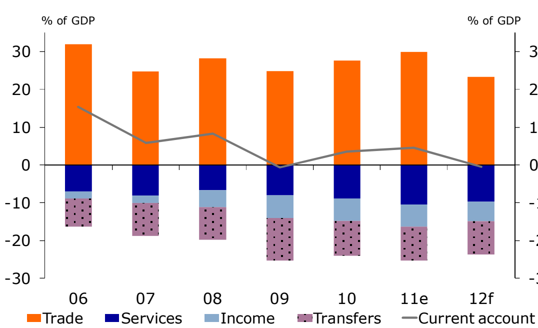
Source: EcoWin

As chart 3 shows, the fiscal position has been and remains very strong: low gross public debt (peaking at 5% of GDP in 2009) and minimal deficits (if at all) over the years. The economic concessions in the form of public sector wage increases and investment plans announced by the government after the unrest in March can still be absorbed as long as the oil price (Oman's main

source of public revenues) remains above USD 60 per barrel. The current price of USD 100+ pb and planned oil production increases provide the short term comfort. Only when oil and gas reserves deplete (in the next decade) and prices go down budget deficits may arise. The published 'almost zero-deficit budget' would show a large surplus if the substantial contributions to the State General Reserve Fund (SGRF) and other reserve accounts (10% of GDP in 2011) are excluded.
Also monetary policy has attained some degree of stability on the nascent domestic capital markets: lending rates were and are projected to be stable at just below 8%. But over the past decade inflation has increased from close to 0% in the 1990's to over 12% in 2008, as a result of a boom in domestic demand. With demand since 2009 much less buoyant and helped by price regulation, measured consumer price inflation has fallen to around 4%, but this is still high by Omani standards.
The core of Oman's monetary policy is the fixed exchange rate of Omani Rial OMR 0.385 to the USD, in place since 1986 and unlikely to change in 2011-12. The often reiterated policy makes sense given the dollar denominated oil revenues and is also credible given Oman's robust external accounts and foreign asset levels to defend the peg. Oman's decision not to join the planned GCC currency union also means that the current rate will not be adjusted or recalculated before entering this currency union.

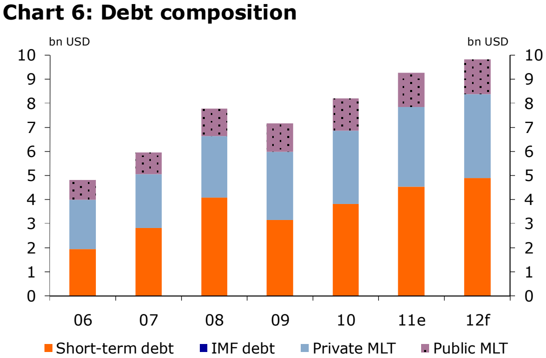
Balance of Payments
As chart 5 shows, the Omani economy registers structural trade surpluses of around 25% of GDP, mainly based on high oil prices and growing export volumes. Gas and energy intensive raw materials complement the oil exports. Exports include oil re-exports (14% of total) though the recently-built ports. On the import side capital goods dominate, but lacking domestic manufacturing and agriculture most consumer goods are also imported.
The three other main components of the current account all register similarly structural deficits. Growing tourism did not (yet) lead to a lower services deficit, the high estimated external assets (based on decades of current account surpluses) do apparently still not yield high registered income returns and the large non-Omani workforce continues to transfer sums to their home-countries. Overall, the current account is projected to show a respectable surplus of 4.5% of GDP in 2011, somewhat less than during the first five years of the past decade (10% of GDP).

Chart 5: Current account



Source: EIU

Chart 6: Debt composition



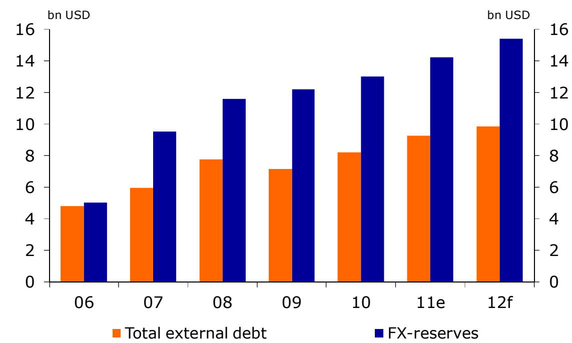
Source: EIU

Foreign direct investment continues to flow in on a net base at around 5% of GDP and gross external debt is on the rise (chart 6), but remains low at 25% of GDP. For other financing flows data is lacking or not reliable. But combining FDI inflows, debt increases and the positive current account over the years of , it can be concluded that only a small portion of these net inflows are reflected in the comfortably rising official reserve position (chart 7), by the end of 2010 equivalent to only 30% of GDP, but this excludes unpublished government-held foreign assets.

External position

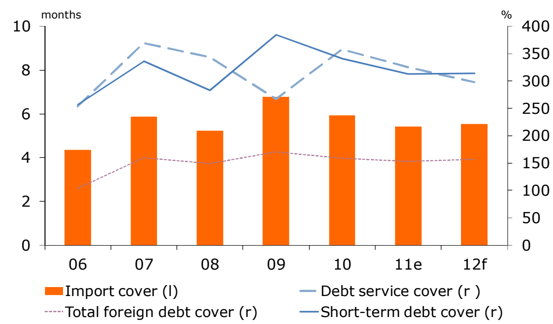
Total external debt reached USD 8bn by the end of 2010, and increased by some 15% p.a. from a low of USD 4bn in 2003. However, in terms of GDP and external trade the foreign debt burden continues to decrease to levels that are (end 2010) by all means acceptable: 14% of GDP and 22% of export revenues. Both these foreign debt ratios have halved since 2001. Effective average maturities on medium and long term debts are long (over 20 years) and interest paid amounts to around 4% of outstanding gross debt. As chart 6 shows half of total debt is short-term, mostly trade-related, with the Omani private sector slowly increasing its share in total foreign loans. Debt is also increasingly extended by private creditors.
With low debt ratios and favorable maturities and interest rates, debt service is also low at 10% of foreign revenues. When excluding short-term obligations, the servicing of existing medium and long-term debt takes only 1% to 2% of total external revenues. All this indicates a comfortable gross solvency position for the country as a whole, which should further strengthen if the unpublished foreign assets were known.

Chart 7: Foreign debt and assets



Source: EIU

Chart 8: External liquidity indicators



Source: EIU

Over the past decade, the accumulated current account surpluses amounted to USD 26bn. Only USD 10bn ended up in the foreign exchange reserves. As a very rough approximation and abstracting from exchange rates and no other value changes, the net additions to Omani's unpublished net foreign assets between 2000 and 2010 could be around USD 16bn. In most likelihood, Oman can be considered a respectable net creditor nation.
The liquid part of the unpublished total foreign assets are reflected in the FX reserves held by the central bank. These assets have grown rapidly from USD 2bn in 2000 to USD 12bn in 2010, more or less in line with higher imports and increased gross debt. The liquidity indicators (chart 8) show a remarkable stability over time, which is projected to continue.

Oman							
Nominal GDP in bn USD	36.8	41.9	60.6	46.9	57.8	61.0	63.8
Selection of economic indicators	2006	2007	2008	2009	2010	2011f	2012f
Key country risk indicators							
GDP (% real change pa)	5.5	6.7	12.8	1.1	4.5	4.7	5.0
Consumer prices (average % change pa)	3.2	6.0	12.5	3.5	3.2	4.4	3.9
Current account balance (% of GDP)	15.4	5.9	8.3	-0.6	3.5	4.5	-0.5
Total foreign exchange reserves (mln USD)	5014	9523	11582	12203	13024	14220	15420
Economic growth							
GDP (% real change pa)	5.5	6.7	12.8	1.1	4.5	4.7	5.0
Gross fixed investment (% real change pa)	14.0	36.9	28.0	-8.5	3.5	6.0	7.5
Private consumption (real % change pa)	9.7	23.5	23.9	-1.9	0.3	5.0	5.7
Government consumption (% real change pa)	5.0	5.8	3.5	7.6	2.0	10.0	6.5
Exports of G&S (% real change pa)	-1.0	6.2	4.7	4.1	4.8	4.7	4.4
Imports of G&S (% real change pa)	12.5	35.4	19.8	-10.3	20.0	8.4	7.6
Economic policy							
Budget balance (% of GDP)	0.3	0.3	0.4	-3.8	-0.2	0.2	-0.1
Public debt (% of GDP)	4	3	3	5	4	4	4
Money market interest rate (%)	10.0	10.3	n.a.	n.a.	n.a.	n.a.	n.a.
M2 growth (% change pa)	24	35	23	5	11	10	13
Consumer prices (average % change pa)	3.2	6.0	12.5	3.5	3.2	4.4	3.9
Exchange rate LCU to USD (average)	0.4	0.4	0.4	0.4	0.4	0.4	0.4
Balance of payments (mln USD)							
Current account balance	5661	2464	5020	-286	2007	2770	-300
Trade balance	11707	10349	17012	11600	15913	18200	14820
Export value of goods	21587	24692	37719	27652	35228	41220	39650
Import value of goods	9880	14343	20707	16052	19315	23020	24840
Services balance	-2592	-3411	-4050	-3763	-5121	-6420	-6230
Income balance	-666	-804	-2761	-2810	-3460	-3590	-3330
Transfer balance	-2788	-3670	-5181	-5313	-5324	-5430	-5570
Net direct investment flows	1596	3332	2359	2210	2500	2450	2800
Net portfolio investment flows	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Net debt flows	790	1075	1676	-597	953	1070	590
Other capital flows (negative is flight)	-7391	-2362	-6996	-706	-4639	-5090	-1880
Change in international reserves	656	4510	2058	621	822	1200	1200
External position (mln USD)							
Total foreign debt	4819	5962	7779	7169	8211	9280	9850
Short-term debt	1953	2835	4093	3173	3818	4550	4910
Total debt service due, incl. short-term debt	1977	2579	3377	4573	3642	4370	5180
Total foreign exchange reserves	5014	9523	11582	12203	13024	14220	15420
International investment position	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Total assets	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Total liabilities	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Key ratios for balance of payments, external solvency and external liquidity							
Trade balance (% of GDP)	31.8	24.7	28.1	24.8	27.5	29.8	23.2
Current account balance (% of GDP)	15.4	5.9	8.3	-0.6	3.5	4.5	-0.5
Inward FDI (% of GDP)	4.3	8.0	3.9	4.7	4.3	4.0	4.4
Foreign debt (% of GDP)	13	14	13	15	14	15	15
Foreign debt (% of XGSIT)	20	21	19	24	22	21	23
International investment position (% of GDP)	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Debt service ratio (% of XGSIT)	8	9	8	15	10	10	12
Interest service ratio incl. arrears (% of XGSIT)	1	1	1	1	1	1	1
FX-reserves import cover (months)	4.4	5.9	5.2	6.8	5.9	5.4	5.5
FX-reserves debt service cover (%)	254	369	343	267	358	325	298
Liquidity ratio	162	149	149	135	140	138	131

Source: EIU 20110719