Oman:
Relying on strategic location as debt mounts

Florence Eid-Oakden, Ph.D, Chief Economist
Charlene Rahall, Analyst

- **Oman, whose budget deficit in percentage terms is among the largest tracked by ratings agencies in MENA, is set to tap capital markets for a fourth straight year with higher costs likely.**
- **The introduction of VAT -- which has already been delayed this year -- is now planned for September, but in our view is far more likely to be implemented in early 2020.**
- **The sultanate continues to balance its regional and international alliances -- with the US and Iran, for example -- through its strategic port of Duqm.**

Cautious economic outlook

The IMF's April Regional Economic Outlook for the MENA region cut the forecast for Oman's economic growth this year from its 5% estimate in October to just 1.1%.

- The 2019 forecast gives Oman the slowest growth rate of any country in the region other than the two economies in recession, Iran and Sudan.[2]
    - This is a sharp reversal. The IMF's October forecast would have made Oman the fastest growing country in the GCC in 2019.
    - The IMF did not disclose its reason for slashing the growth estimate, but the move fit with an across-the-board cut of 2019 growth forecasts for all GCC countries, with oil producers such as Oman expected to fare worse.
    - We believe, however, that based on forecasts for the sultanate's oil and natural gas production and exports, as well as non-oil GDP, the 2019 growth number will be closer to the government forecast of 3%, in the high 2% range.
    - Oil will be the key. The Fund, for example, revised up its Oman GDP growth forecast to 6.2% for 2020 from its previous estimate of 2.7% because of government plans to increase investment in the Khazzan gas field significantly.
    - The 2019 budget assumes a breakeven oil price of USD 58 pb versus USD 50 pb in the 2018 budget. Arabia Monitor bases its more optimistic growth expectation on an oil price forecast of USD 65 pb for 2019.
- The IMF expects inflation at 1.5% this year, a jump from 0.9% in 2018, driven by higher rise in the prices of the major sectors, such as food and non-alcoholic beverages, restaurants and hotels, and clothing.
- The fiscal deficit, according to the IMF, is estimated to have declined to about 7.7% of GDP in 2018 from 12.9% in 2017. This would be smaller than the 10% of GDP estimated by the government.

Table 1 – Oman Macroeconomic Indicators[1]

	2015	2016	2017	2018	2019f
Real GDP Growth (%)	4.7	5.0	-0.9	2.1	1.1
Crude Oil Production (M Bpd)	0.9	1.0	0.9	0.9	0.9
Oil GDP Growth (%)	4.5	3.6	-2.5	1.6	-0.6
Non-Oil GDP Growth (%)	4.8	6.2	0.5	2.5	2.5
CPI Inflation (%)	0.1	1.1	1.6	0.9	1.5
Fiscal Balance (% of GDP)	-15.9	-21.2	-12.9	-7.7	-9.9
C/A Balance (% of GDP)	-15.9	-18.7	-15.2	-5.9	-8.7
Total Gov't. Gross Debt (% of GDP)	15.5	32.5	46.9	50.9	61.3
Total Gross Extrn'l Debt (% of GDP)	52.3	69.2	88.4	88.0	99.6
Gross Official Reserves (Mos. of Imports)	6.7	7.0	5.2	5.5	4.9
Nominal GDP (USD B)	68.9	65.9	70.8	82.2	79.5
Population (Millions)	4.1	4.4	4.6	4.8	4.9

    - For this year, Oman's budget projects spending of USD 33.5B, up 3% YoY, while revenue is estimated at USD 26B.
    - The deficit is expected at USD 7.2B (9.9% of GDP), in line with IMF estimates.
    - In March, a series of selected taxes were approved. Taxes on tobacco, alcohol, energy drinks and pork products will go up by 100% from June, while those for carbonated drinks will go up by 50%.
- The 2019 budget made no reference to VAT, which Oman's regional neighbours -- the UAE, Saudi Arabia and Bahrain have implemented.
    - Originally scheduled to be introduced in conjunction with other GCC states, Oman is now preparing for implementation after September 2019.
    - We believe, however, that it is more likely that VAT implementation will occur in early 2020.

Deficits over the last four years have closely matched spending, helping explain why the main credit rating agencies have downgraded Oman to below investment grade, or junk.

- The latest credit rating revision was by S&P Global Ratings on 21 April which affirmed the 'BB/B' long and short-term foreign and local currency sovereign credit ratings on Oman, but revised its outlook to negative from stable.
- Oman is preparing for a US dollar bond sale to finance its budget deficit, its first issuance for this year.
    - The government had earlier disclosed plans to cover 86% of this year's expected budget deficit through local and foreign borrowing.
    - In 2018, Oman covered its budget deficit by borrowing mainly from external sources (albeit at higher interest rates). This accounted for 69% of total deficit funding, whilst domestic borrowing amounted to only 17%, and the remaining 14% was covered by withdrawal from reserves.
- With all three agencies now sharing the same downbeat view, Oman is likely to find its borrowing costs will rise further.

[1] Arabia Monitor; IMF.

[2] No data was given for Syria.

- To ease fiscal pressure over the short term, Oman could sell off some state-owned assets, but the government will have to come up with other strategies if it is to put its economy on a more stable footing over a longer period.
    - Last October, state-owned Oman Oil Company sold a 10% stake in the Khazzan-Makarem gas field venture to Malaysia's Petronas for USD 1.3B. Most proceeds went to finance the budget.
- With persistent deficits, rising debt levels since 2016 remain a concern of ratings agencies.
- Total government debt is estimated at 50.9% of GDP in 2018 with most of it sourced externally (35% of GDP).
    - Despite this challenge, the government has made progress in reducing the deficit in line with the government's 9th Five Year plan.
    - Further crucial fiscal reforms and diversification efforts are needed especially given current global risks and the increasing cost of debt.

Balancing regional & international partners

March's deal granting the US access to facilities in the ports in Duqm and Salalah was not the first use by Oman of its strategic location on the Arabian Sea. Iran, Britain, South Korea, China, Saudi Arabia and India have also signed various agreements, reflecting Oman's careful balancing act in regional and international politics.

- The British military's Joint Logistics Support Base opened last year in Duqm, which allows easy access to both the Gulf and the Red Sea.
- India obtained the right for its navy to use Omani ports in early 2018.
    - For India, Oman is a strategic commercial door to the region. The port of Mumbai is fewer than 1,000 nautical miles from Muscat, or four to five days at sea.
- Automaker Iran Khodro plans to invest USD 200M in Duqm in a joint facility with Oman Investment Fund.
- South Korea's Daewoo Shipbuilding and Marine Engineering was the main contractor of Oman's dry dock, which opened in 2012.
- China plans to invest over USD 10B in Duqm's port and industrial zone, including construction of a China-Oman Industrial Park.
- Saudi Arabia has likewise invested over USD 200M in Duqm.

Oman also announced plans to reopen its embassy in Iraq, decades after it closed its diplomatic post there.

- Oman closed its embassy in Baghdad in 1990 when Saddam Hussein invaded Kuwait.
- Improving Omani-Iraqi ties follow warming relations between Saudi Arabia and Iraq. Riyadh opened a new consulate in Baghdad in April, part of efforts to counter Iran's influence in Iraq.

Figure 1 – Oman Gross Government Debt[3]

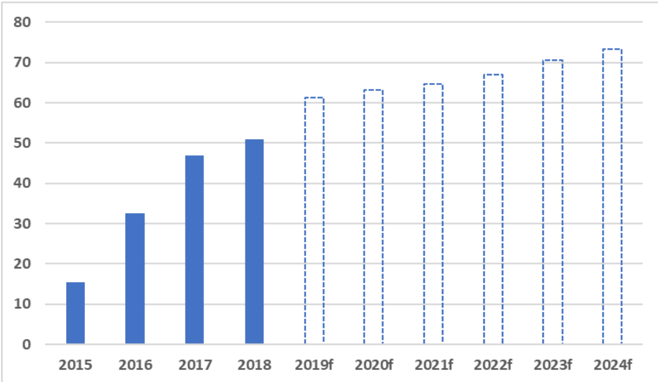
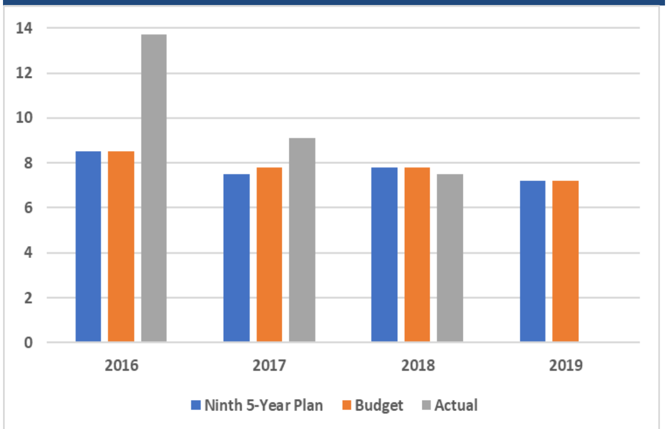


Figure 2 – Oman Deficit against 9th Five-Year Plan (USD, B)[4]



Deepening Muscat-Tehran-Iraq ties are a source of concern within the GCC, but a limited one.

- From the perspective of Saudi Arabia and other GCC states, Oman's role in hosting secret talks on the international nuclear deal with Iran, and pursuing diplomatic avenues independently from its partners was troublesome, but not wholly surprising.
    - Oman's pan-Indian Ocean identity is rooted in a long history, and transcends its Arab/Islamic identity as well as membership in the Saudi-led GCC.[5]
- As Omani-Iranian trade grows, and ports such as Duqm offer opportunities to develop new markets across the Indian Ocean, Oman's fellow GCC states will also have much to gain from the sultanate's expanding infrastructure and its access to the Arabian Sea and Indian Ocean.
    - In particular, it is a chance for GCC countries to decrease their dependence on the Strait of Hormuz for transferring their oil.
    - It should also prompt them to initiate plans to connect their roads, railways and pipelines to Duqm.

[3] Arabia Monitor; IMF WEO Data Mapper.
[4] Arabia Monitor; Royal decree 1/2019 and Oman Ministry of Finance.

[5] The sultanate's commercial, cultural and geospatial links to non-Arab countries are rooted in its history as a former empire that stretched across large portions of East Africa and South Asia.

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Arabia Monitor
Aston House| Cornwall Avenue| London L3 1LF
Tel +44 203 239 4518
info@arabiamonitor.com
www.arabiamonitor.com