OMAN

Compounded by participating in OPEC oil production cuts in 2017, protracted low oil prices and fiscal austerity continue to weigh on Oman's economy. Fiscal and current account deficits remain large, and with Oman increasingly resorting to external borrowing to finance its deficits, public debt is rising rapidly. However, growth is expected to pick up over the medium term following a boost in oil and gas and from expected gains in the non-oil sector resulting from the government's economic diversification plan.

Recent developments

Growth in Oman continues to be held back this year by lower oil production and weaker consumption and investment. Real GDP growth is projected to slow down to 0.1 percent in 2017 from 2.8 percent in 2016. Record high oil production levels (1 million bd) drove overall growth in both 2015 and 2016. In 2017, Oman joined most OPEC non-members in participating in oil production cuts, leading to a contraction of the hydrocarbon sector by 2.8 percent. Non-hydrocarbon GDP growth is estimated to continue to slow down to 2.5 percent in 2017 from 3.4 percent in 2016 as public spending declines with knock-on effects on consumption and investment. According to the national consumer confidence survey, the confidence index slowed to 78.8 percent in 2016 from 95.3 percent in 2015. The current account deficit is estimated to slightly improve to 15.7 percent in 2017 from 17.4 percent of GDP in 2016 on the back of higher oil prices.

The ongoing Gulf sanctions on Qatar had raised concerns over the possibility of the disruption of gas supply to Oman from the Qatari pipeline, however, Qatari officials have confirmed they do not plan on closing the pipeline. In fact, Oman has benefitted from this Gulf crisis with its ports increasingly used as a conduit for exports to Qatar.

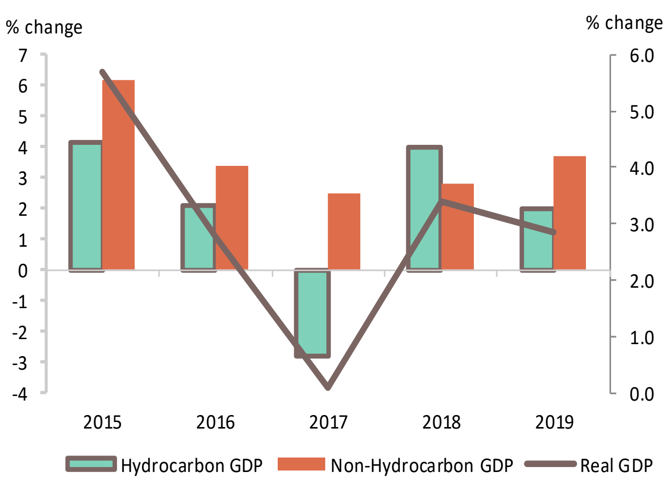
Oman did not follow the recent US policy rate hikes like the other GCC states, but given its peg to the US Dollar the Central Bank alternatively implemented a gradual rate increase to match the US. Inflation is estimated to increase from 1.1 percent in 2016 to 2.0 percent in 2017 reflecting the ongoing subsidy reform.

Fiscal outturns in the first half of 2017 indicate that the deficit is expected to narrow to 13.5 percent from 20.8 percent in 2016. This improvement reflects higher oil revenue receipts due to higher oil prices, and savings coming from higher electricity tariffs for large consumers and a slight uptick in government service fees (such as visa fees). To finance the 2017 budget, Oman has raised US$5 billion from international debt markets in March and US$2 billion from sukuk (Islamic Bond) in May 2017.

The main social concern for Oman is the lack of jobs. ILO estimates unemployment to be about 20 percent on average, but about 50 percent for the youth—a pressing problem in a country where almost 40 percent of the population is younger than 25 years old. Young Omanis have a strong preference for public sector jobs, where pay is higher and working hours are shorter, while the private sector continues to rely on expatriate labor. Oman will have to generate 45,000 jobs annually to address the problem, and the ongoing effort to replace expatriates with Omanis are insufficient without an improvement in the environment for private sector job creation.

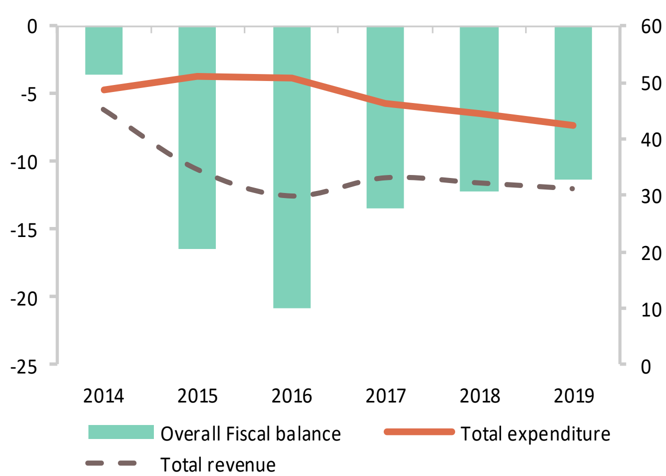
The National Diversification Program (Tanfeedh) provides a roadmap for increasing private sector participation—focusing on logistics, manufacturing and tourism. However, some diversification

FIGURE 1 Oman / Real annual GDP growth



Sources: Omani Authorities, World Bank Staff estimates.

FIGURE 2 Oman / General government operations (in percent of GDP)



Sources: Omani Authorities, World Bank Staff estimates.

reforms such as the removal of subsidies would have negative short-term effects on the population. The government thus faces the challenge of ensuring adequate social protection and mitigation policies. Existing beneficiary identification, welfare measurement and analysis methods and institutions may need to be updated and revalidated.

Outlook

Economic growth is set to modestly recover over the medium term. In 2018, a boost in the hydrocarbon sector will drive the recovery—as the "OPEC plus" restrictions on oil supply are lifted and the Khazzan gas project expands production capacity. As the gradual recovery of oil prices improves confidence and encourages private sector investment, overall GDP growth is projected to rebound to 2.9 percent by 2019. The government's policy reform agenda remains focused on economic diversification and fiscal consolidation. Over the longer term, pro-business reforms such as the foreign ownership law and the FDI law, and the lifting of sanctions on Iran are expected to increase trade and investment opportunities. Monetary policy will remain tight as interest rates continue to rise. Owing to the hike in electricity tariffs and the VAT, inflation is expected to inch up to 2.6 percent in 2018 before moderating to 1.8 percent in 2019 as cost push pressures from subsidy reform dissipate.

In January 2017 electricity subsidies were removed for large consumers, who collectively consume over 30 percent of the total energy supply. Moreover, the adoption of a 5 percent VAT expected in 2018 and higher corporate income tax are expected to narrow the fiscal deficit to 11.4 percent by 2019. Oman's accumulated resource revenue savings are estimated at US$38 billion and have been used to partially finance the fiscal deficit. However greater reliance on foreign borrowing will raise public debt dramatically over the forecast period, estimated at over 50 percent of GDP by 2020 from 5 percent in 2014. The current account deficit is projected to improve to 9.2 percent by 2019 as oil prices rise and non-oil exports grow. By 2020, the gas pipeline with Iran is also expected to increase LNG exports.

Risks and challenges

Inclusive economic growth hinges on the timely implementation of diversification reforms. The massive infrastructure spending program under the 9th Development Plan is likely to encounter delays as the government continues to be fiscally strained. The government will look towards increasing public-private partnerships which might prove difficult in the short term due to falling investor confidence in the region. The government is also likely to continue to face social unrest in response to subsidy reform.

The overall economic outlook is vulnerable to several risks. If the planned consolidation does not materialize, the government's fiscal policy risks losing credibility with negative consequences for financing. External risks include further oil price shocks and the US interest rate hikes. The possible weakening of the US Dollar could raise import costs and deteriorate the external balance. A continued slowdown in China, Oman's main trading partner, would add to downside risks. Financing conditions may become more challenging given the expansion in debt, especially if, with higher U.S. rates, investor sentiment shifts from emerging markets. These stresses are already evident in the recent change in leadership at the Central Bank, which followed a banking system ratings downgrade by Moodys.

TABLE 2 Oman / Macro outlook indicators (annual percent change unless indicated otherwise)

	2014	2015	2016 e	2017 f	2018 f	2019 f
Real GDP growth, at constant market prices	2.5	5.7	2.8	0.1	3.4	2.9
Private Consumption	5.6	2.9	1.9	1.5	2.5	3.0
Government Consumption	9.6	0.8	-2.2	-3.8	0.9	2.4
Gross Fixed Capital Investment	0.8	2.5	1.8	1.7	2.1	2.6
Exports, Goods and Services	-2.1	-9.4	2.3	-1.6	2.5	4.1
Imports, Goods and Services	-9.8	-3.2	-1.5	-1.1	2.3	3.5
Inflation (Consumer Price Index)	1.0	0.1	1.1	2.0	2.6	1.8
Current Account Balance (% of GDP)	5.2	-15.5	-17.4	-15.7	-11.1	-9.2
Fiscal Balance (% of GDP)	-3.6	-16.5	-20.8	-13.5	-12.2	-11.4

Sources: World Bank, Macroeconomics and Fiscal Management Global Practice, and Poverty Global Practice.
Notes: e = estimate, f = forecast.