OMAN

Slower economic growth estimated in 2016 is a reflection of lower oil sector investment coupled with the knock-on effects of lower public spending. Significant fiscal consolidation efforts have led to fiscal savings, but the deficit remains high. Low oil prices have also widened the current account deficit despite higher export volume. Oman continues to resort to its reserves and to borrowing. The projected uptick in oil prices and expansion of the non-oil economy will improve the macroeconomic outlook.

Recent developments

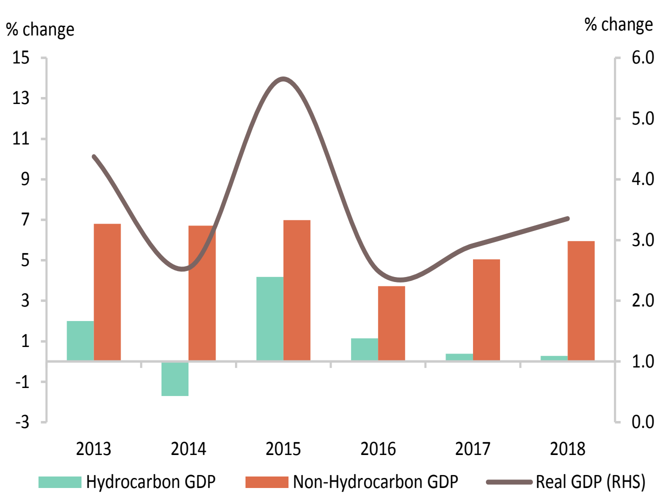
Real GDP growth in Oman is estimated to slow to 2.5 percent in 2016 from 5.7 percent in 2015, according to recently rebased data. Higher growth in 2015 was due to record oil production levels. But lower oil sector investment in 2016 is expected to slow hydrocarbon GDP growth to 1.1 percent from 4 percent in 2015. Non-hydrocarbon GDP growth is estimated to drop to 4 percent in 2016 from 7 percent in 2015 as public spending declines with knock-on effects on investment and consumption. The current account balance turned into a deficit of 15.5 percent of GDP in 2015 and is expected to widen to 20 percent of GDP in 2016 despite higher export volumes. The Central Bank policy rate remained unchanged, but interbank lending rates continue to inch upwards. Inflation is estimated to increase from 0.1 percent in 2015 to 0.9 percent in 2016 reflecting the fuel price hike early this year.

Fiscal consolidation efforts are projected to slightly narrow the fiscal deficit in 2016 to 15.9 percent from the record high level of 16.5 percent of GDP in 2015 (17.2 percent excluding grants). Fuel subsidy reform, cuts in defense and capital spending and wages and benefits were the main levers of consolidation. While oil and gas revenue fell by 20 percent in 2016, non-hydrocarbon revenue is estimated to increase on the back of higher customs and investment income. To finance the deficit Oman borrowed US$1 billion from a consortium of banks in January and issued its first sovereign bond since 1997 worth US$2.5 billion in June. The government plans to tap US$1.5 billion of Oman's general reserves and further borrow US$5-10 billion from the international debt markets in 2016.

The government's policy directions reflect a continued focus on fiscal consolidation and diversification. Sultan Qaboos approved an economic diversification program that uses Malaysia's economic transformation model, and that supports sectors such as logistics, manufacturing and tourism. Reforms began in 2015 with the doubling of gas prices for industrial users, increasing diesel and petrol prices by up to 33 percent, designating an office for speeding up the process for issuing licenses, containing wage bill growth, and removing some tax exemptions. Also, the liberalization of the aviation sector reflects a policy shift away from protectionism. Natural gas projects will be a priority to cater for the increased power demand expected to result from diversification. Other reforms expected to be implemented in the forecast period include higher corporate income tax, a GCC-wide VAT, a move towards a fully cost-reflective tariff for large industrial consumers of electricity, and increasing excises and fees for government services.

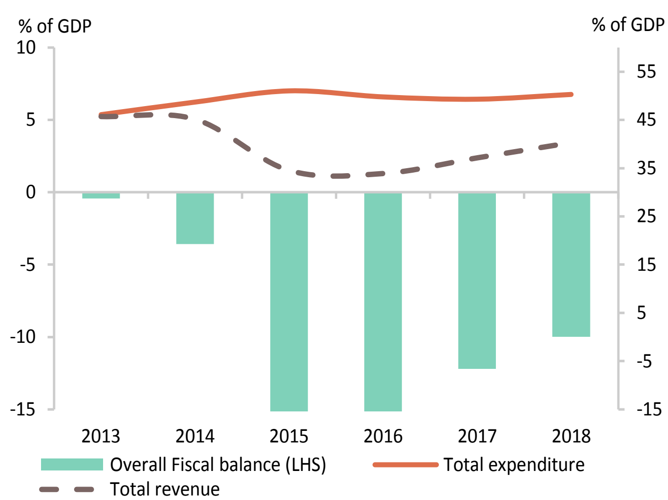
The main social concerns include the lack of jobs for the youth and, to some extent, regional disparities. ILO estimates youth unemployment in Oman at 20 percent, a pressing problem in a country where almost 40 percent of the population is less than 25 years old. Young Omanis typically wait three years to find a job—partly re-

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.

flecting their strong preference for public sector jobs, where pay is higher and working hours are shorter. Oman will have to generate 45,000 jobs annually to address the problem, and the ongoing effort to replace expatriates with Omanis (so-called 'Omanization' policy) will be insufficient without an improvement in the environment for private sector job creation.

Outlook

Overall real GDP growth is projected to slightly recover over the medium term, reaching 3.4 percent by 2018, as a gradual recovery of oil prices improves confidence and encourages private sector investment. This will be further supported by the new foreign ownership law and liberalization in aviation. Oman is expected to focus its infrastructure investment in tourism and logistics. Continued fiscal austerity measures and revenue mobilization, combined with higher oil prices, will allow the budget deficit to further narrow to 10 percent of GDP in 2018. But with further bond issuances in the pipeline, debt is likely to rise dramatically. Trade and investment opportunities with Iran are expected to increase as the sanctions are lifted. The current account deficit is projected to remain high at 19.5 percent in 2017 but should narrow as oil prices rise, non-oil exports grow, and the gas pipeline with Iran increases LNG exports. Cost push pressures from rising global food prices and subsidy reform are expected to increase inflation to 2.8 percent by 2018. Oman is expected to maintain its peg to the US dollar.

Risks and challenges

Continued and gradual reform is needed to maintain fiscal and external sustainability, and to support the peg over the long term. Authorities will need to monitor emerging risks affecting the resilience of Oman's financial sector. In addition, with the Omani population growing at 4 percent annually, job creation is a major challenge. In the medium term Oman may need to adopt policies to mitigate the impact on the population of the declining oil revenues brought by low prices and a relatively short oil horizon. Efficiencies could be gained by moving away from universal subsidies to more targeted transfers. A review of existing social programs and an upgrade of capacity to measure and analyze welfare would be necessary.

Social and political obstacles to cutting expenditure remain; intensifying the need for increasing non-oil revenues. Thus successful implementation of the planned diversification reforms under the 9th development plan is critical to sustaining growth and securing employment opportunities. Key areas of risk facing the Omani economy include further oil price shocks and possible rate hikes by the Fed. Moreover a continued slowdown in China, Oman's main trading partner, would add to downside risks.

TABLE 1 Oman / Macro outlook indicators (annual percent change unless indicated otherwise)

	2013	2014	2015 f	2016 f	2017 f	2018 f
Real GDP growth, at constant market prices	4.4	2.5	5.7	2.5	2.9	3.4
Private Consumption	-6.9	5.6	2.9	2.7	2.8	3.2
Government Consumption	17.6	9.6	0.8	0.6	0.9	1.3
Gross Fixed Capital Investment	6.1	0.8	2.5	2.1	2.3	2.8
Exports, Goods and Services	12.5	-2.1	-9.4	3.0	4.0	4.2
Imports, Goods and Services	18.7	-9.8	-3.2	-2.3	-1.0	1.1
Prices						
Inflation (Consumer Price Index)	1.2	1.0	0.1	0.9	2.5	2.8
Current Account Balance (% of GDP)	6.6	5.2	-15.5	-20.0	-19.5	-16.0
Fiscal Balance (% of GDP)	-0.4	-3.6	-16.5	-15.9	-12.2	-10.0
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Sources: World Bank, Macroeconomics and Fiscal Management Global Practice, and Poverty Global Practice.
Notes: f = forecast. In annual percent change unless indicated otherwise.