MACROECONOMIC PERSPECTIVE

Summary of

IMF Executive Board Article IV Consultation with Oman

May 5, 2015

KEY OBSERVATIONS OF REPORT

- The non-hydrocarbon growth rate is forecast to drop from 6.5% in 2014 to 5% in 2015-16 consistent with the government's spending plans, and thereafter 4.5% in 2017-20.
- The decline in oil prices is expected to push Oman's fiscal and current account balances to deficits from 2014/15.
- The average inflation rate remained at 1% in 2014, given low non-food inflation. Going forward, inflation is projected to remain below 3% in the medium-term consistent with the dollar peg, benign global inflationary environment, and elastic supply of foreign labor.
- The increase in total spending, particularly during 2010-14, mainly in response to social demand, has pushed the breakeven oil price to US$108 per barrel in 2014.
- The overall fiscal deficit is projected at 14.8% of GDP in 2015 and would remain in double digits over the medium-term in the absence of fiscal reforms. Without further fiscal adjustment, financing the projected cumulative fiscal deficit between 2015 and 2020 will erode fiscal buffers and raise debt levels.
- The capital adequacy ratio of banks stood high at 15.1%, supported by low net nonperforming loans of 0.6% and a high provisioning ratio of 136%.
- Stress tests highlighted that under a combination of interest rate and market shocks, the solvency of the banking system would be preserved, although some banks may have to raise capital in order to meet the central bank's regulatory capital requirement.

IMF EXECUTIVE BOARD ASSESSMENT

- Given the challenges associated with low oil prices, it would be prudent for Oman to begin the fiscal adjustment process early, given limited buffers and high breakeven oil prices.
- Achieving fiscal sustainability will require measures to contain expenditure growth, increase non-oil revenues and modernize the current budget system.
- On the expenditure side, curtailing the increase in government jobs in civil and defense services and keeping the growth in government employee compensation constant in real terms; gradually phasing out subsidies, complemented by a social safety net, other targeted mitigating measures, and a well-designed communication strategy; and rationalizing defense spending, would generate savings. Undertaking such reforms in a phased manner and preserving room for capital expenditures would limit the downward drag on growth.
- There is potential for raising non-oil revenues by expanding tax categories and reconsidering tax rates and exemptions for corporates, identifying new sources such as selected excises, VAT and property taxes.
- Oman's banking sector is resilient but the Central Bank of Oman should remain vigilant in monitoring and managing evolving risks including considering measures to enhance capital cushions to equip banks to face potential oil price declines, including strengthening their risk management capacity. A sudden sharp withdrawal of government deposits would induce liquidity pressures in banks.
- Efforts towards economic diversification should be strengthened, to reduce depend dependence on oil to generate jobs for nationals. The business environment also needs to be improved by removing impediments to physical, legal and business infrastructure.
- Developing domestic debt markets will strengthen the diversification process and reduce concentration risks of banks.

Source: International Monetary Fund (IMF), "Press Release: IMF Executive Board Concludes 2015 Article IV Consultation with Oman", May 5, 2015.