

# TRIP NOTE: OMAN

November 2017



GlobalEvolution

# GLOBAL EVOLUTION TRIP NOTE

We visited Oman as part of a longer GCC trip, which also included visits to Qatar and Bahrain. The day in Muscat included meetings with the Ministry of Finance, the Central Bank, local banks and members of the US embassy. The purpose of the trip was to investigate if our negative view on Oman's fiscal position was still valid.

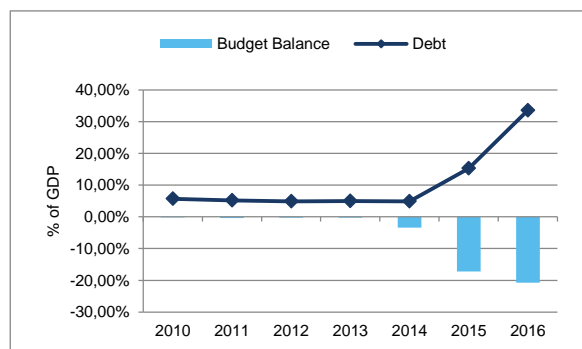
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## Fiscal Performance:

**Improvement in the fiscal position, but Oman's fiscal profile remains vulnerable**

The large decline of oil prices in 2014 was a shock to the fiscal position of Oman. The effect has been an explosion of budget deficits and debt as reflected in chart 1 below.

Chart 1: Budget Balance and Debt accumulation.



Source: Haver Analytics and Central Bank of Oman

Oman still has one of the largest wage bills in the region as it will be around 13% of GDP in 2017. This is a legacy of the Arab Spring in 2011 which in the case of Oman was dealt with by the Sultan, who quickly initiated a government employment program, especially within the Security and Defense sector resulting in an almost 78% increase in military spending from 2010 to 2011.

That being said the fiscal position will improve this year. The positive impact to the fiscal position is coming via increased oil related revenues, but Oman has also benefitted from being neutral in the

blockade of Qatar, as some of the Qatari related trade was redirected to Oman. The indication given from the Ministry of Finance was that the 2017 budget deficit will decrease to 12% of GDP. The government believes that the fiscal breakeven oil price is USD 73/bbl whereas the IMF sees the fiscal breakeven oil price at USD 84/bbl, which is one of the highest in the region.

## 5-year Fiscal Plan:

**Oman has a plan, but is it enough? It does not look like it is**

The Omani Ministry of Finance showcased their 5-year plan for fiscal consolidation. Below are some of the headlines:

- Aim for non-oil revenue to be no less than 30% of total revenue. Currently at 27%.
- Privatization, including infrastructure like ports and airports.
- Expenditures limited to 12bn OMR, from 12.8bn OMR today.
- Debt-to-GDP limited to 55%, from 42% today, while lowering the budget deficit to 5% of GDP by 2021.
- New revenues streams from the Khazzan gas field. The field will reach peak production in 2019, and turn Oman into a net exporter of gas, from a net importer today.
- Introduce VAT in line with the rest of GCC.

We feel the plan lacks details and is unrealistic. The government wants to reduce expenditures by 6.25% but they have no detailed initiatives on how this

should be done. The debt and deficits numbers also seem unrealistic. Again, debt-to-GDP will be 42% this year and the budget deficit is estimated to be 10-11% next year and declining to 5% by 2021. So even if we see no shock to oil revenues, the budget deficits combined with the current debt stock suggest that the debt-to-GDP is not limited at 55% with the current plan.

Regarding VAT, the implementation in Oman will be delayed to mid-2018, while the rest of GCC, except Bahrain, are moving forward with the agreed upon implementation date of 1<sup>st</sup> of January 2018. The government estimates that VAT will reduce the budget deficit by 3.3% annually, which is significantly above the rest of the GCC where this number is about 2%. The estimate of the budget deficit reduction was made by an Omani official in the meeting room who plugged a few numbers into an ordinary calculator. We found it very optimistic and unprofessional.

## Succession Risk:

**Sultan Qaboos may have found his successor, but what will be the effect of a succession?**

Sultan Qaboos is 77 years old and has been the leader of the Sultanate of Oman since 1970. Qaboos is very well respected by other leaders in the GCC, which is also the reason why Oman has been allowed to remain neutral in the Qatari blockade. Alongside being respected by fellow leaders in GCC, Qaboos is also loved by the public. The average age in Oman is 30, so the average Omani has never experienced other leadership and Qaboos has been successful in raising living standards and providing jobs when needed, for example during the Arab Spring.

Qaboos has recently retreated from the public spotlight and many believe it is due to his medical situation. Reportedly, he has been in Germany for cancer treatment. Qaboos has no real successor and the constitution states that the royal family has three days to choose a new Sultan should Qaboos pass away. If an agreement cannot be found, Qaboos has written a name in an envelope and it is then up to the military to make sure the man named by Qaboos is placed as his successor. In the last couple

of months a successor has emerged from the royal ranks, namely Qaboos' cousin Tariq, who has represented Oman at Arab League Summits. Tariq's popular support is nothing compared to that of Qaboos' and a Tariq succession could represent a risk as he would seek to consolidate power after taking over. Such scenario will not be in line with the need for fiscal reforms and a reduction of the wage bill as austerity reforms combined with new leadership could stimulate a second round of the Arab Spring in Oman.

Another risk for the successor is external political pressure coming from the UAE and Saudi Arabia. The neutrality of Oman will come into question when Qaboos is no more. This will force Oman to take a stance against Iran or make a split with Saudi and UAE.

## Conclusion:

**Lack of details to consolidate fiscal position and high risk on instability arising from possible succession of power**

We entered the trip being negative on Oman due to an apparent lack of ability to significantly reduce the double digit deficit and hence the accumulation of debt.

The trip confirmed our view on Oman. Accumulation of debt is going to continue as the 5-year plan outlined on the trip is not going to reduce the budget deficit quickly enough assuming oil at current levels. Gas projects will bring in revenues but it does not seem to be enough to push the needle.

A large risk to a further deterioration of the fiscal position is the succession of Sultan Qaboos. We feel that the risk of significant fiscal slippage on the back of a potential succession is large, and on top of this, the risk of internal GCC tensions looms as the neutrality of Oman could be questioned.

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