Oman at a glance: 2006-07

OVERVIEW
The outlook for Oman remains positive, buoyed by the continued strength of international oil prices, which are set to keep export revenue and fiscal earnings high. Progress with a range of gas-based industrial projects (including a new liquified natural gas facility) also supports the sultanate’s prospects, marking the advancement of its diversification programme and creating some of the jobs urgently required by Oman’s rapidly growing labour force. Encouragingly for the government, many of these new industrial ventures are being funded by foreign investors—a positive sign that its reform programme is yielding results. Overall real economic growth will strengthen more significantly in 2006 on the back of rising export volumes and robust rates of domestic demand growth. Inflation will stay low. The political scene is likely to remain stable, underpinned by the broad support enjoyed by the ruling sultan, Qaboos bin Said al-Said.

Key changes from last month

Political outlook
• The political outlook is unchanged, with Sultan Qaboos’s authority unlikely to be challenged and the prospects of an Islamist-inspired attack in the country remaining low.

Economic policy outlook
• A minor downward revision to the Economist Intelligence Unit’s 2006 oil price forecast has slightly altered the economic policy outlook. However, the fiscal account is still forecast to register a healthy surplus of 11.4% of GDP in 2006, narrowing to 4.8% of GDP in 2007.

Economic forecast
• The sultanate’s external accounts will still register large surpluses over the forecast period, in spite of a minor downward revision to our 2006 oil price forecast.

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The Economist Intelligence Unit
26 Red Lion Square, London WC1R 4HQ
United Kingdom
The Economist Intelligence Unit

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London
The Economist Intelligence Unit
26 Red Lion Square
London
WC1R 4HQ
United Kingdom
Tel: (44.20) 7576 8000
Fax: (44.20) 7576 8500
E-mail: london@eiu.com

New York
The Economist Intelligence Unit
The Economist Building
111 West 57th Street
New York
NY 10019, US
Tel: (1.212) 554 0600
Fax: (1.212) 586 0248
E-mail: newyork@eiu.com

Hong Kong
The Economist Intelligence Unit
60/F, Central Plaza
18 Harbour Road
Wanchai
Hong Kong
Tel: (852) 2585 3888
Fax: (852) 2802 7638
E-mail: hongkong@eiu.com

Website: www.eiu.com

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Outlook for 2006-07

Political outlook

Oman's long-standing political stability, born of the firmly rooted authority of the ruling sultan, Qaboos bin Said al-Said, is unlikely to face any serious challenges over the forecast period. Some Omanis are frustrated by the sultan's gradualist approach to political change, whereas those in more conservative circles perceive his reform programme as a threat to the country's traditional values and structures. Additionally, there are widely held anxieties over rising unemployment, as well as a degree of discomfort with the government's pro-Western stance, particularly at a time when ongoing bloodshed in Iraq is deepening popular opposition to US policy in the region. However, although these issues raise grievances that the government must address (and that provide an incentive for economic reform), they do not run deep enough to pose a threat to the ruling elite. Indeed, the sultan continues to command considerable popular support, shored up by the strength of the country's traditional tribal social structures and the loyalty of the security services.

The Economist Intelligence Unit retains this view, in spite of the discovery early in 2005 of a conspiracy that reportedly sought to re-establish the Ibadi caliphate that ruled parts of Oman up until the 1950s. During Sultan Qaboos's reign there have been a number of similar conspiracies and even rumoured assassination attempts, mainly emanating from elements still loyal to the memory of his long-deposed father, but none have commanded wide support, and the sultan's authority remains as strong as ever. Despite its Islamist overtones, none of those involved in the recent conspiracy had any connection with al-Qaeda or other regional hardline groups, whose presence shows little sign of materialising in Oman. However, the risk of a one-off attack—such as occurred in Qatar in early 2005—remains, as indeed it does across the Gulf region.

The main political uncertainties surround the eventual transfer of power (the sultan is 65). Three of the sultan's first cousins are widely viewed as the leading candidates to succeed him, but the sultan (who has no children) has made clear that he will not publicly name a successor, leaving the decision instead to the ruling family after his death. Should they prove unable to agree, a letter left by the sultan naming his choice of successor will be opened, and that person will become the new leader. The system is unusual—all the other Arab monarchies have named crown princes—and untested, and is therefore a matter of some concern. However, with the Defence Council responsible for ensuring that the sultan's wishes are obeyed, and the ruling family having a clear incentive to manage the transition with the minimum of disruption, it is likely that the transfer of power will be effected without dispute. Of perhaps greater concern is the fact that none of the likely candidates for the succession has yet held high office. As a result, little is known of their political views or personal qualities. It is also possible that their lack of experience will hamper their ability to take over the highly personalised power structure currently centred on Sultan Qaboos.
Ties with Oman's key international allies—the US and the UK—remain strong. Despite anxieties over US-led policy in Iraq, the sultanate was one of the first regional states to offer some recognition to the US-appointed Iraqi Governing Council in 2003 and backed the Iraqi elections that took place in January 2005. The ongoing insurgency in Iraq creates some discomfort within government circles, but Oman will nonetheless maintain its co-operative stance with the US and the UK, confirming its position as a dependable and stable regional ally. Even a further deterioration in the conflict in Iraq is unlikely to lead to a fundamental shift in Oman's foreign policy stance.

**Economic policy outlook**

Aided by the continuing strength of international oil prices, the government will attempt to accelerate its economic reform programme, primarily designed to meet the growing demand for jobs caused by sustained growth in the young adult population. To this end, “Omanisation” (the replacement of expatriate workers with local staff) remains high on the government's agenda. As well as stepping up training, the government will press the private sector to provide employment opportunities for Oman's overwhelmingly young workforce. However, supply-side problems—most notably the greater cost of employing locals and the additional rights they enjoy once in a post—are likely to continue to slow progress.

The government will be careful to balance its drive to boost local employment with its efforts to increase the role played by the private sector across the economy. The completion of new private power plants is evidence of the gains the policy has achieved, and the selection of a private foreign firm to operate the second mobile-phone network shows the commitment to using the private sector to expand infrastructure provision. The government has also finally part-privatised the monopoly telecommunications provider, Oman Telecommunications Company, and there are plans to sell existing assets in the power sector, as well as to establish more privately owned and financed power plants. However, the problems experienced by the foreign-led private consortium that recently handed control of Oman's airports back to the government, two years after being awarded a 25-year operating contract, underscores the fact that reverses can occur on such projects.

Moves towards economic reform will concentrate principally on diversifying the economy. Since the marked downturn in the country's oil production, which began in 2001, Oman has sought alternative means to achieve growth and create jobs, with efforts focused chiefly on the development of its gas resources. Beyond hydrocarbons, prospects for the services sector are strong, with expansion of the Salalah container port set to continue and spending on new tourism ventures already under way.

With oil prices in 2006 now forecast to remain virtually unchanged on 2005, revenue growth will be driven by a modest pick-up in oil production as well as a rise in the government's share of liquefied natural gas (LNG) earnings as a new train is commissioned. Accordingly, gross revenue will climb to OR6.1bn
(US$15.8bn), an all-time high for the fourth year in succession and more than OR2bn above the annual average generated over the preceding five years. Although unease over oil output had lent a degree of caution to government spending plans, sustained high oil prices, coupled with the understanding that oil production will now rise slightly (following successful remedial work), have relaxed the government’s concerns over its fiscal position. We therefore expect expenditure growth of around 7%, similar to that recorded in 2005, with total government spending forecast to reach OR4.4bn. As a result, Oman’s gross fiscal surplus will widen to OR1.47bn, or 11.4% of GDP.

In 2007 gross government revenue will fall by some 11%, as oil prices decline. A pick-up in oil production and continued strong LNG receipts will help to partly offset some of the impact of the drop in prices, and overall revenue, at OR5.4bn, will remain strong by historical standards, at almost double the average recorded in the ten years to 2004. In anticipation of the fall in oil prices, the authorities will attempt to rein in spending, which is expected to grow by just over 4% to OR4.6bn. Nevertheless, the gross surplus will contract acutely to OR586m (US$1.5bn), or 4.8% of GDP.

**Monetary policy**

Strong ongoing inflows of foreign exchange and the continuation of the riyal’s peg to the US dollar will ensure that Omani interest rates will continue to track those in the US closely, with no significant widening of the differential likely. Over the forecast period, this will result in average rates steadily picking up from their recent lows to resettle at their long-term historical average levels by the end of 2007. Growth in lending rates will be held in check by pressure applied by the Central Bank of Oman on the commercial banks to reduce their spreads on consumer loans.
After several years of strong expansion, the global economy is likely to be characterised by a gradual deceleration in output and demand growth over the forecast period, driven in particular by more sluggish economic activity in the key economies of the US and Japan. We expect world GDP growth (on a purchasing power parity basis) to slow to 4% in 2006 and to 3.9% 2007, down from 4.4% in 2005.

With the slowdown in global expansion, energy demand growth is expected to ease slightly, with the benchmark dated Brent Blend now forecast to average US$55/barrel in 2006, before declining markedly to US$46.8/b in 2007 as supply bottlenecks are circumvented, helped by the expected easing of sociopolitical tensions in key oil-producing regions. Nevertheless, the average of US$51/b over the forecast period is more than US$24/b higher than the average over the previous ten years (1996-2005).

In 2007 private consumption will remain strong, underpinned by continued firm growth in government spending and relatively low interest rates. Investment spending will also remain robust, although the pace of expansion
will ease from the highs seen in 2004 and 2005. Growth in net exports, though slowing slightly, will remain substantial, with LNG output reaching full capacity and oil production continuing to grow, albeit modestly. Real GDP growth will therefore slow slightly, but remain healthy at 4.9%.

**Inflation**

We expect the long-standing trend of low inflation to continue, although sustained growth in domestic demand is likely to create some upward pressure on consumer prices, as will the weakness of the US dollar (and, by extension, the Omani riyal) against the currencies of Oman's main import suppliers. Price growth will be constrained by the government's extensive subsidy system, however, which will continue to hold in check the prices of a range of core goods and services. Given the comfortable outlook for the public finances, there is little prospect that the government will come under pressure to alter what remains a key—and politically sensitive—system for safeguarding living standards. We estimate that annual inflation edged over 1% in 2005, and expect it to do so again in 2006 before easing slightly in 2007.

**Exchange rates**

There is very little prospect of an alteration in the fixed exchange rate of OR0.385:US$1 during the forecast period. The Central Bank has maintained the rate since 1986 and remains firmly committed to it. The outlook for Oman's external accounts is sufficiently robust to ensure that no liquidity pressures will emerge to threaten the peg.

**External sector**

Owing to a minor revision to our oil price forecast, projected oil export earnings will rise marginally in 2006, as prices remain stable and production pick up slightly and LNG output also increases, following the commissioning of the third LNG train at the start of the year, resulting in total export revenue of some US$20.4bn, a rise of 10.3% on the estimated outturn for 2005. Import spending will continue to rise, as domestic demand strengthens and the US dollar weakens marginally on average, although the pace of growth will slow to around 7%. This will lift the import bill to about US$9.2bn in 2006, more than 50% above the US$6.1bn recorded as recently as 2003. Despite this, the trade surplus will widen further to US$11.2bn. Oman's invisible trade account will stay firmly in deficit; services and income credits will remain minimal and outflows will increase as interest on debt rises, income repatriation by foreign companies grows and service charges associated with imports expand in line with import volume growth. Nonetheless, Oman's current-account surplus will widen further, to US$5.1bn, or 15.1% of GDP.

In 2007 oil export revenue will tail off considerably, as oil prices decline by some 15%, causing overall export earnings to contract by around 11%. Even so, export revenue will remain extremely strong by historical standards, although continued import growth will cause the trade surplus to contract by almost US$2.8bn. The non-merchandise deficit will also narrow slightly, but remain sizeable, resulting in a significantly reduced current-account surplus of US$2.4bn, equivalent to 7.5% of GDP.
Forecast summary
(% unless otherwise indicated)

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<sup>a</sup> Actual.  <sup>b</sup> Economist Intelligence Unit estimates.  <sup>c</sup> Economist Intelligence Unit forecasts.  
<sup>d</sup> Excludes SGRF operations.  <sup>e</sup> Includes SGRF operations.