GRAY/08/1246

April 18, 2008

**Statement by Mr. von Stenglin and Mr. Denk on Oman**
**(Preliminary)**
**Executive Board Meeting 08/35**
**April 21, 2008**

We thank the staff for an insightful paper as well as Mr. Shaalan for his helpful buff statement.

**We welcome Oman's strong economic performance,** which was underpinned by soaring international oil prices and buoyant growth in the non-hydrocarbon sectors. The country's outlook is also largely favorable, as the diversification of the economy is projected to progress in the wake of a strong performance in tourism, construction, and trade. On the downside, however, prices have begun to rise quickly as a result of rapid domestic demand growth, supply bottlenecks, and external factors such as high international food prices and the weakening of the U.S. dollar. In agreement with staff, we regard inflationary pressures as Oman's key challenge at present. Furthermore, continued efforts will be needed to promote the development of the non-hydrocarbon sector and to sustain high economic growth in the face of depleting oil and gas reserves.

We broadly agree with the staff appraisal and limit our comments to the following points:

1. **As the authorities are committed to maintain the U.S. dollar peg in the course of the loosening of U.S. monetary policy, a prudent fiscal stance is required to curb domestic demand growth and rein in inflation.** We therefore welcome the narrowing of the non-hydrocarbon fiscal deficit in 2007, made possible by lower defense spending. However, it might be necessary to tighten fiscal policy further. Against this background, we encourage the authorities to vigorously pursue plans to introduce a VAT and to gradually reduce implicit subsidies on domestic petroleum products.

2. **On the expenditure side, the authorities should attempt to contain increases in public wages and transfers.** In this respect, the recently approved wage increase of 5%

to 42% in the public sector raises concerns about a possible upward adjustment of longer-term inflation expectations. Against this backdrop, we are pleased to note the consensus between staff and the authorities on the need to slow the pace of capital spending, should inflationary pressures continue to persist.

3. **We encourage the authorities to move ahead with plans to raise the efficiency of the pension system** and part with the past practice of covering actuarial deficits by lump sum transfers from the budget. Planned measures such as the consolidation of pension funds and the increase in retirement age and employee contribution are welcome.

4. **The abundance of liquidity in the banking system warrants close monitoring and further mitigating measures.** Negative real interest rates, speculative inflows, and increased competition among banks have fuelled rapid private sector credit growth, precipitating inflationary tendencies. Measures aimed at mopping up excess liquidity are certainly going in the right direction, particularly the increase in reserve requirements and the planned reduction in government cash deposits with commercial banks. But more may need to be done. As recommended by staff, aligning short-term interest rates with U.S. benchmark rates would contribute to improving liquidity management. Furthermore, the authorities may need to consider sterilizing excess liquidity if price stability is to be maintained in the context of an exchange rate peg against the U.S. dollar. Alternatively, a change in the current exchange rate regime – for instance a peg to a basket of currencies – could be an option.

5. **We welcome the authorities' efforts on structural reforms as well as the progress made on the diversification program.** Liberalization of land ownership and the implementation of planned development projects over the medium-term will benefit the real estate and tourism sectors. The privatization of public utilities should further stimulate a favorable private sector development. Related plans to phase out subsidies in the sector should contribute to a strengthening of the fiscal stance. The planned enhancement of the legal framework also promises to yield lasting improvements in the business environment, thus fostering growth prospects of the private sector. Finally, we appreciate the emphasis placed by the authorities on addressing Oman's shortage in skilled labor by expanding the provision of education and training.

6. **We encourage the authorities to consent to the publication of the staff documents.**