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April 18, 2008

Statement by Mr. Charleton and Mr. Perrault on Oman
(Preliminary)
Executive Board Meeting 08/35
April 21, 2008

We thank the staff for their report and Mr. Shalaan for his helpful buff. As in the case of Kuwait and countries in the region, Oman is facing a challenge in controlling inflation. Unfortunately, as is again the case in other countries in the region, the inflation problem was foreseeable in last year's Article IV consultation. The depreciation of the US dollar exacerbated the increase in import prices; the pegged exchange rate has resulted in rapid credit growth; and the frontloaded implementation of the public investment program has added to demand pressures. These factors led to a rise in inflation, as required by the real equilibrium exchange rate. Consequently, we are not surprised at the inflationary outcome, and we believe that the authorities will continue to face challenges in controlling inflation given the constraints of the current exchange rate arrangement. As noted in our statement for the Kuwait Article IV discussion, we consider that authorities throughout the region would benefit from a critical review of alternative exchange rate arrangements. We thus very much look forward to the staff's promised work in this area.

We note, however, that some work seems to have been done in this field. Box 3 reports that the macroeconomic balance approach to the equilibrium exchange rate is based on panel data estimates for GCC countries. *What is this work and when will it be shared with the Board?* We would have appreciated some review of this work in a selected issue given its application in the staff report.

We note the accommodative stance of monetary policy in Oman, as exemplified by the negative real interest rates and the negative spread between the CBO's 28-day CD rate and the US Federal Funds Target rate. There is clearly little scope for independent monetary policy given the peg, but the authorities commitment to inflation control must be called into question if they are unwilling to normalize rates (to low levels) given the robust growth and rising inflation. We encourage the authorities to follow the staff's recommendations and align domestic interest rates with those of the United States. More generally, we are struck by the disconnect between the authorities' view that inflation is the main policy challenge, and the paucity of actions being contemplated by them.