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Statement by Ms. Xafa on Oman
(Preliminary)
Executive Board Meeting 08/35
April 21, 2008

Oman's economic performance remains strong, with GDP growth driven exclusively by the non-hydrocarbon sector. The authorities have been using the windfall hydrocarbon revenues to diversify the economy through an ambitious public investment program and structural reforms aimed at improving competitiveness. These efforts are bearing fruit, as the non-hydrocarbon sector grew by 9 percent in 2007, contributing to GDP growth of 6.4 percent despite a modest decline in hydrocarbon output. On the fiscal side, the authorities have succeeded in building the non-hydrocarbon revenue base in line with the changing structure of the economy. The overall fiscal surplus declined in 2007 reflecting falling hydrocarbon revenue, despite a decline in the non-hydrocarbon fiscal deficit due to lower defense spending. However, inflation pressures intensified and the CPI rose to 5.5 percent in 2007 from 3.2 in 2006. We share staff assessment and have a few comments on the inflation outlook and the exchange rate regime.

Inflation is the authorities' main concern. Even it is partly driven by external factors – soaring food prices and the depreciation of the dollar – we agree with staff that a slower pace of capital spending would reduce overheating pressures. Public investment projects could be prioritized based on their ability to alleviate supply bottlenecks. We note that the government recently granted public sector wage increases of between 5 and 42 percent, and wonder if the upper end of this range is indeed meant to prevent an inflation-driven erosion in real income, as stated in the Buff. Also, the cap on rent increases, if applicable to new construction, will worsen inflation longer-term by limiting supply.

We agree that the dollar peg should be maintained as an anchor of stability over the medium term, even at the cost of tolerating some inflation in the near term. A one-off revaluation will not address inflation pressures on a lasting basis and will generate expectations of further revaluation, attracting short-term capital inflows. We understand that the authorities' decision to withdraw from the planned GCC monetary union is based on their concern that Oman's dwindling hydrocarbon endowment and rapid diversification away from the hydrocarbon sector will expose them to asymmetric shocks relative to other GCC members. The Euro area's experience maybe relevant in this regard, as countries can certainly adjust to asymmetric shocks with instruments other than the exchange rate, especially in a region with flexible labor markets such as the GCC. *Staff comments on the above points are invited.*