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April 18, 2008

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

Oman continued its strong economic performance in 2007. Both the short and medium-term outlook remain favorable, underpinned by the rising oil price expectation and the increasing role of the country's private sector. Like its peer countries, inflation has been identified as the key challenge for the Omani authorities. Recognizing the potential risk, we note from Mr. Shaalan's Buff that a ministerial committee is looking into inflation issues and stands ready to cut government expenditures to dampen demand-side pressures. With a fixed exchange rate regime and open current account, the authorities and staff are of the view that fiscal policy is the main tool to contain rising inflationary pressures.

As containing inflation is the key challenge, we note staff's efforts in elaborating how price pressures have been built up from different sources. Box 1 is a good example. It suggests that there are external factors—higher international food prices and imported labor costs—and domestic factors—strong private sector demand owing to the increased number of expatriates and abundant liquidity. However, the factors leading to inflation are not consistently reflected in other parts of the report. In paragraph 32, the increase in price pressures is said to be attributed to supply-side constraints, rising aggregate demand, and increases in international food prices. In the executive summary, the depreciation of the U.S. dollar is also cited as a factor contributing to increased inflation. Would staff clarify which underlying factors are crucial to Oman's inflation?

We note an acceleration in the money growth owing to the accumulation of foreign assets and strong growth in credit to the private sector. We are interested to hear from staff if excessive liquidity is a major factor leading to inflation in Oman. Nevertheless, we agree with staff's recommendation that liquidity conditions should be closely monitored. We are also impressed by the authorities' readiness to further raise reserve requirements to mop up liquidity, if so required.

The authorities are committed to maintaining the U.S. dollar peg. Staff's analysis suggests that the level of Oman's real exchange rate is broadly in line with fundamentals. Although the recent global financial crisis appears not to have affected the country's financial system, we encourage the authorities to remain vigilant. After all, a robust and healthy financial system is one of the best defense mechanisms against any unfavorable systemic event.

Finally, we commend the authorities on continuing to improve the business environment, making it more conducive to private sector growth. We are assured by their proactive stance in carrying out reforms aimed at enhancing the investment climate and diversifying the economy.