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

1. We thank staff for a concise report and Mr. Shaalan for his informative Buff statement.

2. Oman's economy has been growing rapidly, driven by hydrocarbon exports and strong investments in petrochemicals, transportation, and construction. The fiscal position remains in surplus, while the external current account surplus remains high despite some signs of narrowing due to stronger import growth. The immediate risk to the economy is the current acceleration in inflation, emanating from a combination of strong domestic demand, rising food prices, and higher costs of imported goods and labor. Going forward, near-term growth prospects are favorable, but the inflationary pressures are likely to continue and pose a challenge to macroeconomic policy. In the longer term, we share staff's comment that diversifying the economic base away from the hydrocarbon sector provides the key challenge to the authorities. As we broadly concur with the thrust of the staff appraisal and policy recommendations, we will focus our comments on key issues mainly for emphasis.

3. We support the authorities and staff's view that the US dollar exchange rate peg has served Oman well by providing a credible anchor for monetary policy and by helping to maintain external stability. We note from the staff's analysis that the level of Oman's real exchange rate is broadly in line with fundamentals. We share Mr. Shaalan's view that the application of the 2007 Surveillance Decision to oil producing countries is not an easy exercise, particularly because of difficulties in estimating the current account norm due to volatility of oil prices. Looking ahead, the authorities were of the view that the revaluation of the Omani riyal is not necessary as the inflationary pressures stemming from dollar's depreciation is not a dominant factor. *In this regard, staff's elaboration on the magnitude of pass-through effect of dollar depreciation to domestic inflation would be appreciated.*

4. Given the limited role of monetary policy in the exchange rate peg regime, the fiscal policy should play an important role in containing inflationary pressures. We are encouraged

to note that the authorities stand ready to slow the pace of implementation of government expenditures, particularly if inflationary pressures persist. But at the same time, this should not sacrifice the government's efforts to improve infrastructures needed to reduce supply constraints and thus to alleviate inflationary pressures. *We would invite staff's suggestion on which government's investment projects should be prioritized in this regard.* In light of the increase in world oil prices, we agree that adjustment in the implicit petroleum subsidies would be needed and note that the authorities are also cognizant in this regard. Nonetheless, we are sympathetic to the authorities' concern that at this time such an adjustment needs to weigh against its aggravating impact to inflation and public opposition. *We would invite staff's elaboration on the share of implicit petroleum subsidies in the government budget.*

5. We also encouraged by the authorities' steps to tighten liquidity by raising reserve requirements (RR) and remove the cap on the total outstanding stock of CDs, given the limited flexibility of monetary policy to reign in inflation under the peg exchange rate system. These policies, together with the authorities' intention to raise RR and invest some of the government deposits abroad, should help slow the credit growth and thus the domestic demand pressures going forward. On the financial sector, we note that the banking system is sound and resilient to shocks, and the impact of the global financial turmoil seems to be very limited. We appreciate the authorities' continuous efforts to improve regulatory and supervisory standards, including the implementation of Basle II and raising banks' minimum capital requirement.

6. On structural reform, we welcome authorities' ongoing projects to improve infrastructure for develop tourism, manufacturing and gas-based non-hydrocarbon industries. These efforts would help to diversify the economy away from the hydrocarbon sector and thus increase flexibility of the economy in responding to shocks. In this regard, the authorities' priorities on higher education and training to raise the labor productivity are steps in the right direction. *Staff's comments on what the authorities could learn from other GCC countries in diversifying the economy is welcome.*

7. With these remarks, we wish the authorities every success in their future endeavor.