Economic Update

NBK Economic Research Department I 18 December 2018

Oman outlook

Diversification efforts to proceed; public finances should improve

> Dana Al-Fakir
Economist
+965 2259 5373, danafakir@nbk.com

> Omar Al-Nakib
Senior Economist
+965 2259 5360, omarnakib@nbk.com

Highlights

- Real growth is expected to rise from an estimated 2.4% in 2018 to 3.6% in 2020 on continued gains in hydrocarbon output and non-oil activity, supported by the government's diversification and infrastructure spending program.
- Continued high spending levels amid a slightly softer oil price environment is likely to see the fiscal deficit widen to around 7% of GDP in 2019; non-oil revenues (e.g. from VAT) should, however, begin to increase going forward.
- Inflation is expected to climb to 2.9% in 2019 from an estimated 0.9% in 2018 if the VAT is rolled out as planned.
- Public debt is likely to continue rising, to just above 50% of GDP by 2020, as the authorities pursue further debt issuances to finance the deficit, but privatization and foreign investments are also being explored.

Pro-growth reforms set to persist in 2019 and 2020

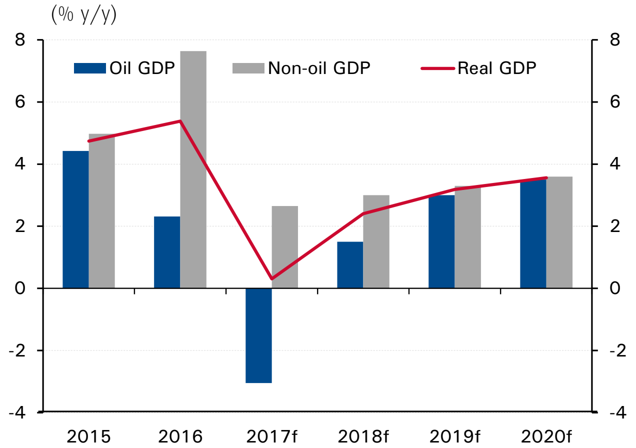
The government's development and diversification drive will continue to support the oil and non-oil sectors, respectively. In the energy sector, the authorities are committed to developing the country's downstream oil processes and further expanding gas production capacity. In the non-oil economy, the government will continue to realize plans for a multi-billion-dollar special economic zone in Duqm and an infrastructure development project that will connect Oman's three major ports Salalah, Sohar and Duqm, which is likely to be a boon for trade and investment prospects in the sultanate. The non-oil economy is also likely to get a further boost from the tourism sector, which the government hopes will increase by a minimum 65% in the number of tourists by 2020. . To this end, we potentially see economic growth averaging around 3.4% over 2019 and 2020, on the back of a recovery in both oil (3.3% y/y on avg.) and non-oil sector activity (3.5% y/y on avg.). (Chart 1.)

Table 1: Key economic indicators

		2017	2018f	2019f	2020f
Nominal GDP	USD bn	73	75	80	84
Real GDP	% y/y	0.3	2.4	3.2	3.6
- Oil	% y/y	-3.0	1.5	3.0	3.5
- Non-oil	% y/y	2.6	3.0	3.3	3.6
Inflation	% y/y	1.6	0.9	2.9	1.4
Budget balance	% of GDP	-14.7	-5.3	-6.8	-5.9

Source: Official sources, NBK estimates

Chart 1: Real GDP growth



Source: Thomson Reuters Datastream, NBK estimates

Oil and gas sector outlook looks promising

Notwithstanding Oman's participation in the OPEC+ production cut agreement, which had called for a 45 kb/d cut in Omani crude output (Oman averaged 92% compliance in 2018, according to the IEA), it is Oman's gas sector that is increasingly driving hydrocarbon sector growth and revenues, especially following recent non-associated natural gas discoveries and new project partnerships with international energy firms. Indeed, Omani gas supplies set new records in 2018, mainly on the back of an increase in production at the BP-operated 1 billion cubic feet per day Khazzan gas field.

Earlier this year BP initiated the development of Phase 2 (Ghazeer), which is expected to add by 2021 a further 500 million cubic feet per day to its production capacity.

Furthermore, state-led Petroleum Development Oman (PDO) announced that it had discovered about 4.4-4.7 trillion cubic feet and 112 million barrels, respectively, of recoverable gas and condensate reserves at Mabrouk North East. Production at this site is likely to begin in three to four years' time.

Non-oil growth anchored on diversification strategy

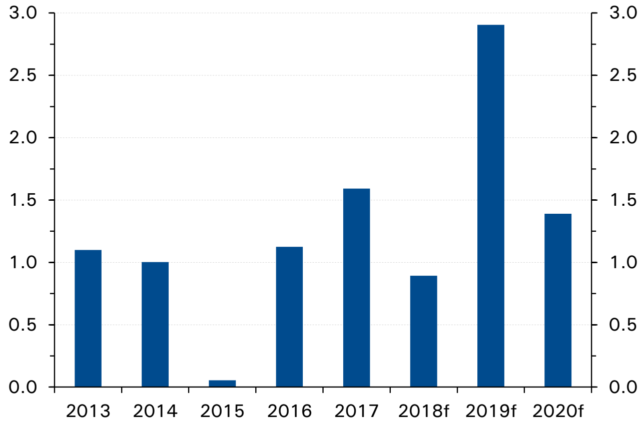
In tandem with Oman's Vision 2020 plan, the Omani government's steadfast commitment to its diversification strategy, which sees the development of key sectors including manufacturing, transport, logistics and tourism, is likely to support non-oil GDP growth going forward. The potential gains in these respective sectors are expected to temper the expected moderation in consumer demand within the next two years, triggered by the possible introduction of the value-added tax (VAT) in 2019. We therefore expect real non-oil GDP growth to continue to gather momentum and rise from an estimated 3.0% in 2018 to 3.3% in 2019 and 3.6% in 2020.

Inflation to gradually rise as economy recovers

Inflation is expected to pick up over the next two years in-tandem with an economic recovery. In the event that the VAT is introduced as planned in 2H19, we expect annual inflation to rise from an estimated 0.9% in 2018 to around 3.0% in 2019. The initial impact will fade away, however, and inflation will moderate to around 1.4% in 2020. (Chart 2.)

Chart 2 : Inflation

(% y/y)



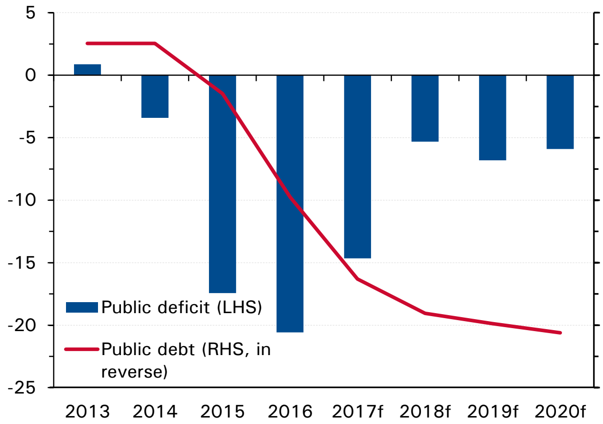
Source: Thomson Reuters Datastream, NBK estimates

Fiscal deficit to widen in 2019 on higher spending

Oman's budget deficit is expected to rise to around 7% of GDP in 2019 as the government pursues an expansionary fiscal policy to support economic growth. The deficit should narrow to around 6.0% of GDP in 2020 as revenues are driven up by higher real oil and non-oil output. (Chart 3.) A planned excise tax on sugary beverages and tobacco products and the possible introduction of VAT in 2019, should give non-oil revenues a further boost.

Chart 3: Fiscal balance and public debt

(% of GDP)



Source: Thomson Reuters Datastream, NBK estimates

Authorities to finance deficits via further debt issuances and the privatization of state-owned firms

Oman's persistently high spending has caused public debt levels to rise to almost 50% of GDP from a mere 13% of GDP in 2015. This has led to a series of credit rating downgrades, with Oman currently being rated below investment grade territory by S&P and one notch above non-investment grade by both Fitch and Moody's. Nonetheless, the authorities have been successful at issuing sovereign debt, albeit at elevated cost premiums, to plug the fiscal deficit, against a backdrop of relatively modest sovereign wealth assets. Indeed, Oman sold a $1.5bn seven-year sukuk at the start of 4Q18, its second debt issuance this year after the sale of a $6.5bn conventional bond in January 2018.

In addition, the government is also looking to attract foreign investment. It plans to privatize two electricity companies, Oman Electricity Transmission and Muscat Electricity Distribution ($3.2bn in total assets), which would also help lower subsidy costs.

Economic outlook encouraging despite downside risks

Downside risks to Oman's outlook stem mainly from continued budget deficits and the accumulation of public debt, which could further affect its credit rating. The planned introduction of the VAT and excise taxes next year should raise non-oil revenues and improve the fiscal balance within the next two years. In case Oman participates in a potential further round of OPEC+ production cuts in 2019, this will have a small impact on public finances and growth. However, further gains in gas output and non-oil sector activity are likely to more than offset those risks going forward.

Head Office

Kuwait
National Bank of Kuwait SAKP
Abdullah Al-Ahmed Street
P.O. Box 95, Safat 13001
Kuwait City, Kuwait
Tel: +965 2242 2011
Fax: +965 2259 5804
Telex: 22043-22451 NATBANK
www.nbk.com

International Network

Bahrain
National Bank of Kuwait SAKP
Zain Branch
Zain Tower, Building 401, Road 2806
Seef Area 428, P. O. Box 5290, Manama
Kingdom of Bahrain
Tel: +973 17 155 555
Fax: +973 17 104 860

National Bank of Kuwait SAKP
Bahrain Head Office
GB Corp Tower
Block 346, Road 4626
Building 1411
P.O. Box 5290, Manama
Kingdom of Bahrain
Tel: +973 17 155 555
Fax: +973 17 104 860

United Arab Emirates
National Bank of Kuwait SAKP
Dubai Branch
Latifa Tower, Sheikh Zayed Road
Next to Crown Plaza
P.O.Box 9293, Dubai, U.A.E
Tel: +971 4 3161600
Fax: +971 4 3888588

National Bank of Kuwait SAKP
Abu Dhabi Branch
Sheikh Rashed Bin Saeed
Al Maktoom, (Old Airport Road)
P.O.Box 113567,Abu Dhabi, U.A.E
Tel: +971 2 4199 555
Fax: +971 2 2222 477

Saudi Arabia
National Bank of Kuwait SAKP
Jeddah Branch
Al Khalidiah District,
Al Mukmal Tower, Jeddah
P.O Box: 15385 Jeddah 21444
Kingdom of Saudi Arabia
Tel: +966 2 603 6300
Fax: +966 2 603 6318

Jordan
National Bank of Kuwait SAKP
Amman Branch
Shareef Abdul Hamid Sharaf St
P.O. Box 941297, Shmeisani,
Amman 11194, Jordan
Tel: +962 6 580 0400
Fax: +962 6 580 0441

Lebanon
National Bank of Kuwait
(Lebanon) SAL
BAC Building, Justinien Street, Sanayeh
P.O. Box 11-5727, Riad El-Solh
Beirut 1107 2200, Lebanon
Tel: +961 1 759700
Fax: +961 1 747866

Iraq
Credit Bank of Iraq
Street 9, Building 187
Sadoon Street, District 102
P.O. Box 3420, Baghdad, Iraq
Tel: +964 1 7182198/7191944
+964 1 7188406/7171673
Fax: +964 1 7170156

Egypt
National Bank of Kuwait - Egypt
Plot 155, City Center, First Sector
5th Settlement, New Cairo
Egypt
Tel: +20 2 26149300
Fax: +20 2 26133978

United States of America
National Bank of Kuwait SAKP
New York Branch
299 Park Avenue
New York, NY 10171
USA
Tel: +1 212 303 9800
Fax: +1 212 319 8269

United Kingdom
National Bank of Kuwait
(International) Plc
Head Office
13 George Street
London W1U 3QJ
UK
Tel: +44 20 7224 2277
Fax: +44 20 7224 2101

National Bank of Kuwait
(International) Plc
Portman Square Branch
7 Portman Square
London W1H 6NA, UK
Tel: +44 20 7224 2277
Fax: +44 20 7486 3877

France
National Bank of Kuwait
(International) Plc
Paris Branch
90 Avenue des Champs-Elysees
75008 Paris
France
Tel: +33 1 5659 8600
Fax: +33 1 5659 8623

Singapore
National Bank of Kuwait SAKP
Singapore Branch
9 Raffles Place # 44-01
Republic Plaza
Singapore 048619
Tel: +65 6222 5348
Fax: +65 6224 5438

China
National Bank of Kuwait SAKP
Shanghai Office
Suite 1003, 10th Floor, Azia Center
1233 Lujiazui Ring Road
Shanghai 200120, China
Tel: +86 21 6888 1092
Fax: +86 21 5047 1011

NBK Capital

Kuwait
NBK Capital
38th Floor, Arraya II Building, Block 6
Shuhada'a street, Sharq
PO Box 4950, Safat, 13050
Kuwait
Tel: +965 2224 6900
Fax: +965 2224 6904 / 5

United Arab Emirates
NBK Capital Limited - UAE
Precinct Building 3, Office 404
Dubai International Financial Center
Sheikh Zayed Road
P.O. Box 506506, Dubai
UAE
Tel: +971 4 365 2800
Fax: +971 4 365 2805

Associates

Turkey
Turkish Bank
Valikonagl CAD. 7
Nisantasi, P.O. Box. 34371
Istanbul, Turkey
Tel: +90 212 373 6373
Fax: +90 212 225 0353