

**CENTRAL BANK OF OMAN**

**Mid-Year Review of  
the Omani Economy  
2010**



December 2010

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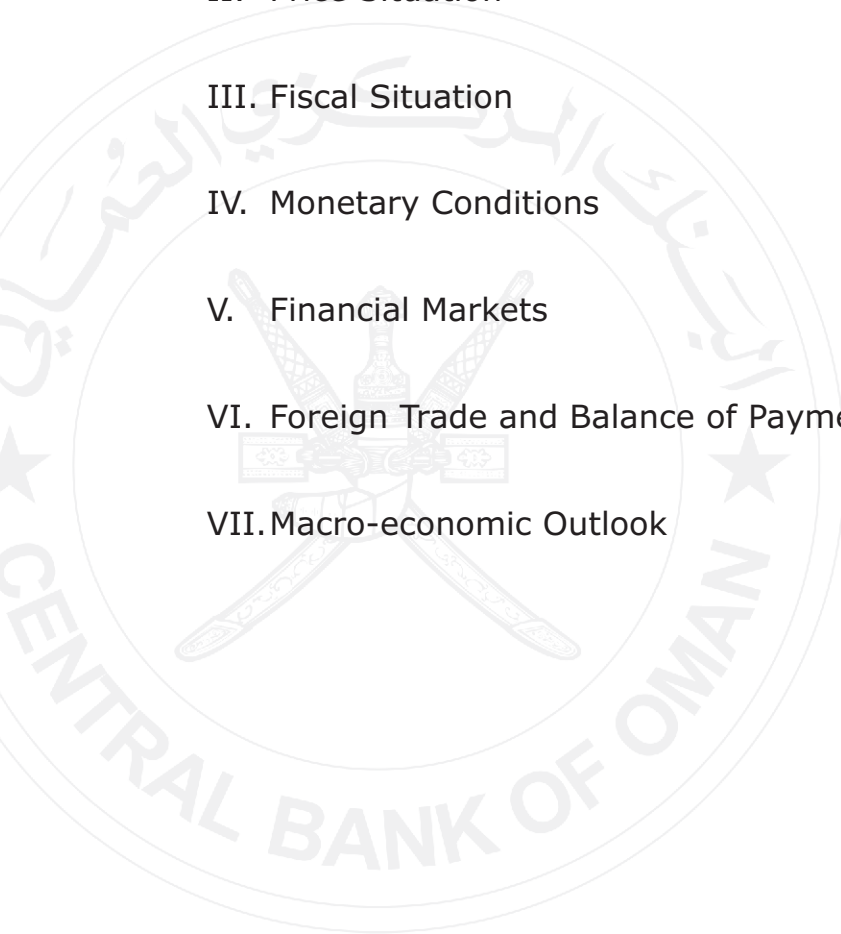
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Economic Research and Statistics Department

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## **FOREWORD**

After publication of the Annual Report of the Central Bank of Oman (CBO) in June/July every year, general public do not get comprehensive assessment of the Omani economy till the next Annual Report is published. In order to reduce this long time gap, the Economic Research and Statistics Department of the CBO took the initiative to bring out the first *Mid-Year Review of the Omani Economy for 2010*. The Mid-Year Review covers developments relating to the recovery of the Omani economy, price situation, fiscal situation, monetary conditions, financial markets, foreign trade and balance of payments and macro-economic outlook.

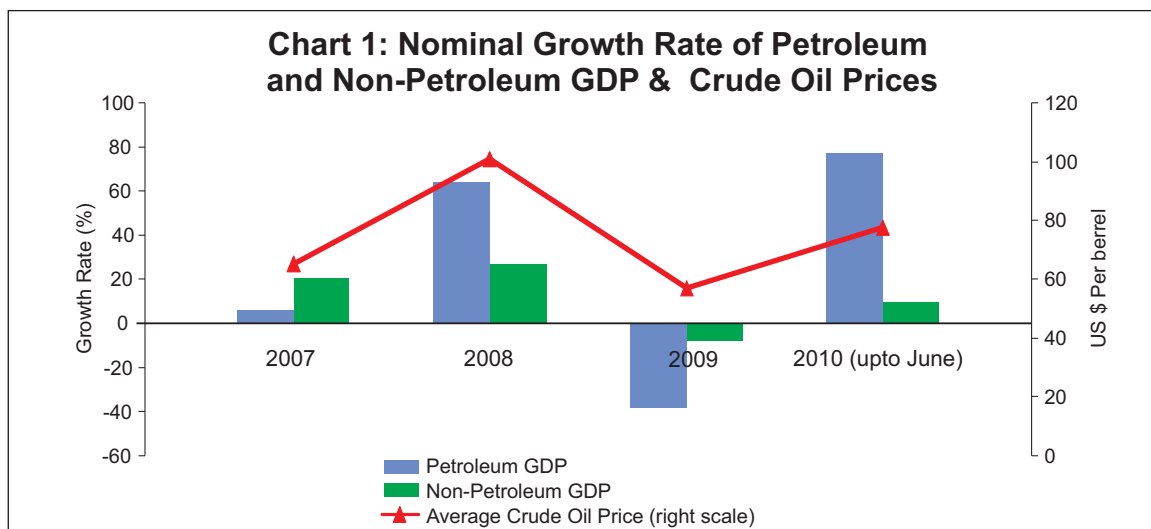
Feedback on the first Mid-Year Review of the economy may be sent to **[cboresb@omantel.net.om](mailto:cboresb@omantel.net.om)**. On the basis of the feedback likely to be received from the users, this publication may be enriched. The Research Department may bring out this review regularly by December every year covering the latest information for the benefit of the general public.

**Hamood Sangour Al-Zadjali**  
Executive President  
Central Bank of Oman

# MID-YEAR REVIEW OF THE OMANI ECONOMY 2010

## I. Output Growth

The recovery in the overall GDP growth in Oman witnessed during the first quarter of 2010 was sustained during the second quarter. During the first half of 2010, Gross Domestic Product (GDP) at current prices grew by 33.9 percent to RO 10,862.4 million in contrast to a decline of 26 percent to RO 8,110.8 million during the corresponding period of the previous year. While the nominal GDP emanating from the hydrocarbon sector posted a robust growth of 77.1 percent, the same from the non-petroleum activities rose by 9.7 percent during the first half of 2010. Break-up of petroleum GDP indicated an impressive growth of 82.9 percent in case of crude petroleum and 31.6 percent in case of natural gas during the first half of 2010 over the same period last year. Within the non-hydrocarbon sector, smart recovery was observed in case of industrial activities (13 percent), followed by services activities (8.6 percent) and agriculture and fishing (3.7 percent). Although recovery seems to be broad-based, performance of the construction sector (1.5 percent) and hotels and restaurants (-0.8 percent) was sluggish. Nominal GDP growth in Oman during the recent years closely followed the movement of crude oil prices in the international markets (Chart 1). The turnaround in GDP growth in Oman in 2010 was mostly driven by recovery in crude oil prices in the international markets, supported by accommodative domestic monetary and fiscal policies. Rise in average daily crude oil production by 6.7 percent to 860.2 thousand barrels per day up to September 2010 over the same period last year also contributed to the process of recovery.

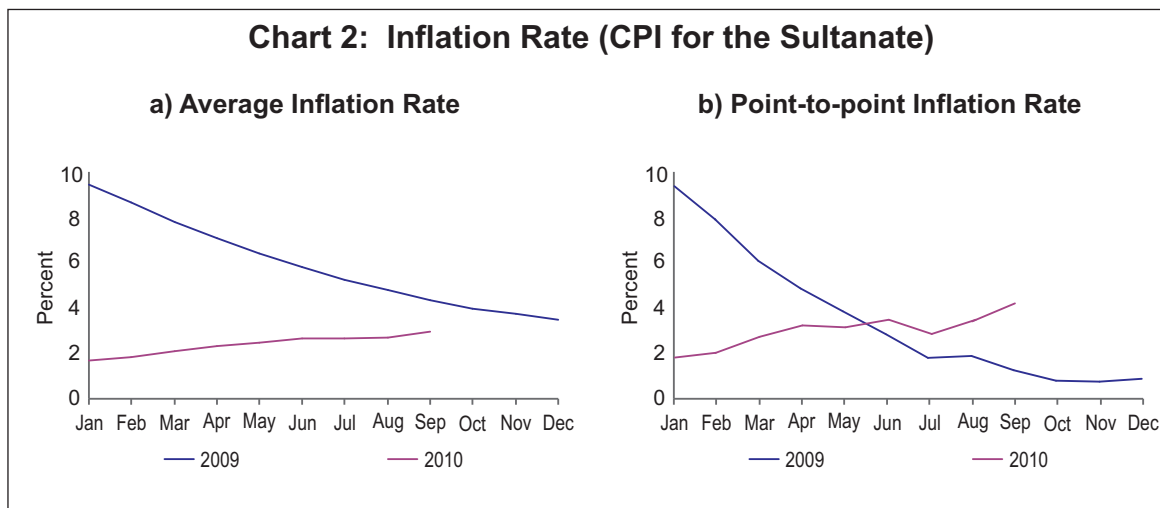


Source : Ministry of National Economy.

## II. Price Situation

Price situation remained, by and large, under control in Oman during 2010. Up to September 2010, the average inflation rate, measured by annual variation in the Consumer Price Index (CPI) for the Sultanate, stood at 3.0 percent compared to 4.4 percent a year ago (Chart 2a). Major group-wise, average inflation rate was the highest for 'personal care items and other services' (12.8%), followed by education services (5.3%) and 'rent, electricity, water and fuel' (4.0%). On a point-to-point basis, fall in the inflation rate bottomed out in November 2009, when the annual inflation rate was 0.8 percent. Thereafter, the inflation rate, on a point-to-point basis, gradually increased to 4.2 percent by September 2010 (Chart 2b) as against 1.2 percent a year ago. This could be attributed partly to sustained domestic demand and more importantly to steady increase in international prices of essential commodities since the first quarter of 2010. Oman being an importer of essential commodities, recent rise in prices of essential commodities such as sugar, cereals, edible oil etc., in the international markets is a matter of concern for the CBO. The global price situation is expected to remain benign during the remaining period of 2010, as the global recovery is expected to slowdown in the second half of 2010, particularly in the developed

countries. The CBO is keeping a close vigil over the prices of essential commodities in the domestic as well as international markets.



Source : Ministry of National Economy.

### III. Fiscal Situation

During 2009, the Omani economy suffered major setback mainly due to fall in the prices of crude oil in the international markets. Global recession and associated adverse impact on trade and financial flows led to cyclical downturn of the oil exporting countries in the Middle East, including Oman. In order to sustain aggregate demand, while CBO adopted accommodative monetary policy since the last quarter of 2008, the Government pursued countercyclical fiscal policy. The objective was to minimize adverse effects of the global recession during 2009-10, despite pressure on the overall fiscal balance in 2009. As a result of the accommodative monetary and fiscal policies, the Omani economy recovered since the first quarter of 2010. The major driver of the recovery in Oman so far, has been public sector activities, supported by domestic consumption demand. However, the private sector is yet to regain full confidence. Under this backdrop, Annual Budget for 2010 was presented by the Government in January 2010 envisaging a growth of 11.8 percent in

total expenditure and 10.9 percent in the capital expenditure over the previous year budget. Under the assumption of an average crude oil price of US \$ 50 per barrel, the Annual Budget anticipated 13.6 percent rise in revenues. As a result, the Annual Budget anticipated an overall deficit of RO 800 million in 2010. As the average Omani crude oil price realization up to September 2010 worked out at US \$ 76.6 per barrel, the overall fiscal balance may turn out to be positive in 2010.

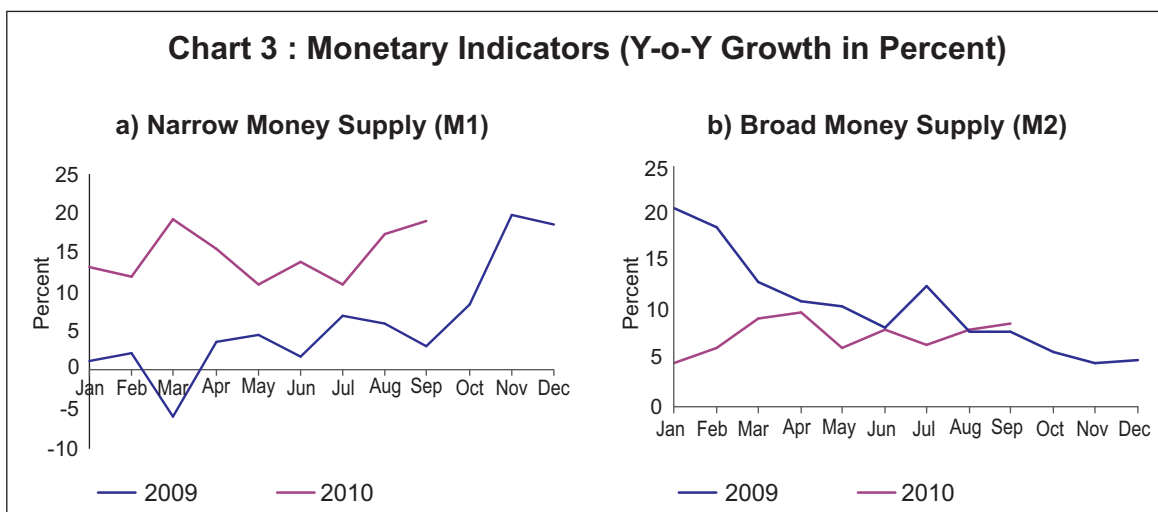
Latest data available up to September 2010 indicate that there has been 19.4 percent rise in total revenues during the first nine months of 2010 compared to the same during the corresponding period of 2009. Net oil revenues surged by 27.7 percent during the first three quarters of 2010 and other current revenues declined modestly by 7.1 percent during the same period. This indicates slowdown in the corporate profit and the attendant constraints to increase the private investment in the economy. Unlike in 2009, Government could be able to allocate sizeable amount to various wealth funds due to buoyancy in the oil revenues. In order to support activities in the private sector, Government has accelerated participation and support to the private sector by 48.2 percent to RO 356.4 million during the first nine months of 2010 compared to RO 240.5 million up to the same period last year.

Total debt of the Government stood higher at RO 1,205.9 million at the end of September 2010 compared to RO 1,068.3 million at the end of 2009 – a rise of 12.9 percent over the period. External debt increased by 7 percent to RO 879.8 million up to September 2010 while domestic debt rose by 32.6 percent to RO 326.1 million during the same period. Total government debt to GDP ratio at the end of December 2009 was 6 percent compared to 4.2 percent a year ago. Debt-GDP ratio was low in Oman compared to many other countries of the world.

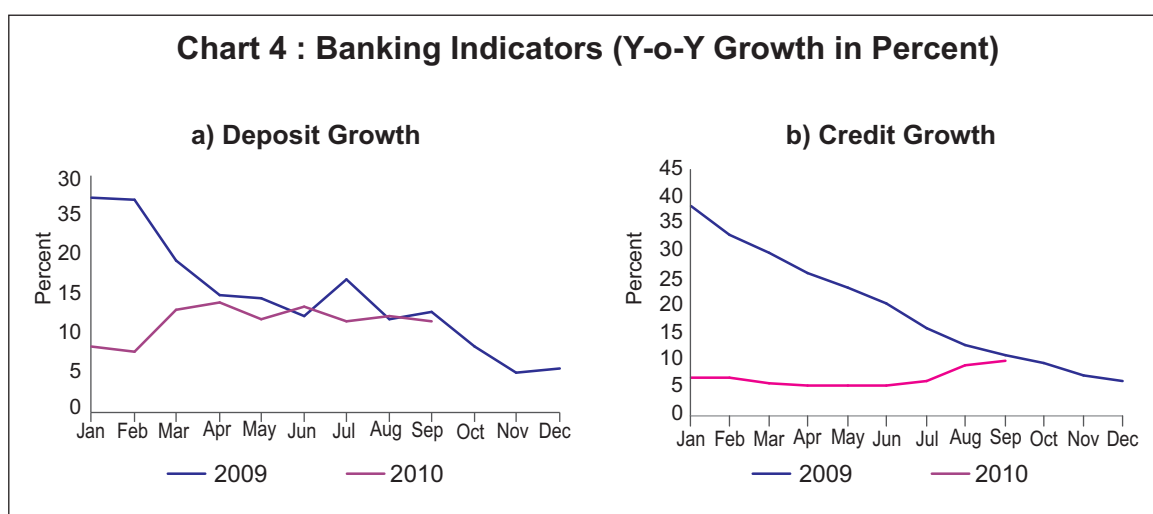
#### IV. Monetary Conditions

In order to support the incipient recovery, the CBO continued to pursue an accommodative monetary policy during 2010. Liquidity conditions remained comfortable throughout the year as evidenced by large roll over of CBO CDs in the weekly auctions. Reflecting recovery of the economy, money supply (M1) i.e., currency with the public and demand deposits with banks increased significantly by 19.1 percent to RO 2,666.7 million up to September 2010 on a year-on-year basis compared to 3.2 percent rise during the corresponding period of the previous year (Chart 3a). Broad money (M2) i.e., M1 plus quasi-money (time deposits) also expanded at a higher rate of 8.7 percent to RO 8,334.6 million up to September 2010 compared to a rise of 7.7 percent up to September 2009 (Chart 3b).

Omani banking system continued to depict optimism and resilience during 2010, consistent with recovery of the real economy. During the first nine months of 2010, aggregate deposits of commercial banks, on a year-on-year basis, increased by 11.6 percent to RO 9,971.3 million compared to 12.6 percent rise during the corresponding period of the previous year (Chart 4a). Private sector deposits, which constituted 70 percent of the total deposits,

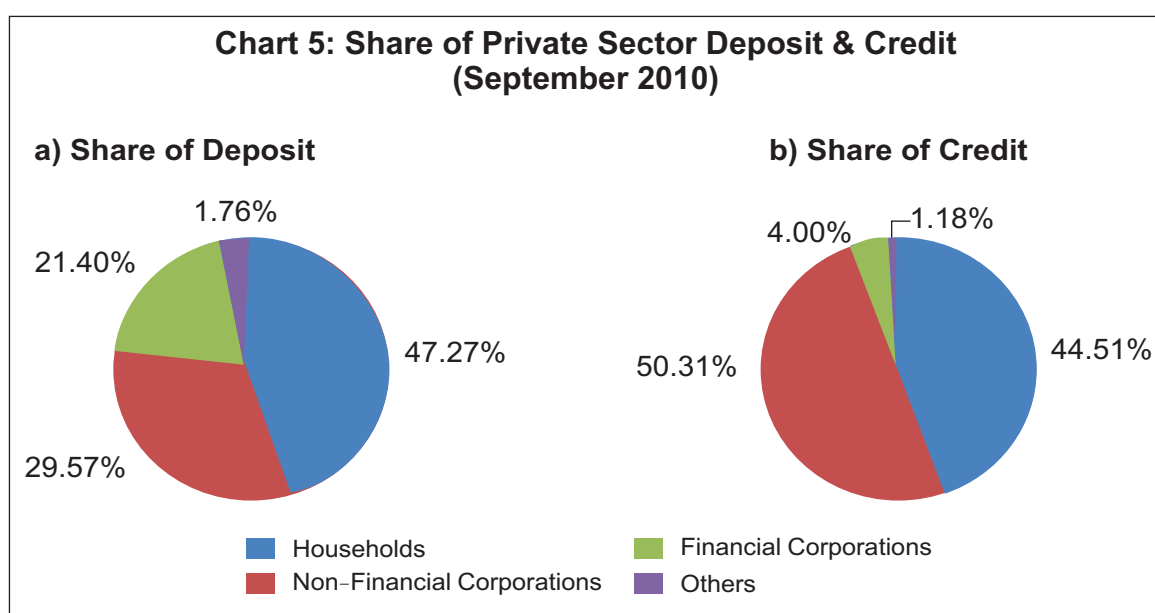


rose by 8.2 percent up to September 2010, while the government deposits and deposits by public enterprises increased by 18.6 percent and 25.7 percent, respectively. Within the private sector deposits, the share of household sector was 47.3 percent, followed by non-financial corporation at 29.6 percent, and financial corporation at 21.4 percent (of which pension funds alone accounted for 17.8 percent of total private sector deposits).



The credit growth has so far been lower at 9.9 percent up to September 2010 compared to 11.1 percent up to the same period last year (Chart 4b). This could be seen in the context of sluggish demand for credit by the Government as well as by the private sector. Government has reduced its dependence on bank credit due to revenue surplus arising out of higher realization of Omani crude oil price in the international markets. The nominal GDP growth emanating from non-petroleum activities has so far been modest, i.e., 9.7 percent in the first half of 2010 which partly explains deceleration of credit growth at 7.2% to the private sector. However, since July 2010, the private sector credit growth has improved considerably. Of the total credit to the private sector by September 2010, the share of non-financial corporations was 50.3 percent, followed by household sector (44.5 percent), and financial corporation (4 percent) (Chart 5). As the recovery has been mostly driven by public sector activities, credit to public

enterprises went up significantly by 57.2 percent to RO 815.4 million during the first nine months of 2010. The gross non-performing loans as percentage of total credit of the commercial banks at the end of June 2010 stood at 3.3 percent, slightly lower than 3.5 percent at the end of 2009. Commercial banks earned a net profit of RO 183.6 million (provisional) during the first three quarters of 2010, which was modestly lower than that of RO 194.9 million up to the same period in 2009.

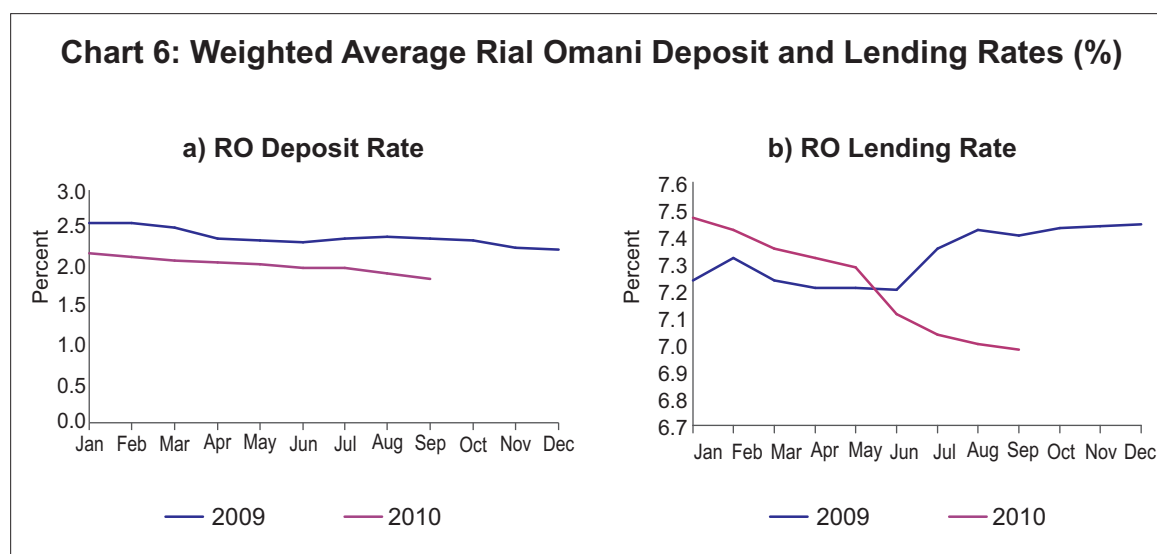


## V. Financial Markets

Activities in the credit market, which were sluggish in the first half of 2010, picked up in the third quarter in consonance with significant recovery of the Omani economy. Total assets/liabilities of the commercial banks increased by 12.6 percent to RO 15,705.3 million up to September 2010 compared to RO 13,943.6 million up to the same period of 2009. Credit accounted for 67.3 percent of total assets and 106.0 percent of total deposits at the end of September 2010 compared to 69 percent and 107.6 percent, respectively, a year ago. Total investment of the commercial banks rose marginally by 1.1

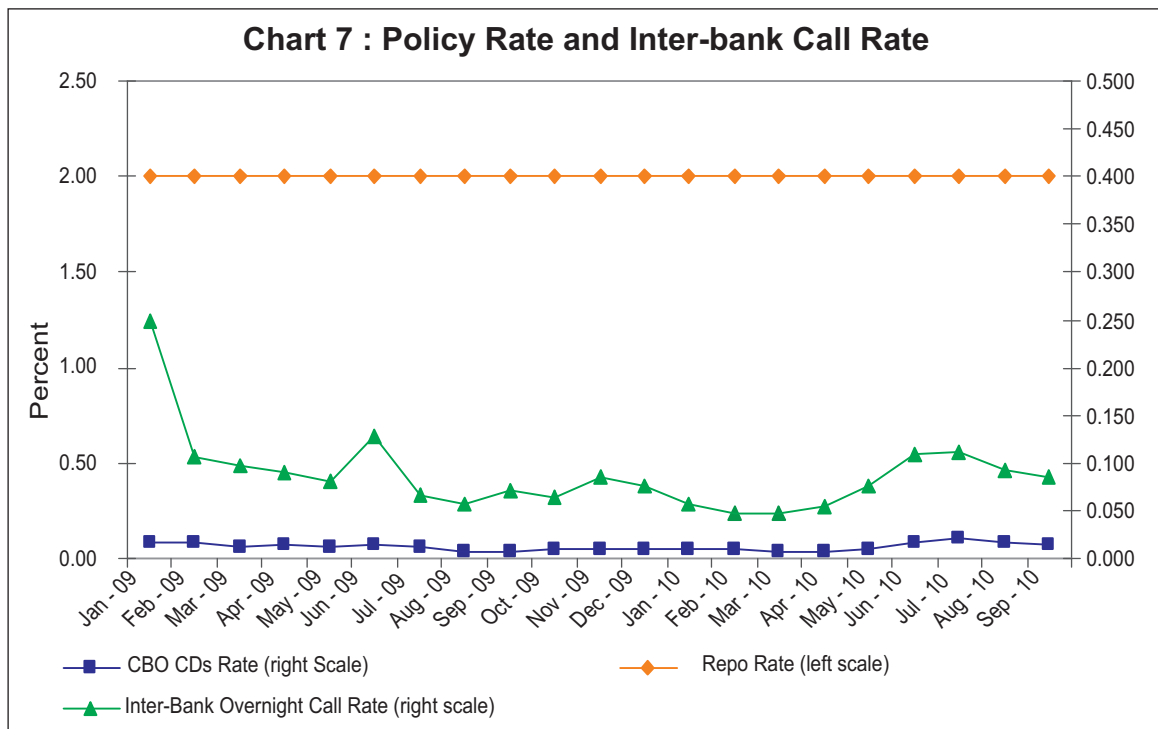
percent to RO 1,693.9 million by September 2010 compared to RO 1,675.8 million a year ago. About 70 percent of these investments were in CBO CDs in September 2010 compared to a little over 68.5 percent in September 2009, reflecting easy liquidity condition in the banking system. Commercial banks reduced their investment in foreign securities and other domestic securities up to September 2010 in anticipation of turnaround in interest rates and consequent fall in the value of securities.

Reflecting comfortable liquidity condition, both deposit and lending rates in Oman softened over the year. While the weighted average Rial Omani deposit rate dwindled from 2.36 percent in September 2009 to 1.85 percent in September 2010, the weighted average Rial Omani lending rate declined from 7.40 percent to 6.98 percent during the same period (Chart 6). Despite fall in the Rial Omani deposit and lending rates, commercial banks enjoyed a better interest rate spread of 5.14 in September 2010 compared to 5.04 a year ago. Easy liquidity condition was mainly driven by deposits received from the Government, public enterprises, and pension funds. Private sector deposit growth was modest as absolute decline in time deposit was more than offset by rise in demand and saving deposits.



Interest rate on foreign currency deposits declined from 0.915% in December 2009 to 0.792% in September 2010. Since December 2008, banks have been offering lower interest rate on foreign currency deposit compared to Rial Omani deposit, which was consistent with prevailing LIBOR rate. Despite significant fall in interest rate in foreign currency deposits, its growth rate was impressive at 23.7 percent by September 2010. Notwithstanding fall in the foreign currency deposit rate, it was still higher than the comparable rates in many western countries, which might have attracted such deposits. However, the lending rate in foreign currency, which was 2.869% in December 2009, softened marginally to 2.853% by September 2010. Commercial banks enjoyed a spread of over 2 in foreign currency lending over the foreign currency deposit rate in September 2010 compared to 1.954 in December 2009 and 1.689 a year ago. Interest rates on foreign currency deposit and lending were mostly governed by those prevailing in the international markets, while domestic deposit and lending rates were influenced by domestic demand and supply conditions.

Average monthly turnover in the over-night call money market in Oman during first nine months of 2010 was marginally higher at RO 24.35 million compared to RO 24.07 million during the same period of the previous year. However, the monthly average call money rate declined to 0.08 percent per annum from 0.11 percent during the same period reflecting continued surplus liquidity in the banking system. The inter-bank call money rate was marginally higher than the CBO CD rate throughout 2009 and 2010 (Chart 7). While the structural excess liquidity seems to have been mopped up by weekly auction of the CBO CDs, the frictional liquidity found its equilibrium among banks in the overnight call money market at a modest premium over the CBO CD rate.



Similar to certain other GCC countries, capital market remained subdued in Oman during 2010, despite considerable recovery of the economy. Although medium term fundamentals of the economy are robust, stock market activities mostly reflected sluggish growth of the private sector and fragile global recovery. Up to September 2010, the MSM index declined by 1.5 percent over the end September 2009 level while the value of turnover plummeted by 45.8 percent to RO 952.8 million during the same period.

Foreign exchange market worked smoothly during the first three quarters of 2010 despite turbulence in the international financial markets. Government continued to remain the main supplier of foreign exchange due to its dollar denominated oil revenues which it sells to the CBO for its local currency requirements. Commercial banks, on the other hand, purchased foreign exchange from the CBO to meet the customers demand for foreign exchange arising from transactions related to imports, workers' remittances and other capital account transactions. Commercial banks also accept foreign currency deposits, bulk of which is denominated in the US dollar. While foreign currency

deposits mostly finance foreign currency lending, commercial banks can borrow from the overseas markets within the aggregate gap limit prescribed by the CBO.

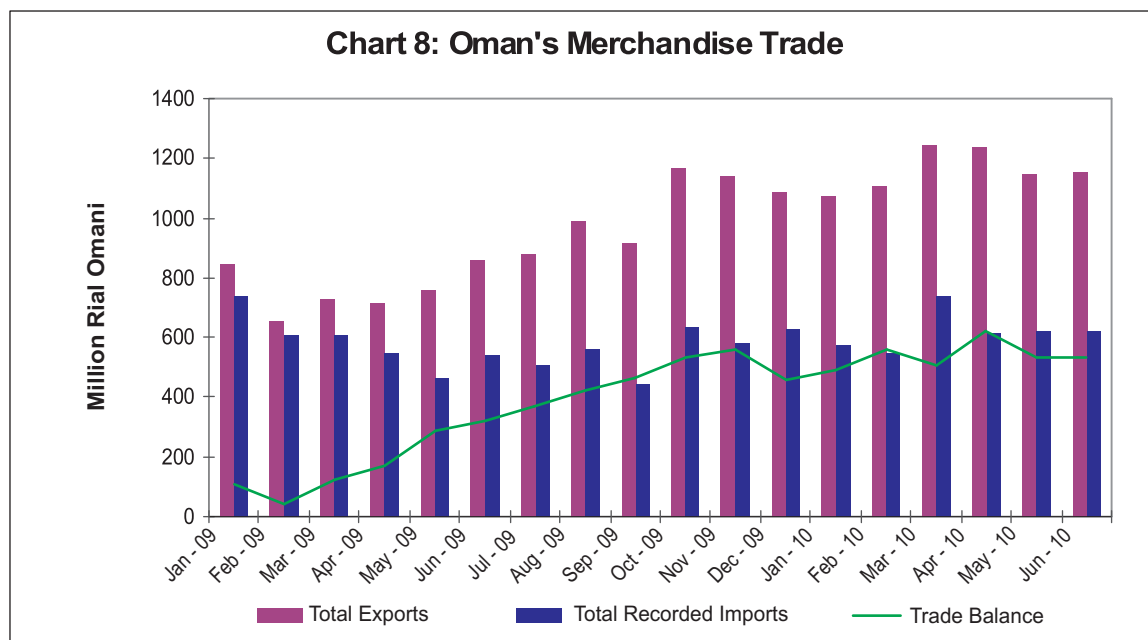
The 18- country import weighted Nominal Effective Exchange Rate (NEER) of Rial Omani, which was appreciating up to May 2010, depreciated to 91.4 by September 2010 compared to 92.5 in December 2009. The movement of NEER was broadly in line with the US dollar due to fixed exchange rate regime. Non-oil exports from Oman are expected to improve in the second half of 2010 due to depreciation of NEER.

## **VI. Foreign Trade and Balance of Payments**

Following recovery of crude oil prices in the international market, Oman's total exports remained above RO one billion every month since October 2009. The monthly average exports during the first half of 2010 was RO 1,158.9 million while average monthly recorded imports were RO 618.7 million. As a result, the average monthly merchandise trade balance improved to RO 540.2 million during the first six months of 2010 compared to RO 175.8 million during the corresponding period of 2009 (Chart 8). Improvement in the external merchandise trade balance was mainly on account of higher exports. Decomposition of exports into price effect and volume effect indicates predominance of price effect contributing to higher exports. Nevertheless increase in volume growth during the same period was a positive sign of rise in global demand although from a low base. The average price realization of Omani crude oil during the first six months of 2010 was US \$ 77.6 per barrel compared to US \$ 45.7 per barrel during the same period last year.

While oil and gas exports increased by 70.5% to RO 4,811.6 million during the first half of 2010, non-oil exports rose by 49% to RO 1,221.3 million. Increase in the re-exports was rather modest, i.e.; 10.2% during the same period. Within

the non-oil exports, the highest growth rate was achieved in case of mineral products (173.2%), followed by chemical products (120.3%), and plastic and rubber products (41%).



Source : Ministry of National Economy.

Although quarterly balance of payments data are not available in the public domain, the recent trend in merchandise trade indicates likely current account surplus in the first half of 2010. Workers' remittances during the first half of 2010 remained more or less in the previous year's level of a little over RO one billion. During 2010, the CBO expects the external current account to witness surplus as against small deficit in 2009. Although firm data are not available on foreign investments, foreign direct investment may be sustained in 2010 while portfolio investment may remain subdued. Despite strong medium term fundamentals of the economy, portfolio investments in Oman did not pick up in 2010 due to sluggish growth of the private sector in general and low corporate profit in particular. Reflecting the country's overall balance of payments position which seems to have remained comfortable during 2010, the foreign assets of the CBO during the first three quarters of 2010 increased by 16.6 percent to RO 5,040.6 million compared to RO 4,323.4 million a year ago.

## **VII. Macroeconomic Outlook and Policy Challenges**

The macro-economic outlook for 2010 remained positive for the Omani economy. The recovery witnessed in the first half of 2010 is expected to gather further momentum in the second half of 2010. This is corroborated by the fact that credit growth has started picking up from July 2010. Pressures on overall fiscal balance and also on country's external balance, witnessed in 2009, have receded in 2010 following significant turnaround in global crude oil prices and recovery in the domestic economy. The recent depreciation of the US dollar may contribute in sustaining the global prices of crude oil at an elevated level despite increase in downside risks to global growth in the second half of 2010. Negative output gap and high level of unemployment in the developed countries may keep the global inflationary pressures under check. Oman, as an importer of essential commodities, is expected to benefit from the benign inflation expectations in the western countries.

Keeping in view the heightened uncertainties as regards the momentum of global recovery and also sluggish growth of the domestic activities in the non-hydrocarbon sector, the major policy challenge before the CBO is to secure a broad-based recovery in Oman. The accommodative monetary policy pursued by the CBO since the last quarter of 2008, has been sustained in 2009 and 2010. The CBO may continue with the easy monetary policy for some more time so that confidence in the non-hydrocarbon sector is strengthened to sustain a reasonably high rate of growth in the medium-term.

The CBO is monitoring the price situation in the domestic and global markets, particularly in the context of the recent rise in prices of certain essential commodities in global commodity markets. A view is emerging that second quantitative easing pursued by the US Fed may increase global liquidity. This may increase both commodity and asset prices around the world. If global

recovery remains fragile beyond 2010, there could be quick turnaround in the inflation expectations. CBO is therefore prepared to take appropriate actions depending on global and domestic situations as regards prices. Conducting public policy in any country in a highly uncertain world characterized by excess liquidity, large unemployment, fiscal unsustainability, external current account imbalances and exchange rate misalignment has become more challenging now than ever before. Although the fear of double dip recession has receded, slowdown of global economic recovery spilling over to 2011, particularly in the developed countries, is a matter of concern. While developing countries witnessed signs of decoupling, there could be policy divergence based on domestic compulsions which may constrain global policy coordination for securing broad-based global recovery.

As of now, the financial sector in Oman has been found to be, by and large, resilient. Regulatory and supervisory concerns are being addressed by fine-tuning respective regulations consistent with international best practices. Although financial stability could be maintained in Oman, even during the worst phase of the recent global financial crisis, CBO's endeavour has been to safeguard the financial system in the medium term against global and regional shocks. Keeping in view the outcome of the recent global financial crisis and consequent financial sector reforms suggested by the global standard setting bodies, the CBO has already initiated a number of regulatory and supervisory measures recently to improve efficiency of the country's financial system in general and the banking system in particular. Mention may be made about the minimum regulatory capital, which was recently raised from 10% to 12% of the risk-weighted assets, to be achieved by the end of 2010. The risk-based supervision, which has been introduced recently on a pilot basis, would cover the entire banking system by 2012. Inflow of information from the risk-based supervision is being integrated with the off-site monitoring to keep a constant vigil over the banking system. Moreover, the CBO is currently working to

develop a set of macro-prudential indicators to assess the vulnerability of the financial system in Oman. As financial stability has emerged as a global problem, preliminary work has already been done to set up a financial stability unit within the CBO for macro-prudential supervision of the financial system and to produce the financial stability report in due course. The Monetary Policy and Banking Development Committee (MPBDC) is regularly evaluating the regulatory and supervisory reforms suggested by the international bodies and appropriate actions are being taken on those issues keeping in view their relevance to Oman. The Joint Mission of the IMF and the World Bank has recently given their update on the Financial Sector Assessment Program (FSAP) for Oman. The report is being examined by respective departments of the CBO.





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