

Research Update:

Rating On Oman Removed From Watch Negative, Affirmed At 'A' On Strength Of Fiscal, External Positions; Outlook Negative

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Overview

- We view Oman's net external and general government asset positions as substantial, and we note that protests have declined since May 2011.
- We are therefore affirming our 'A/A-1' long- and short-term ratings on Oman.
- We have removed the ratings from CreditWatch Negative in light of immediate political pressures easing. Aside from an isolated killing in Sohar, the protests were largely peaceful, and the quick response of Sultan Qaboos bin Said al-Said to protestor demands appears to have eased tensions.
- The outlook is negative, reflecting our view of the likelihood of a downgrade if latent political risks re-emerge and cannot be appeased by the planned increases in spending that aim to address demands raised earlier in 2011.

Rating Action

On July 20, 2011, Standard & Poor's Ratings Services affirmed its 'A/A-1' long-term and short-term local and foreign currency ratings on the Sultanate of Oman. We removed the ratings from CreditWatch with negative implications, where they were placed on March 7, 2011. The outlook is negative. Oman's transfer and convertibility (T&C) assessment remains 'AA-'.

We have also removed the government-supported ratings on Oman Power and Water Procurement Co. SAOC (OPWP) from CreditWatch with negative implications. The outlook on OPWP is negative.

Rationale

The ratings are supported by Oman's substantial net external and general government asset positions and constrained, in our view, by a heavy dependence on hydrocarbons, political risk, and some shortfalls on transparency with regard to government assets. The removal of the ratings from CreditWatch negative comes as immediate political tensions appear to have dissipated in recent weeks, and seem likely to remain subdued in the short term. Moreover, the unrest did not appear to have an appreciable impact on economic activity or foreign investment inflows.

The popular unrest during January-May, on the heels of the turmoil seen in Tunisia and Egypt, seems to have subsided in recent weeks. The protests that

began in the cities of Sohar and Muscat, and later spread south, were generally small and remained largely peaceful. The demonstrators did not target the ruler with their grievances, instead focusing on the need to fight government corruption, provide better employment opportunities, and raise living standards. In our view, the easing of tensions and the return to normal could be attributed to the Sultan swiftly addressing some of the demands. Measures included reshuffling the government, raising private-sector wages, creating 40,000 new public-sector jobs, providing unemployment benefits for job seekers, increasing the amount of public scholarships available for higher education, and building a second public university. The cost of these measures is estimated to reach 4% of GDP in 2011.

Oman has a comfortable fiscal buffer, which enables such spending. It had a fiscal surplus of 10% of GDP in 2010 and we estimate this will reach 12.0% in 2011. Oman could also gain from possible additional funding from the Gulf Cooperation Council Development Fund, which has pledged the equivalent of 1.5% of GDP per year for the next 10 years.

Still, continued demands for higher social spending could strain public finances over the medium term, particularly if Oman's terms of trade were to deteriorate. Oman's vulnerability to oil-price volatility is a function of the dominant role oil-related revenues plays in the government revenue base, as well as exports. On the political side, we remain unclear as to what extent the Sultan will follow through with plans to increase the legislative power of the elected Majlis al-Shura (a consultative assembly that acts as a bridge between the people and the government) as demanded in the recent demonstrations.

Oil production in Oman continued to increase in 2010 and is expected to grow further during 2011-2012. In our view, this will hasten the Omani economy's recovery from a 8.7% contraction in real GDP per capita in 2009. Higher oil receipts also boosted the buffer that the government has used for stimulus measures and on public spending. We expect this spending will help lift real per capita economic growth to around 2% annually over the next few years. Moreover, sharp increases both in oil prices and Oman's oil exports have helped shore-up the country's external performance, which has seen a major turnaround from the 2009 current account deficit.

Our local currency rating is equalized with the foreign currency rating because monetary policy options, which underpin a sovereign's greater flexibility in its own currency, are constrained by Oman's pegged exchange rate regime and relatively less-developed bond markets. Our T&C assessment reflects our opinion that the likelihood of the sovereign restricting access to foreign exchange needed by Oman-based non-sovereign issuers for debt service is moderately lower than the likelihood of the sovereign defaulting on its foreign currency obligations. There are very few foreign exchange restrictions, and economic policy tends to be outward oriented.

Outlook

The negative outlook reflects our view of the likelihood of a downgrade if political tensions heighten due to renewed protests in response to shortfalls or delays in addressing popular demands. The ratings could also come under downward pressure if fiscal performance weakens in the absence of revenue-enhancing measures outside the oil sector.

Alternatively, the ratings could stabilize at their current level if political and social reforms ease tensions, and if the underpinnings of economic growth strengthen, based on tangible diversification of the economy.

Related Criteria And Research

- Sovereign Government Rating Methodology And Assumptions, June 30, 2011.
- Use Of CreditWatch And Outlooks, Sept. 14, 2009.
- Methodology: Criteria For Determining Transfer And Convertibility Assessments, May 18, 2009

Ratings List

Ratings Affirmed; CreditWatch/Outlook Action

Oman (Sultanate of)

Sovereign Credit Rating	A/Negative/A-1	A/Watch Neg/A-1
Transfer & Convertibility Assessment	AA-	

Oman Power and Water Procurement Co. SAOC

Sovereign Credit Rating	A/Negative/--	A/Watch Neg/--
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Oman (Sultanate of)

Senior Unsecured	A	A/Watch Neg
Short-Term Debt	A-1	A-1/Watch Neg

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