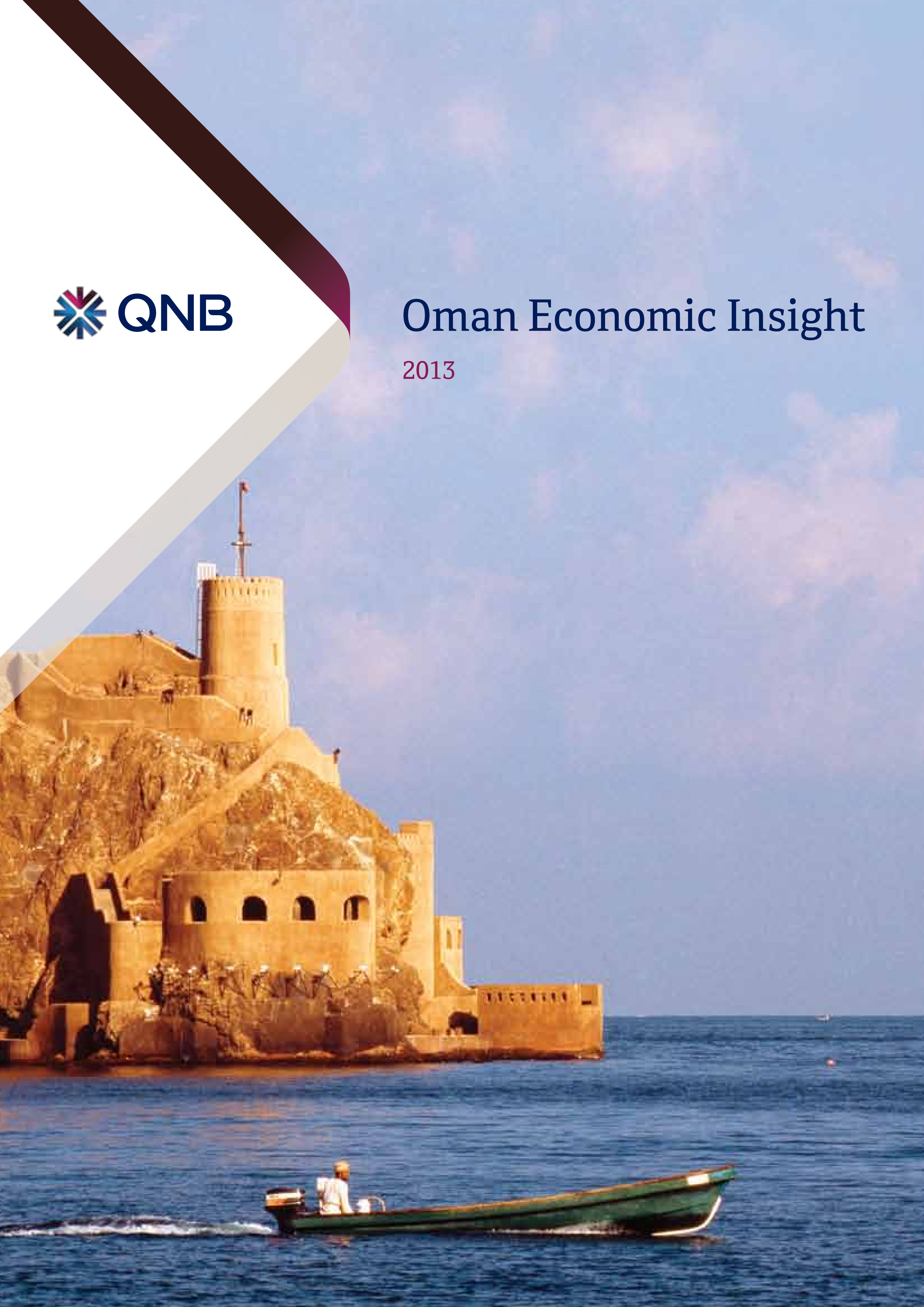


Oman Economic Insight

2013


IRAN
Strait of Hormuz
Bukha
(RAK Petroleum)
Al Khasab
Musandum
OMAN
ARABIAN GULF
OMAN
QATAR
GULF OF OMAN
Burami
Sohar
Burami
UNITED ARAB EMIRATES
Barka
Batinah
MUSCAT
W. Hajar Mountains
Al Rustaq
Qurayat
Muscat
Safah
Occidental)
Ibri
Dhahirah
Nizwa
E. Hajar Mountains
Sur
Ras al-Hadd
Lekhwair
Daleel
(Daleel Petroleum)
Fahud
Adam
Yibal
Yibal
Khazzan
Markarem
(BP)
Dakhiliyah
Sharqiyah
Saih
Rawl
Saih
Nihayda
QarnAlam
Abu Butabul
(OEPC)
Barik
SAUDI ARABIA
OMAN
Masirah Island
Gulf of Masirah
Wusta
Hayma
Duqm
Mukhaizna (Occidental)
Bahja
ARABIAN SEA
Swaqirah Bay
Marmul Bahja
Nimr
Dhofar
Harweel
RJQ
YEMEN
Salalah
Main road
International boundary
Main airport
Planned airport
Capital
Regional Capital
Other large town
Regional borders
Major Oilfiled cluster*
Major gasfields*
Gas pipeline
Oil pipeline
Industry
LNG
Oil Refinery
Oil exports
0 km
50
100
150
200
0 miles
50
100

Contents

Economics Team

economics@qnb.com.qa

Mohamad Moabi
Assistant General Manager
+974 4453 4638
mohamad.moabi@qnb.com.qa

Roy Thomas
Senior Economist
+974 4453 4648
roy.thomas@qnb.com.qa

Justin Alexander
Senior Economist
+974 4453 4642
justin.alexander@qnb.com.qa

Rory Fyfe
Economist
+974 4453 4643
rory.fyfe@qnb.com.qa

Minko Markovski
Economist
+974 4453 4649
minko.markovski@qnb.com.qa

Hamda Al-Thani
Economist
+974 4453 4646
hamda.althani@qnb.com.qa

Editorial closing, 25th February 2013

Summary

- Oman has been successful in *diversifying its economy*. The non-oil sector increased its share of real GDP from 50% in 2000 to 70% in 2012 and currently drives overall economic growth.

- *Real GDP growth is forecast at 3.8% in 2013 and at 3.0% in 2014*, driven by the non-oil sector as government spending further stimulates economic activity. Oil and gas production is expected to remain largely flat in 2013-14.

- The Government is committed to *creating jobs for Omanis*. It is estimated that 50,000 jobs need to be created each year to cater to the nationals entering the workforce. The government is likely to generate 56,000 jobs in 2013, mainly in the public sector. Attracting nationals to take up jobs in the private sector will remain a challenge.

- Oman has been able to *reverse its decade long oil production decline* using enhanced oil recovery techniques. It produced 918k barrels per day in 2012, up from 885k in 2011.

- Increased oil production and exports coupled along with manufacturing exports improved the current account in 2012, while foreign investments negated the overall balance of payments situation. *Foreign investment outflows* are likely to be cutback in 2013-14, improving the international reserves position.

- Interest rates have been *softening in 2012* due to buoyant market conditions. It is likely to remain stable in 2013.

- Inflation was at 3.0% in 2012 and has been on a downward trend. We forecast *inflation to remain muted in 2013 at 2.5%*, with a cooling in the housing market and an easing in food prices.

- The government is expected to continue with its *large public investment plan*, while budget surpluses are used to reduce government debt. The 2013 budget also includes record spending on *social benefits for nationals*.

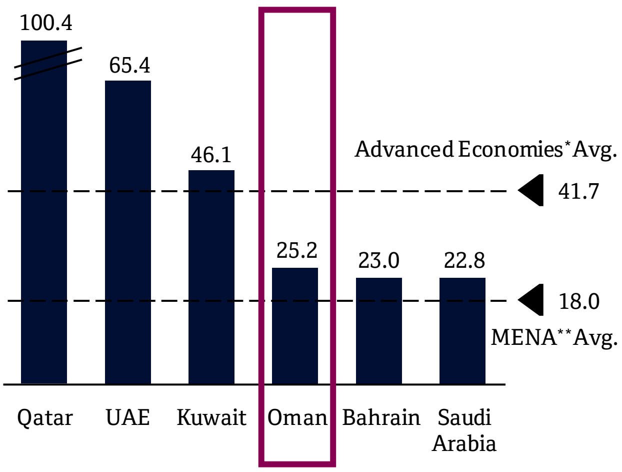
- The *banking system is stable with good asset quality*. The non-performing loans ratio has declined from 2.9% in 2010 to 2.5% in 2012.

- The banking sector is most likely to continue the strong growth trend in 2013-14 as continued government fiscal expansion stimulates credit growth. The recent *introduction of Islamic banking* will also provide immense opportunities for asset gains in the banking sector.

1. Overview

Oman has benefited in recent years from higher oil prices and production, which has translated into increased revenues and additional government spending. This in turn has supported the diversification of the economy and the growth of the non-oil sector. The non-oil sector currently accounts for 48% of nominal GDP and is a key economic growth driver. Economic growth has increased prosperity, which, as measured through GDP per capita at current prices, is estimated at US$25,152 in 2012 (Fig 1.1). Oman's GDP per capita is higher than the Middle East and North Africa (MENA) average.

Fig 1.1: GDP Per Capita (2012)
(US$k)



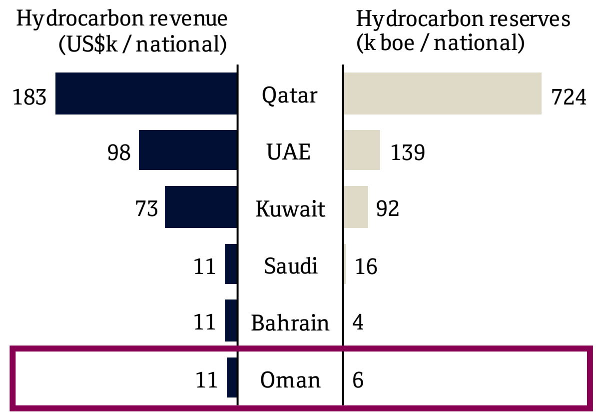
* A grouping of 35 developed global economies
** A grouping of 19 MENA economies
Source: International Monetary Fund (IMF) and QNB Group estimates

Hydrocarbons revenue has increased, however natural resources are limited

Oman's economy is mainly oil and gas, although economic diversification efforts by the government continue. Robust growth in the oil and gas sector has brought in an additional US$8.1bn in output as compared to 2008 and increased its share in nominal GDP to 52% in 2012. Oil and gas also accounts for the vast majority of exports and government revenues. A useful measure of Oman's relative hydrocarbon wealth is the government's revenue from hydrocarbon exports weighted against the national population. This was estimated at US$11,108 per national in 2012 (Fig 1.2).

Oman's natural resources are limited as oil and gas reserves which are currently estimated at 6,200 barrels of oil per citizen, are much smaller than those of all the other GCC members (except Bahrain). In addition, they are also more expensive to extract as the geographical terrain in Oman makes drilling difficult and more costly.

Fig 1.2: GCC Oil and Gas Wealth (2012)



Source: British Petroleum (BP), IMF and QNB Group estimates

Oman's Vision 2020 looks at economic balance and sustainable growth

Oman's Vision 2020 was developed in 1995 with assistance from the IMF. It outlined a developmental path towards an economy that is less dependent on the oil sector and in which gas resources are leveraged to boost industry, providing for more sustainable growth in the long-term (Table 1.1). Concurrently, the vision also aims at creating more job opportunities for nationals and provide training.

Table 1.1: Vision 2020 Nominal GDP Structure

% of GDP	1995	2020
Oil and Gas	**38.1%**	**19.0%**
Oil	37.2%	9.0%
Gas	0.9%	10.0%
Non-oil	**61.9%**	**81.0%**
Agriculture	2.8%	5.1%
Industry	8.4%	29.0%
Services	50.7%	46.9%

Source: Ministry of National Economy (MONE)

Oman has also been successful in diversifying its economy in real terms, after the implementation of the national vision. The non-oil sector has increased its share of real GDP from 50% in 2000 to 70% in 2012. Long-term planning for economic balance, sustainable growth and development of human resources have been key contributors to this success.

The Omani government implements its national vision over the medium-term through a series of five-year plans. The 8th five-year plan began in 2011 and has budgeted a 48% increase in spending for investment in infrastructure.

2. Demographics

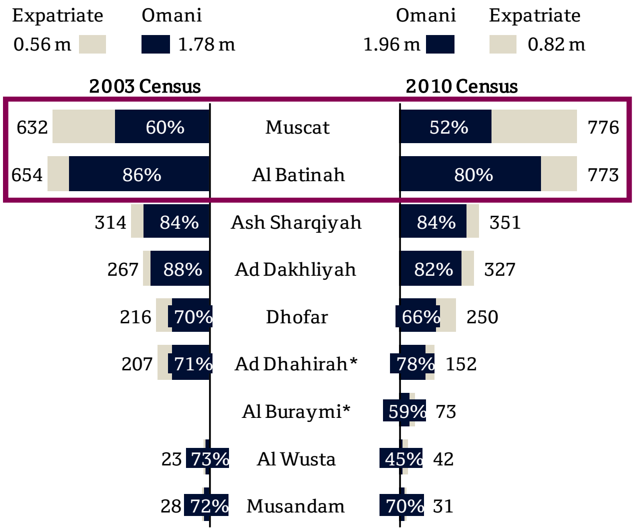
A. Population

The majority of the population resides in the northern territories

Oman is the second largest country in the GCC by land area, measuring 309.5k km^2. With most of the land area being arid terrain it is less densely populated as compared to other GCC countries. The most recent official data estimates the total population at 3.30m in 2011[1]. The majority of the population reside along the northern coastline in the Muscat governorate and Al Batinah Region (Fig 2.1).

Fig 2.1: Population by Governorate/Region (2003/2010)

(k and % share)



* Al Buraymi Governorate was instituted in 2008 separate from Ad Dhahirah Region

Source: MONE and QNB Group estimates

QNB Group estimates that the total population increased by 11.5% in 2012[2] to 3.68m. The increase was mainly due to higher government spending on major projects that created additional jobs and an inflow of expatriate workers. QNB Group forecasts a more gradual population growth of 5.0% in 2013-14 as additional infrastructure spending leads to further inflows of expatriate workers.

NCSI estimates show the national population accounting for 61% of the total population. Outside the Muscat governorate, there is a higher percentage of nationals as a majority of the projects and main industries, which attract expatriate workers, are located in and around the capital city Muscat.

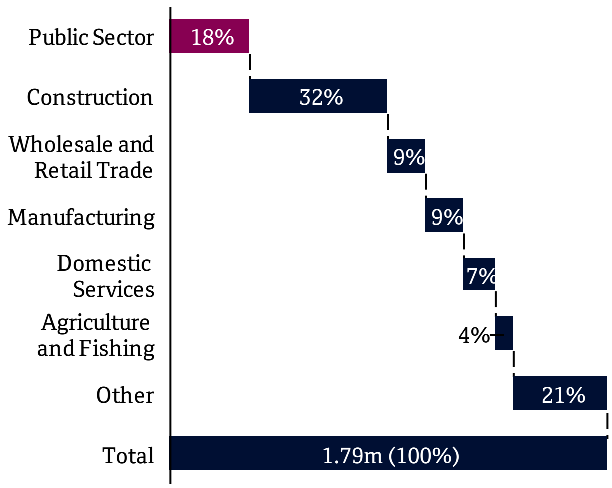
B. Labour Force

The workforce grew rapidly in 2011-12, particularly in the private sector

QNB Group estimates the total labour force increased by 13.6% in 2012 to reach 1.79m (Fig 2.2), mainly due to the inflow of foreign workers. The private sector created around 83% of the new jobs and is the largest employer. The private sector currently accounts for 82% of the total workforce, with Omani nationals representing a 12% share of private sector jobs.

Fig 2.2: Labour Force by Sector (2012)

(% share)



Source: MONE, Central Bank of Oman (CBO) and QNB Group estimates

The Omani workforce is heavily skewed towards the public sector with 92% of public sector jobs going to Omanis. In common with other GCC countries, nationals prefer public sector jobs due to the higher pay packages and benefits.

With nearly half the Omani population under the age of 20, it is estimated that over 50,000 jobs need to be created every year over the next decade to provide opportunities for the Omanis entering the job market. The government has committed to creating an additional 56,000 jobs in 2013[3], with 36,000 of these coming from the public sector. The government has set minimum wages in the private sector to lure nationals. However, Omanis are still not attracted to the job openings in the private sector due to the structural imbalances in pay and benefits as compared to the public sector. Expatriates are likely to continue filling the bulk of the jobs in the private sector in 2013-14.

[1] This is a mid-year estimate from the National Center for Statistics and Information (NCSI). The mid-year estimates are significantly higher compared to the census numbers, largely due to expatriates being on holiday outside the country at the time of the census.

[2] This is a year-end estimate.

[3] According to government sources.

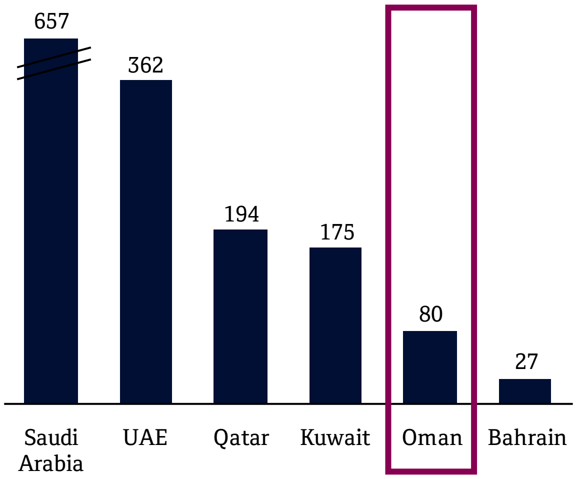
3. GDP

A. Nominal GDP

Oman has a relatively small economy compared to other GCC countries (Fig 3.1).

Fig 3.1: Nominal GDP in the GCC (2012)

(US$bn)



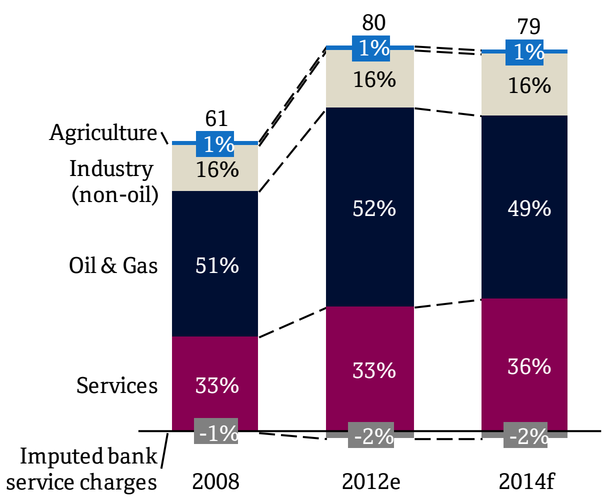
Source: NCSI, MONE, IMF and QNB Group analysis

Higher oil prices and production have driven rapid economic growth in recent years

Nominal GDP increased by 10% in 2012 after growing by 23% in both 2011 and 2010. Even as the non-oil sector expands, the high nominal growth in recent years has been driven by the oil and gas sector, which increased by 16%[4] in the last three years as oil prices and production rose. This resulted in the share of the oil and gas sector reaching 52% of GDP in 2012 (Fig 3.2).

Fig 3.2: Nominal GDP by Sector (2008-14)

(US$bn and % share of total)



Source: NCSI, MONE and QNB Group estimates and forecasts

[4] This is the compounded annual growth rate (CAGR), which is a geometric mean. In general, unless otherwise specified, all multi-year growth rates mentioned in this report will be CAGRs, rather than arithmetic means.

QNB Group forecasts a slight decline in nominal GDP for 2013-14, mainly due to a drop in oil price assumptions.

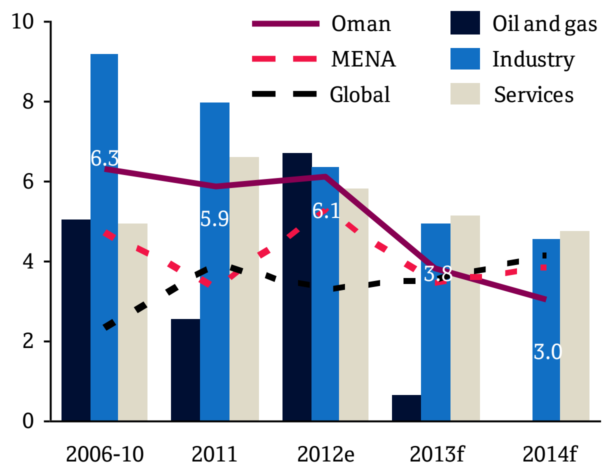
B. Real GDP

The non-oil sector is currently the key contributor and driving force for real growth

Real[5] GDP grew by 6.3% during 2006-10. The non-oil sector grew by 8.0% during the same period, resulting in a significant increase in its overall contribution to real GDP. As such, it has become the driving force for Oman's real GDP growth in recent years. Within the non-oil sector, the sub-sector industry grew at a rapid pace of 9.2% during 2006-10 (Fig 3.3).

Fig 3.3: Real GDP Growth by Major Sectors (2006-14)

(% change)



Source: MONE and QNB Group estimates and forecasts

Real sector activities remain buoyant, largely boosted by government spending

Real GDP growth is estimated at 6.1% for 2012, boosted by strong growth in all major economic sectors. The oil and gas sector is estimated to have grown by 6.7%, mainly due to increased oil production which reached an average of 918k barrels per day (b/d), from 885k b/d in 2011. Meanwhile, government spending boosted other major sector activities.

QNB Group forecasts real growth of 3.4% in 2013-14, as oil and gas production remains flat and growth is supported by government and private infrastructure investment, which will stimulate economic activity in the construction, logistics, manufacturing and financial services sectors.

[5] Real GDP shows the absolute change in the volume of economic output, by keeping prices constant at a certain base year, while nominal GDP shows the total value of economic output.

4. Economic Sectors

Oil and Gas (Section A) is the largest component of nominal GDP, accounting for 52% of GDP in 2012. It mainly includes crude oil and gas production (Fig 4.1).

Services (Section B) accounted for 33% of overall GDP in 2012. Wholesale and retail trade make up the largest sub-component of this sector.

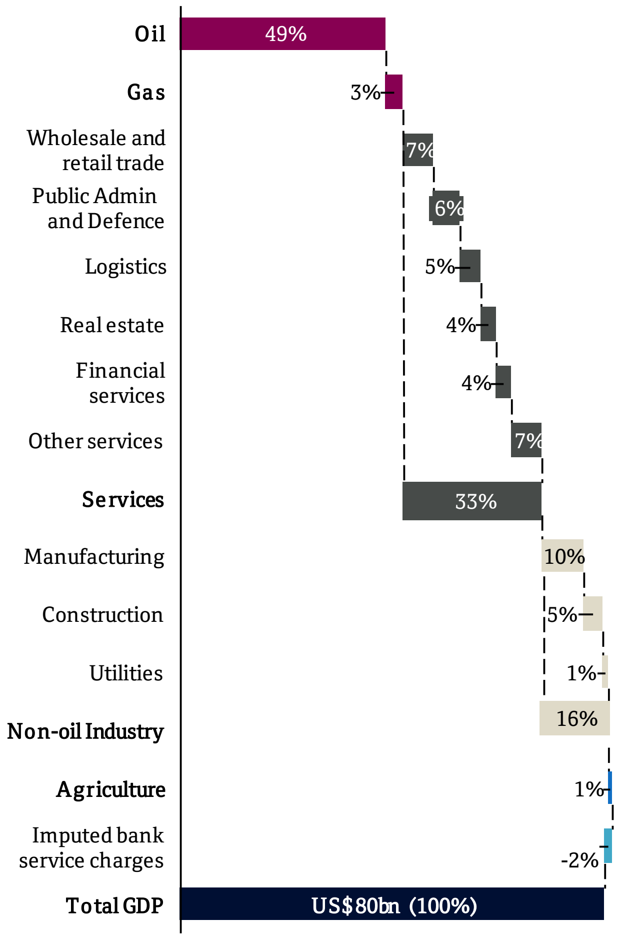
Non-oil Industry (Section C) formed 16% of GDP in 2012. It consists of manufacturing, construction and utilities. The manufacturing sector has witnessed significant growth over the past decade and forms the largest sub-sector.

Agriculture accounts for only a small proportion of GDP, which stood at 1% in 2012.

Imputed bank service charges are deducted from the overall GDP.

Fig 4.1: GDP by Economic Sectors (2012)

(% share and US$bn)



Source: MONE, QNB Group analysis and estimates

A. Oil and Gas

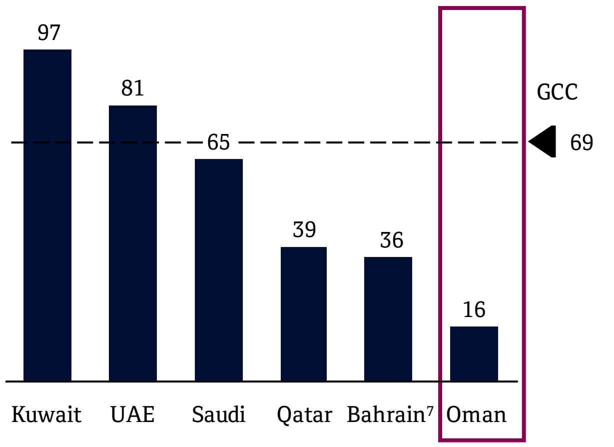
Oil

Oil reserves are relatively low compared to other GCC countries while production costs are high

Oman's proven oil reserves are currently estimated at 5.5bn barrels[6]. It is relatively low as compared to other GCC countries. Together with rising production, this has resulted in a low reserves to production ratio (Fig 4.2). This implies that at current production levels oil reserves will last for only another 16 years. Oil fields are located in north and central Oman and comprise of disparate clusters of smaller fields in mountainous regions. This geological structure makes production costs one of the highest in the region.

Fig 4.2: GCC Oil Reserves -to-Production (2012)

(Years of production at current output levels)



Source: BP Statistical Review of World Energy – June 2012, NBS and QNB Group estimates

Oil production has been boosted by EOR and the development of new fields

From 2001-07, Oman witnessed a long decline in oil production due to maturing oil fields. Average oil production declined from a peak of 956k b/d in 2001 to a low of 710k b/d in 2007 (Fig 4.3). Oman has managed to achieve a turnaround over the past five years due to enhanced oil recovery (EOR) techniques[8] and the development of new fields. In particular, Occidental's

[6] According to British Petroleum (BP) Statistical Review of World Energy – June 2012.

[7] For Bahrain, the reserves include its share with Saudi Arabia in the offshore Abu Safah field, which has around 5bn barrels. This has resulted in the relatively high reserves-to-production (R/P) for Bahrain.

[8] EOR involves the application of techniques such as miscible gas injection, steam injection and polymer flooding. These techniques can be used on both mature and new fields, and can improve extraction rates from perhaps 5-15% to 20-30% of in-place reserves.

Mukhaizna 53 field[9] has added an estimated annual output of 130k b/d. In 2012, average oil production[10] rose for the fifth consecutive year to reach 918k b/d.

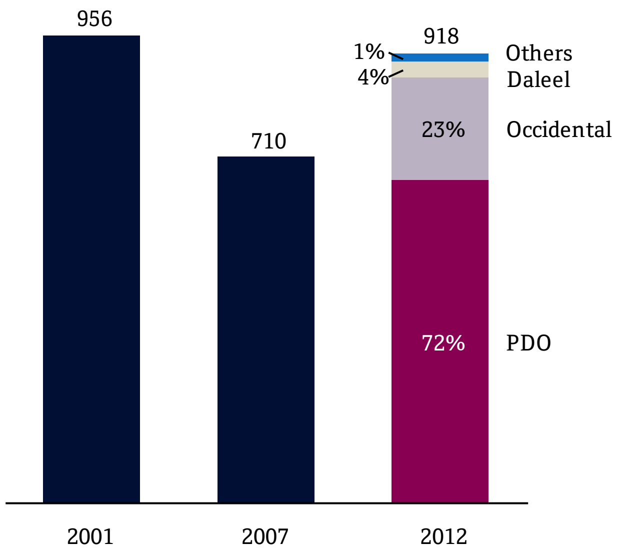
PDO and Occidental account for 95% of total oil production

Oman has developed its oil sector by awarding exploration concessions. There are now 18 companies[11] involved in oil exploration and production, out of which 8 are currently producing oil.

Petroleum Development Oman (PDO) was the first oil company to be established and holds over 90% of Oman's oil reserves. It is the largest oil producer (Fig 4.3) and is owned by the Government of Oman (60%), Shell (34%), Total (4%) and Partex (2%). PDO has invested heavily in EOR in recent years and been able to reverse its production decline. Its US$5.2bn-a-year investment plan for 2012-16 aims to increase production by a further 140k b/d. Occidental Petroleum is the second largest oil producer. It has been able to develop the Mukhaizna field and ramp up production by 130k b/d.

Fig 4.3: Oil Production and Producers (2001-12)

(k b/d and % share of production)



Source: Ministry of Oil and Gas and QNB Group estimates and analysis

[9] This is a large and unexploited field located west of Duqm. It was transferred in 2005 from PDO to a consortium led by Occidental.

[10] Oil production includes both crude oil and condensates. Average crude oil production by itself was 813k b/d in 2012, while condensates was 105k b/d.

[11] Oil producing companies are the national oil company, Petroleum Development Oman (PDO), Occidental Oman, Rak Petroleum, Daleel, Petrogas, Consolidated Contractors Energy Development (CCED), PTT Exploration and Production (PTTEP), and BP Oman. Other oil exploration companies active in Oman are Circle Oil, Epsilon Energy, Hunt Oil, Maersk Oil, MOL Group, OEPC Oman, Reliance Industries, a joint venture of Rex Oil & Gas and Petroci Holding (Côte d'Ivoire), Taqah Oman and Tethys.

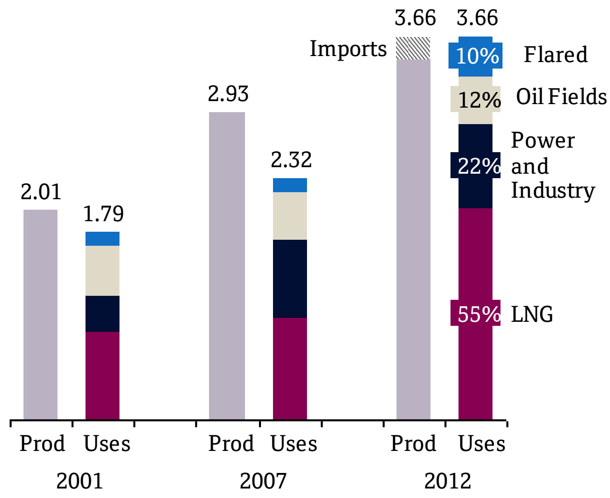
Natural Gas

Gas demand is growing faster than production requiring Oman to import

Oman's proven gas reserves are currently estimated at 33.5 trillion cubic feet[12] (tcf). At current production rates, reserves are expected to last for 36 years. However, due to growing demand from EOR applications, increasing domestic demand and liquefied natural gas (LNG) export commitments, Oman's gas consumption has outpaced its production. Oman currently imports around 200m cubic feet per day (cf/d) of gas from Qatar to meet additional demand (Fig 4.4).

Fig 4.4: Gas Production and Uses (2001-12)

(bn cf/d and % share)



Source: Ministry of Oil and Gas and QNB Group estimates and analysis

Long-term contracts have tied up gas for LNG exports

LNG production started in 2000 with a nameplate capacity of 2.3m tonnes/year (t/y). Further capacity has been added subsequently, reaching a total of 10.3m t/y in 2012, although actual exports were below capacity at an estimated 8.6m tonnes. Even with the ongoing shortage, 55% of gas production is consumed for LNG exports due to commitments under long-term sales contracts.

Oman's immediate gas shortage will be eased through increased output from PDO and state-owned Oman Oil Company (OOC). While PDO will optimise existing production, OOC is looking at bringing 140m cf/d of new production online in 2013-14.

[12] According to BP Statistical Review of World Energy – June 2012.

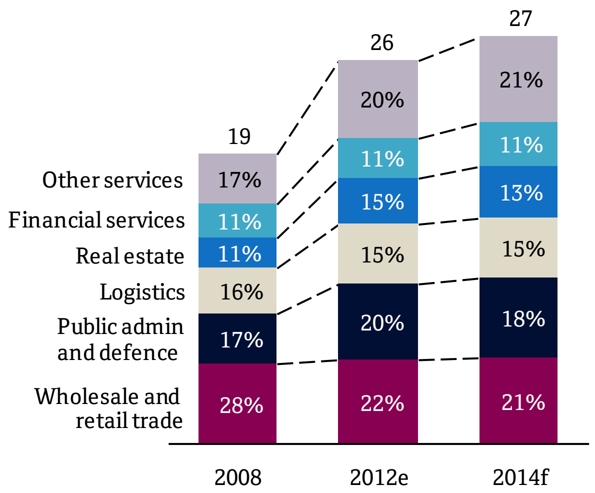
B. Services

The services sector accounted for 33% of nominal GDP in 2012, and 50% of the total workforce. Oman's national vision aims at increasing the services sector share to 47% of overall GDP by 2020.

The government has been pursuing a policy to expand domestic services. Infrastructure investments in new ports and free trade zones have encouraged the development of domestic services, such as logistics, trade and finance. This has supported real growth of 6.4% for the services sector in 2008-12.

Within the services sector, logistics stood out with a growth of 11.1%, receiving extra impetus from the opening up of the telecommunications sector, while trade and financial services grew by 4.0% and 9.1% respectively. Government services account for 20% of the services sector (Fig 4.5) and recorded a strong growth of 4.9% from 2008-12.

Fig 4.5: Services Sector Nominal GDP (2008-14)
(US$bn and % share)



Source: MONE and QNB Group analysis

Infrastructure development and an improving business environment will drive growth

The services sector grew in real terms by an estimated 5.8% in 2012, supported by robust growth in wholesale and retail trade and also public administration and defence. The influx of expatriate workers and increased public sector hiring were key drivers to this growth.

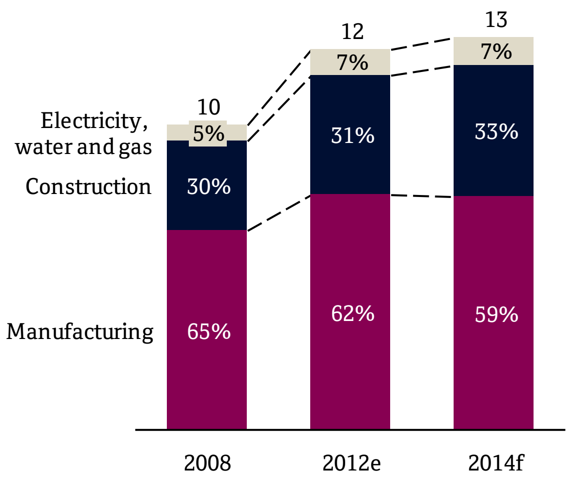
We forecast the services sector to grow by 4.9% in 2013-14. The key driver for growth will be the public investment program that includes a rail network, new air and sea ports, and education and social development initiatives. The government will also continue to provide investment incentives to attract more foreign direct investment into developing the logistics infrastructure.

C. Non-oil Industry

Manufacturing forms the cornerstone of Oman's diversification strategy

The non-oil industry consists of manufacturing, construction and utilities. This sector accounted for only 16% of nominal GDP in 2012 (Fig 4.1), but it employs 45% of the country's labour force. The national vision aims to increase the non-oil industry sector share to 29% of overall GDP by 2020. Manufacturing was the main contributor to the non-oil industry in 2012 (Fig 4.6). It forms the cornerstone of Oman's diversification strategy and is envisioned to account for 15% of overall GDP by 2020.

Fig 4.6: Industry Sector Nominal GDP (2008-14)
(US$bn and % share)



Source: MONE and QNB Group analysis

The non-oil industry sector grew at a real rate of 10.4% in 2007-11. Manufacturing grew in real terms by 8.5% in 2007-11 and by 6.5% in 2012. The manufacturing sector has witnessed strong growth due to the expansion of petrochemicals, fertilisers, cement, metals and refineries.

We forecast a more gradual growth of 4.2% in 2013-14 for the manufacturing sector as further expansion in the petrochemicals and fertiliser industry is likely to remain muted due to the shortage of gas feedstock. However, Oman's oil refining capacity is set to increase from the present 220,000 b/d with the Sohar refinery adding 60,000 b/d of capacity by 2015.

The construction sector showed a good recovery in 2011-12, after coming to a near standstill in 2010. The sector grew by 6.1% in 2011 and by 5.6% in 2012 as project spending picked up. We forecast growth of 5.0% in 2013-14 as government infrastructure spending boosts construction sector activity.

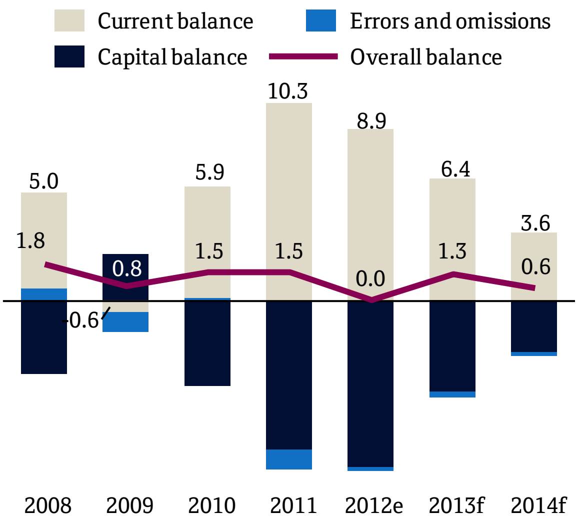
5. External Sector

A. Balance of Payments

Outward investment flows in the financial account have narrowed the overall surplus

Oman's external position showed a significant improvement in recent years mainly due to the rise in oil prices, supported also by the strong growth in non-oil exports. Even as the current account was boosted by higher oil prices, the financial account saw large foreign investment outflows which have brought down the balance of payments surplus. This has resulted in the overall balance of payments position, which represents the combined effect of the net flows emerging out of the current, capital, and financial accounts, witnessing a marginal surplus of US$1.5bn in both 2010 and 2011 (Fig 5.1).

Fig 5.1: Balance of Payments (2008-14)
(US$bn)



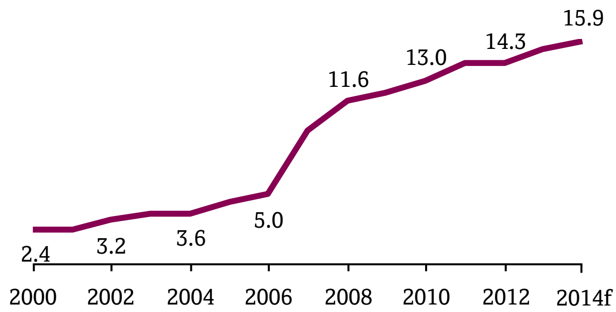
Source: CBO, MONE and QNB Group forecasts

International reserves may rise as outward foreign investments fall back from recent highs

The overall balance of payments reveals the changes in the country's international reserves. For Oman, the international reserves include both the central bank reserves and government reserves held with the State General Reserve Fund[13] (SGRF). With the foreign direct investment into Oman remaining subdued in 2012 and large capital outflows for the purchase of foreign assets, the overall international reserves declined marginally in 2012.

Oman's foreign exchange reserves were estimated at US$14.3bn as at year-end 2012 (Fig 5.2). This is expected to provide cover for seven months of imports, which is safely above the IMF suggested minimum of three months cover. We forecast international reserves to move up gradually in 2013-14 as outflows of foreign investments are scaled back from recent highs in line with a lower current account surplus.

Fig 5.2: International Reserves (2000-14)
(US$ bn)



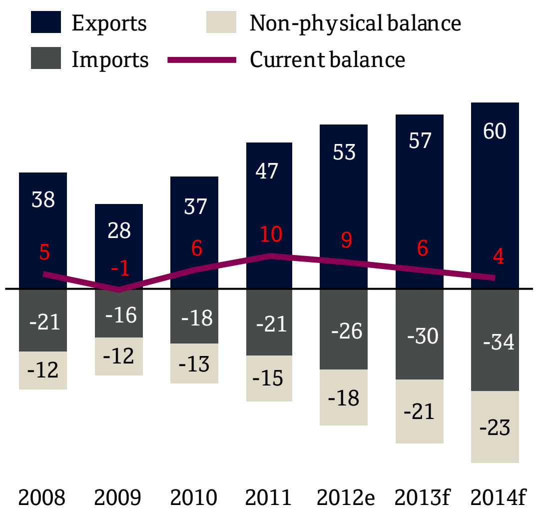
Source: CBO and QNB Group forecasts

B. Current Account

Growing imports and non-physical payments are impacting the current-account balance

Although Oman's current account has been boosted by increasing exports, the overall balance has been impacted on the reverse by increasing imports and non-physical outflows (Fig 5.3). Imports have increased rapidly by 20% in 2011 and by 21% in 2012 as robust economic activity increased the demand for capital goods. The non-physical balance has been impacted by a decline in tourism receipts, a surge in transportation costs for imports and a rising repatriation of company profits and workers remittances.

Fig 5.3: Current Account (2008-14)
(US$ bn)



Source: CBO and QNB Group forecasts

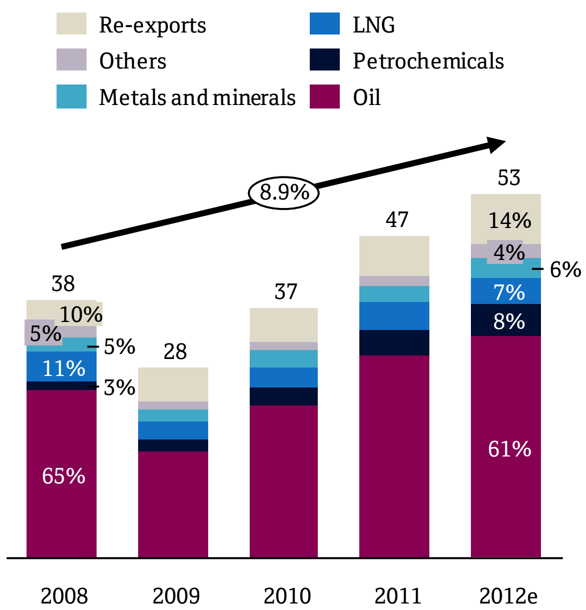
[13] One among the sovereign wealth funds of Oman.

Exports

Oil dominates export growth with increasing contribution from metals and minerals

In 2012, Oman's exports increased by an estimated 13% to a record level of US$53bn (Fig 5.4). Growth has come mainly from increased oil exports due to higher prices and production.

Fig 5.4: Exports (2008-12)
(US$ bn, % share and CAGR shown)

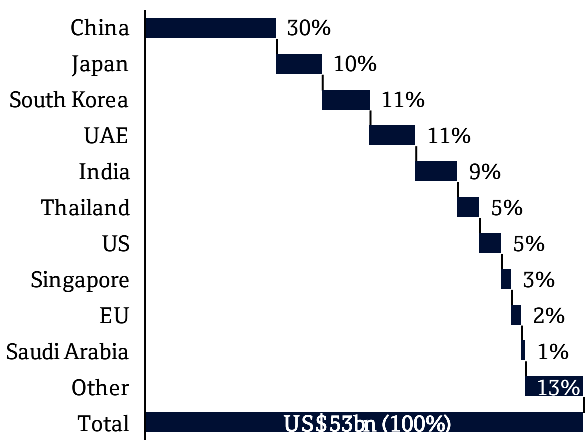


Source: MONE, Directorate General of Customs and QNB Group analysis

Over half of exports are directed towards Asia

China is the leading export destination for Oman, mainly due to sizeable oil exports. Japan and South Korea are other key export markets (Fig 5.5).

Fig 5.5: Export Destinations (2012)
(US$ bn, % share)



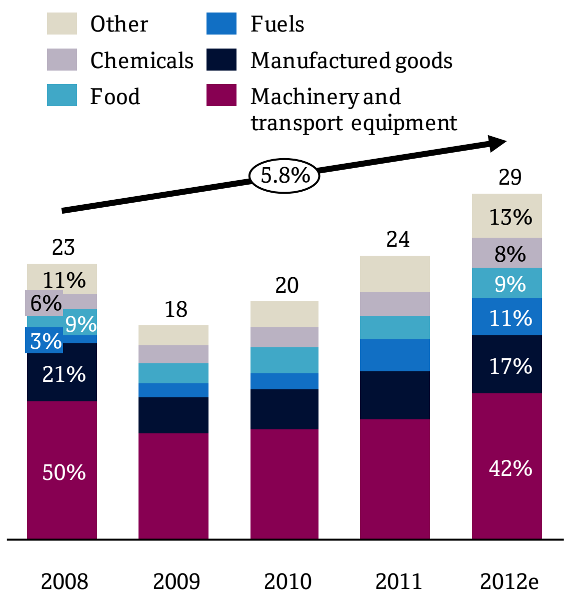
Source: MONE, IMF and QNB Group analysis

Imports

Robust economic activity and population growth has boosted imports

Imports grew by 11% in 2012 to reach a high of US$29bn (Fig 5.6). The increase has been mainly driven by a pick up in economic activity and an inflow of expatriate workers.

Fig 5.6: Imports (2008-12)
(US$ bn, % share and CAGR shown)

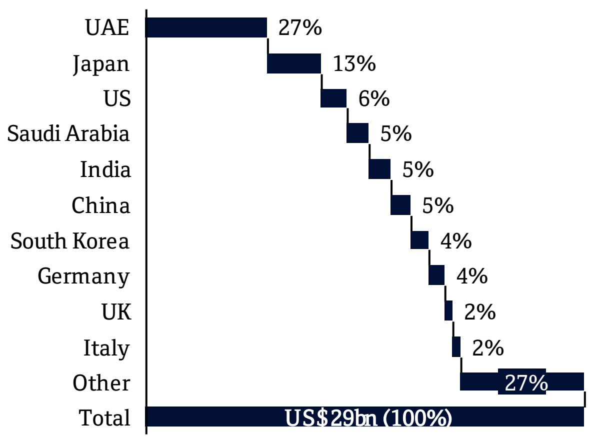


Source: MONE and QNB Group analysis; Note: totals are CIF (including customs, insurance and freight) and thus higher than in Fig 5.3

Over a third of the imports come from the GCC

The UAE is the leading import source for Oman (Fig 5.7) and the main items of imports are machinery and minerals.

Fig 5.7: Import Sources (2012)
(US$ bn, % share)



Source: MONE, IMF and QNB Group analysis

6. Money and Prices

The fixed exchange rate limits the effectiveness of monetary policy tools but provides stability

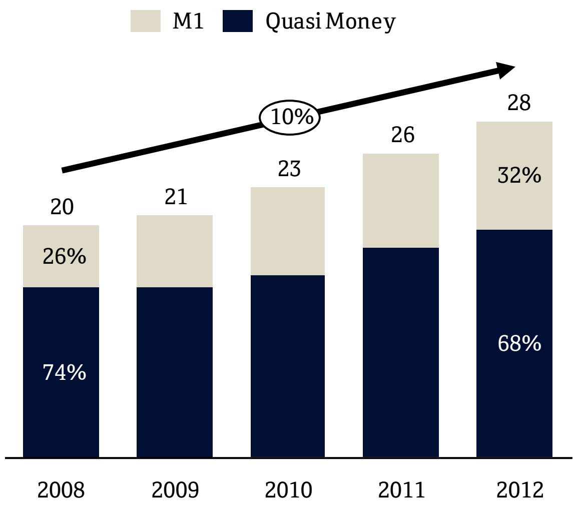
Oman operates a fixed exchange rate system with the Omani Rial pegged to the US Dollar at US$1=OR0.3845 since 1986. The fixed exchange rate system sets the monetary policy framework with the main objective of protecting and defending the peg. This means that official interest rates in Oman will have to closely follow those set by the US to avoid arbitrage pressure on the peg. Although the currency peg limits the monetary policy in terms of setting domestic interest rates, it has encouraged investment, trade and economic growth by providing exchange rate stability.

The CBO has absorbed excess liquidity in the banking system

The CBO has to ensure an appropriate level of liquidity so as to avoid internal and external currency imbalances. The CBO uses direct policy tools with commercial banks such as cash reserve requirements and the loans-to-deposit ratio to manage liquidity. Also, indirect instruments such as certificates of deposit (CD) to absorb excess liquidity and repo operations to inject liquidity are used. In 2012, the CBO issued short-term[14] CDs to lap up the excess liquidity in the banking system. The surge in money supply was created by increasing long-term bank deposits arising from buoyant economic activity and expansionary fiscal policies. Broad money supply (M2) grew by 11% in 2012 to US$28bn (Fig 6.1).

Fig 6.1: Money Supply (2008-2012)

(US$ bn, % share and CAGR shown)



Source: CBO and QNB Group analysis

Interest rates have been softening due to buoyant market conditions

The CBO policy repo rate was reduced by 100 basis points (bp) in March 2012 to 1% and remains at that level. The rate paid on CDs declined from 0.10% as at year-end 2011 to 0.09% as at December 2012.

With respect to the domestic interest rate structure of commercial banks, the weighted average interest rate on local currency deposits declined from 1.42% as at year-end 2011 to 1.32% as at December 2012, while the weighted average lending rate declined from 6.19% to 5.65% during the same period. The softening of interest rates in 2012 reflected the buoyant market conditions and ample liquidity.

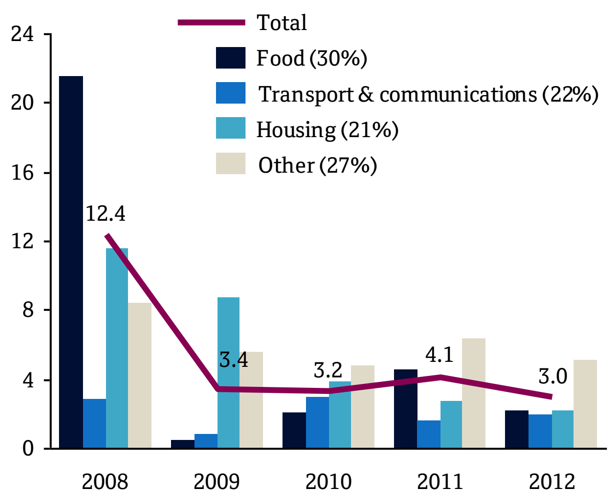
Food and housing prices are major drivers of inflation

Annual inflation as measured through the movement in the consumer price index (CPI), increased by an average of 3.0% in 2012. Inflation in Oman has been on a downward trend in 2012 due to the easing of global commodity prices, especially food items. The grouping of food which has the highest weightage on the CPI, increased by an average of 2.2% in 2012, compared to an increase of 4.5% in 2011 (Fig 6.2). The other major inflation driver in 2012 has been housing costs, which also moved up by 2.2%. Among the other groups, education increased by 15.2% in 2012.

We forecast inflation to remain muted in 2013 at 2.5% as global food prices ease further.

Fig 6.2: CPI Inflation (2008-2012)

(% change, weights shown in legend)



Source: NCSI and QNB Group analysis

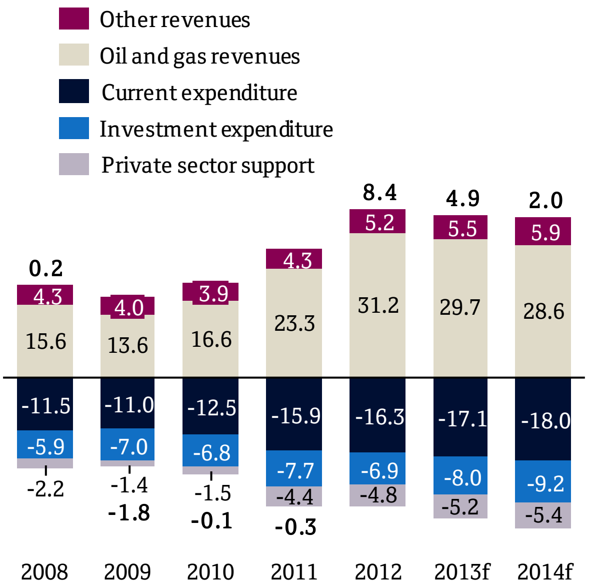
[14] CDs maturity is at 28 days.

7. Public Finance

Fiscal policy focuses on consolidation and a large public investment program

The government of Oman has been actively pursuing a policy of fiscal consolidation along with a large public investment plan. The government has been successful in its consolidation process in recent years and has achieved a turnaround in government finances. From deficits during 2009-11, the government accounts have reversed to a surplus of US$8.4bn in 2012 (Fig 7.1). In context of the public investment program, the 8th five-year plan (2011-15) reveals a budgeted 48% increase in spending for developing infrastructure and creating additional jobs.

Fig 7.1: Fiscal Balance (2008-2014)
(US$ bn, overall balance in bold)



Source: Ministry of Finance (MoF), CBO and QNB Group forecasts

Government revenues are highly dependent on the oil and gas sector, which accounted for an average of 81% of total revenues over the past five years. Oil and gas revenues increased by 34% in 2012, taking its share in overall government revenues to an all time high of 86% in 2012. This was achieved primarily due to the higher oil prices which averaged US$110/b during the year and oil production which reached 918k b/d. Other government revenues (corporate taxes, customs duties etc.) increased by 20% in 2012 and is beginning to show encouraging signals of growth in income diversification.

Government expenditure grew by 9% in 2008-12. After going up by 35% in 2011, overall expenditure has remained steady in 2012. The major increase in government spending has come from current expenditure, which increased by 15% in 2011-12. The bulk of current expenditure goes towards defence and national security and civil ministries as the government continued to address the rising pressures of the labour market of Omanis through their employment in defence and national security institutions, civil ministries, and other public sector institutions. There has also been a correspondingly significant rise in support to the private sector as the government set minimum wages in this sector to attract Omani nationals.

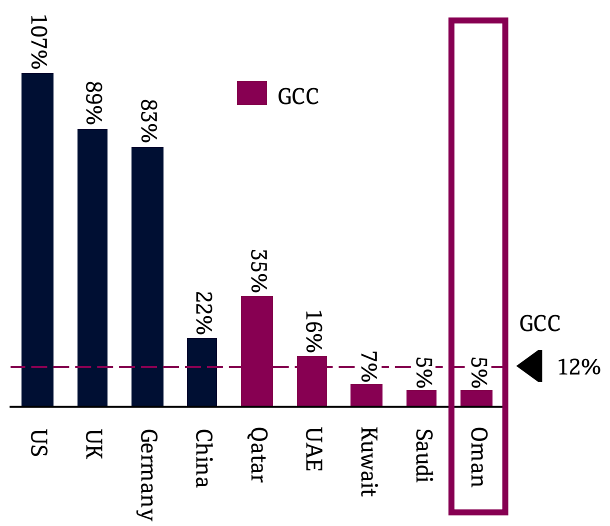
The 2013 budget includes record spending on social benefits for nationals

The State General Budget for 2013 projects total revenues to increase by 27% over the previous budget to US$29bn, while total government expenditures are forecasted to increase by 29% to US$34bn, resulting in a deficit of US$5bn. The 2013 budget has the biggest ever spending directed towards providing nationals with social benefits such as education, training, social security and housing. Current expenditures will account for 63% of overall budget spending in 2013, while investment expenditures will account for 24% and support to the private sector the remaining 13%. The Budget for 2013 is based on an oil price assumption of US$85/b. With oil prices well above this level, we expect the actual budget to be in surplus by around US$5bn.

Budget surpluses have been used to reduce government debt

Oman's government debt to GDP was very low at 5% in 2012, as compared to debt in most other countries (Fig 7.2). The government has been utilising surpluses from 2002-08 to reduce government debt, which stood at 17% of GDP in 2002.

Fig 7.2: Government Debt/GDP (2012)
(Government debt as % of GDP)



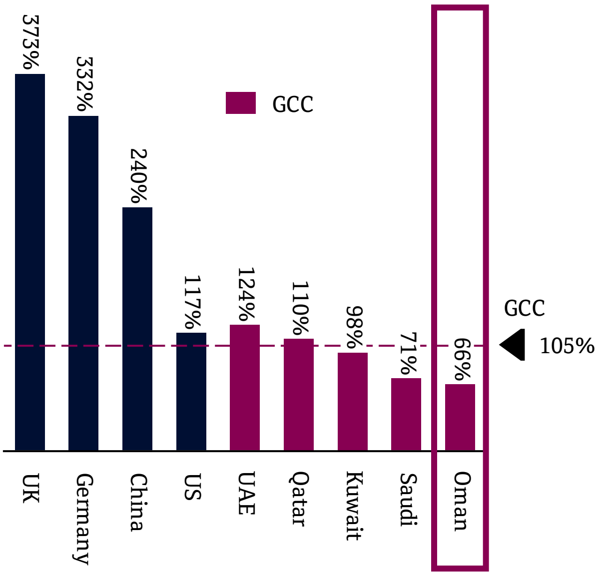
Source: Ministry of Finance, IMF and QNB Group estimates

8. Banking

The banking system is stable with good asset quality and underlying growth opportunities

The banking system in Oman has remained stable, with the balance sheet of commercial banks strengthening due to a favourable economic environment and sound regulatory supervision by the CBO. The total banking assets to GDP was at 66% in 2011 and reached 68% in 2012. This is a relatively low level compared to major global economies and other GCC economies (Fig 8.1). Oman's banking sector asset quality has been good with the non performing loans (NPL) ratio declining from 2.9% in 2010 to 2.5% in 2012.

Fig 8.1: Total Banking Assets to GDP (2011)
(Total Assets as % of GDP)



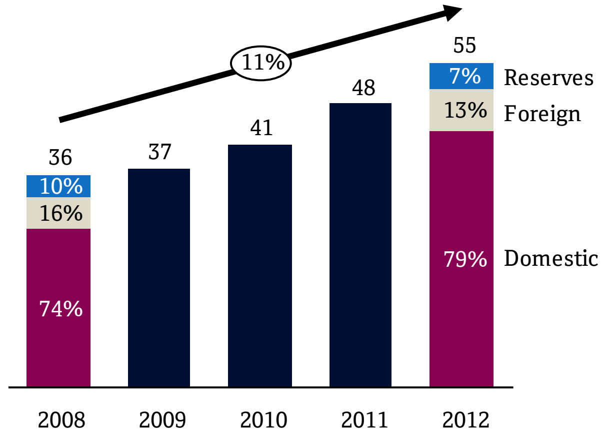
Source: Central Banks and QNB Group analysis

Economic growth and fiscal spending has provided for credit expansion and asset gains

The banking sector in Oman is relatively small in size compared to its GCC neighbours. While the overall assets of commercial banks in UAE and Saudi was at US$490bn and US$462bn, respectively in 2012, that of Oman stood at US$55bn. However, Oman's banking sector has been resilient even in the midst of the global financial crisis and grew rapidly. The balance sheet of banks expanded by 11% during 2008-12 (Fig 8.2), supported by buoyant economic activities and government spending that has led to the robust growth in deposits and credit.

Total credit facilities which accounted for 68% of total assets, increased by 14% in 2012 driving the overall growth in assets. Reserves went up by 60% in 2012.

Fig 8.2: Total Banking Sector Assets (2008-12)
(US$bn, CAGR shown)

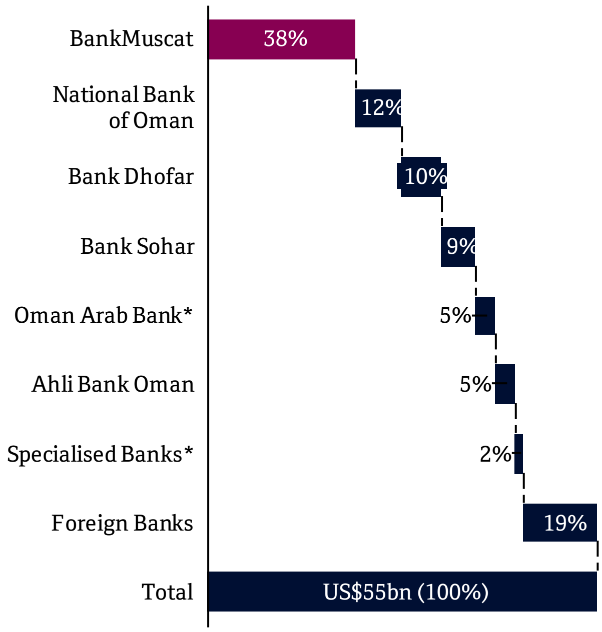


Source: CBO and QNB Group analysis

Local banks dominate the banking sector with a 79% share in assets

There were 16 commercial banks operating in Oman as at year-end 2012. This includes six local and ten foreign banks. Also present are two specialised banks, the Oman Housing Bank and the Oman Development Bank. Oman's banking sector concentration is similar to other GCC countries due to the favourable regulations supporting local banks. The six local banks accounted for 79% of the banking sector assets in 2012 (Fig 8.3).

Fig 8.3: Banks Share of Assets (2012)
(% share)



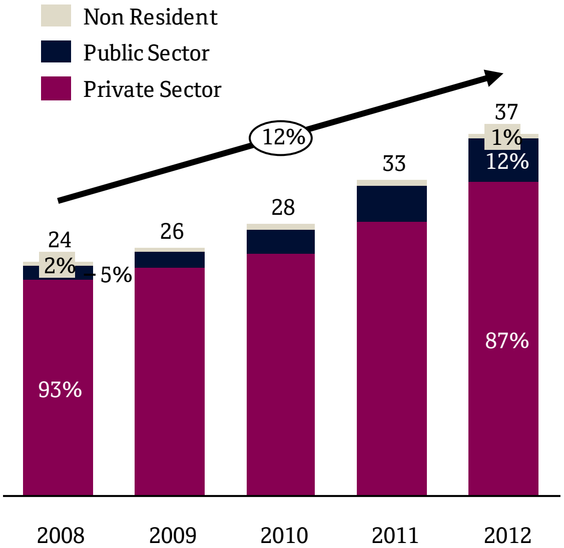
* Based on 2011 data

Source: CBO, individual bank financials and QNB Group analysis

Loans to the private sector for consumption has been driving overall credit growth

Credit facilities to the private sector accounts for the largest portion of overall loans (Fig 8.4). It increased by 15% in 2012 to US$32bn and has been largely driven by personal loans which went up by an estimated 18% in 2012. Loans to the public sector increased by 16% and were mainly directed towards public enterprises. Credit facilities to non-residents fell by 24% in 2012 as the CBO put credit limits in place. The exposure limit to non-residents has been recently reduced from 5% to 2.5% of the net worth of each borrower.

Fig 8.4: Banks Credit Facilities (2008-12)
(US$bn, % share and CAGR shown)

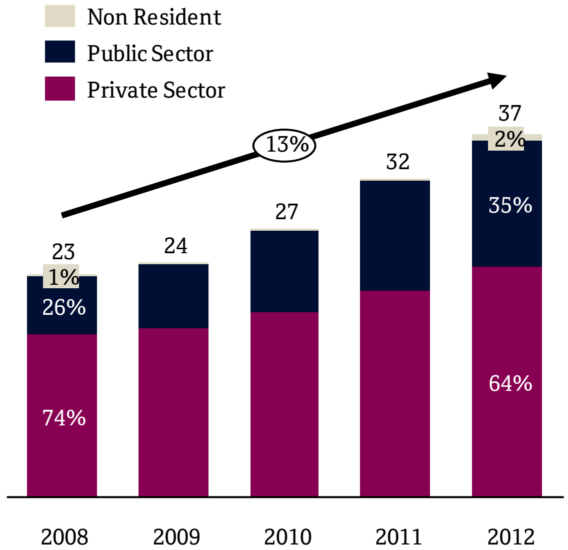


Source: CBO and QNB Group analysis

Deposits have outpaced loan growth in recent years

Banking sector deposits increased by 13% during 2008-12 (Fig 8.5), slightly outpacing credit facilities growth of 12% during the same period. Private sector deposits went up by 12% as both short-term and long-term deposits grew. Public sector deposits moved up by 13% supported by government deposits.

Fig 8.5: Banks Deposits (2008-12)
(US$bn , % share and CAGR shown)



Source: CBO and QNB Group analysis

We expect Oman's banking sector to continue its strong expansion in 2013-14 as rising government spending stimulates credit growth across the economy, boosted by the recent introduction of Islamic banking.

Islamic Banking has huge potential for growth

Oman finalised and introduced for the first time the regulatory framework for Islamic banking in December 2012. Two banks (Bank Nizwa and Alizz Islamic Bank) have been granted licences, while nearly all local conventional banks have evinced interest in opening Islamic windows. In 2013, a new era of Islamic banking begun with Bank Nizwa starting operations. Concurrently, conventional banks such as BankMuscat and National Bank of Oman have opened Islamic windows. Alizz Islamic Bank has been listed on the securities market and is expected to commence operations soon, while Oman Arab Bank and Bank Dhofar have also announced plans to start Islamic operations soon. Industry analysts estimate that the asset base of Islamic banks could reach US$4bn by year-end and has the potential to more than double to around US$9bn in about three to four years time. Islamic banking is also estimated to mobilise about US$2.5bn in terms of deposits and capture a market share of about 6.5% by year-end. It is also likely that institutional money and high net worth funds invested abroad will find its way back to the country as demand for Sharia compliant products increase. The growth in Islamic bonds (Sukuk) is likely to follow as excess liquidity from Islamic banking is lapped up and channelised to finance infrastructure development, manufacturing and other small and medium enterprises.

Key Macroeconomic Indicators

	2008	2009	2010	2011	2012	2013f	2014f
Population							
Total (m, year end)	2.87	3.17	2.77	3.30	3.68	**3.86**	**4.05**
Growth (%)	4.5	10.7	-12.6	18.8	11.5	**5.0**	**5.0**
GDP							
Nominal GDP (US$bn)	60.7	48.3	59.2	72.7	80.0	**80.4**	**79.0**
Growth (%)	44.9	-20.5	22.7	22.7	10.1	**0.4**	**-1.8**
Oil and Gas Sector (% share)	50.7	40.0	45.8	50.9	52.5	**51.0**	**49.3**
Real GDP Growth (%)	13.1	3.9	5.0	5.9	6.1	**3.8**	**3.0**
Oil and Gas Sector Growth (%)	8.6	8.0	5.8	2.5	6.7	**0.6**	**0.0**
Non-oil Sector Growth (%)	14.9	3.6	4.9	7.1	6.0	**5.1**	**4.6**
Fiscal Indicators (% of GDP)							
Revenue	32.7	36.4	34.8	38.0	45.4	**43.7**	**43.7**
(US$bn)	19.9	17.6	20.6	27.6	36.4	**35.2**	**34.5**
Expenditure	32.4	40.0	35.0	38.4	35.0	**37.7**	**41.2**
(US$bn)	19.7	19.3	20.7	27.9	28.0	**30.3**	**32.5**
Balance	0.3	-3.7	-0.2	-0.4	10.5	**6.0**	**2.5**
(US$bn)	0.2	-1.8	-0.1	-0.3	8.4	**4.9**	**2.0**
Public debt	4.1	5.6	5.0	4.5	4.3	**4.2**	**4.0**
Current Account (% of GDP)							
Balance	8.3	-1.3	9.9	14.1	11.1	**7.9**	**4.5**
Trade Balance	28.0	24.0	31.6	35.2	33.8	**33.7**	**33.6**
Exports (US$bn)	37.7	27.7	36.6	47.1	53.1	**56.6**	**60.2**
Imports (US$bn)	-20.7	-16.1	-17.9	-21.5	-26.1	**-29.5**	**-33.6**
Services Balance	-6.7	-8.0	-7.4	-6.8	-7.0	**-8.0**	**-9.5**
Income Balance	-4.5	-6.3	-4.7	-4.4	-4.9	**-5.7**	**-6.5**
Current Transfers Balance	-8.5	-11.0	-9.6	-9.9	-10.8	**-12.1**	**-13.1**
International Reserves (US$bn)	11.6	12.2	13.0	14.4	14.3	**15.4**	**15.9**
Import Cover (months)	6.7	9.1	8.7	8.0	6.6	**6.3**	**5.7**
External Debt	14.7	17.5	11.8	11.4	10.4	**10.0**	**9.8**
Industry Indicators							
Oil Production (k b/d)	758.8	812.5	864.6	884.9	918.5	**935.0**	**935.0**
Omani Crude Oil Price (US$/b)	101.1	56.7	76.6	103.0	109.7	**108.0**	**102.0**
Gas Production (bn cf/d)	2.9	3.0	3.2	3.4	3.5	**3.5**	**3.5**
Monetary indicators (%)							
Consumer Price Inflation	12.4	3.4	3.2	4.1	3.0	**2.5**	**2.8**
Food	21.5	0.5	2.0	4.5	2.2	**4.2**	**4.0**
Housing	11.5	8.7	3.9	2.8	2.2	**2.5**	**2.8**
Weighted Average Deposit Rate	2.5	2.2	1.7	1.4	1.3	**-**	**-**
Weighted Average Lending Rate	7.1	7.4	6.8	6.2	5.7	**-**	**-**
Broad Money (M2) Growth	23.3	4.7	11.3	12.2	10.7	**8.3**	**8.0**
Exchange Rate US$:OR	0.3845	0.3845	0.3845	0.3845	0.3845	**0.3845**	**0.3845**

Source: MONE, CBO, NBS, Ministry of Oil and Gas, MoF, IMF and **QNB Group estimates and forecasts;** Data as at 25th February 2013

QNB Group International Network

QNB Group International Branches and Representative Offices

United Kingdom
51GrosvenorStreet
London W1K 3HH
Tel: +44 207 6472600
Fax: +44 207 6472647
QNBLondon@qnb.com.qa

France
65 Avenue d'lena
75116 Paris
Tel: +33 1 53 23 0077
Fax: +33 1 53 23 0070
QNBParis@qnb.com.qa

Kuwait
Al-Arabia Tower, Bld 4
Ahmad Al-Jaber Street, Sharq Area
P.O. Box: 583, Dasman 15456 Kuwait
Tel: +965 2226 7023
Fax: +965 2226 7051
QNBKuwait@qnb.com.qa

Lebanon
Capital Plaza Building, Ahmad Shawki Street
Mina El Hosn, Solidere
Beirut – Lebanon
Tel: +961 1 762 222
Fax: +961 1 377 177
QNBLebanon@qnb.com.qa

Mauritania
Al Khaima City Center
10, Rue Mamadou Konate
Nouakchott – Mauritania
Tel: +222 4524 9651
Fax: +222 4524 9655
QNBMauritania@qnb.com.qa

Oman
QNB Building
Building No:1540, CBD Area
P.O. Box: 4050, PC 112
Ruwi – Oman
Tel: +968 24 725 555
Fax: +968 24 779 233
QNBOman@qnb.com.qa

Sudan
Africa Road – Amarat Street No. 9
P.O. Box: 8134
Tel: +249 183 480000
Fax: +249 183 486666
QNBSudan@qnb.com.qa

South Sudan
Plot No 64, Port Road
P.O. Box: 587 Juba
QNBSouthSudan@qnb.com.qa

Singapore
Three Temasek Avenue
27-01, Centennial Tower
Singapore 039190
Tel: +65 6499 0866
Fax: +65 6884 9679
QNBSingapore@qnb.com.qa

Yemen
QNB Building
Alzubairi Street
P.O. Box: 4310 Sana'a – Yemen
Tel: +967 1 517 517
Fax: +967 1 517 666
QNBYemen@qnb.com.qa

Iran
Representative Office
No. 17 Africa Highway
Navak Building, 6th Floor, Unit 14
Tehran – Iran
Tel: +98 21 88 889 814
Fax: +98 21 88 889 824
QNBIran@qnb.com.qa

QNB Group International Network

QNB Subsidiaries / Associates

Iraq
Subsidiary
Mansour Bank
P.O. Box: 3162
Al Alawiya Post Office, Al Wihda District
Baghdad – Iraq
Tel: +964 1 717 5586
Fax: +964 1 717 5514
www.mansourbank.com

Syria
Subsidiary
QNB – Syria
Al Abbassiyeen Square
P.O. Box: 33000
Damascus - Syria
Tel: +963 11 2290 1000
Fax: +963 11 4432 221
QNBSyria@qnb.com.qa

Jordan
Associate Company
The Housing Bank for Trade and Finance (HBTF)
P.O. Box: 7693, PC 11118
Amman – Jordan
Tel: +962 6 500 5555
Fax: +962 6 567 8121
www.hbtf.com

Tunisia
Subsidiary
Tunisian Qatari Bank
Rue de la cité des sciences
B.P. 320 – 1080
Tunis Cedex – Tunisia
Tel: +216 71 750 000
Fax: +216 71 235 611
www.tqb.com.tn

Libya
Associate Company
Bank of Commerce and Development
BCD Tower, Gamol A Nasse Street
P.O. Box: 9045, Al Berka
Benghazi – Libya
Tel: +218 619 080 230
Fax: +218 619 097 115
www.bcd.ly

UAE
Associate Company
Commercial Bank International
Al Riqqa Street, Deira
P.O. Box: 4449
Dubai – UAE
Tel: +9714 227 5265
Fax: +9714 227 9038
www.cbiuae.com

Switzerland
Subsidiary
QNB Banque Privée (Suisse) SA
3, Rue Des Alpes, 1201
Geneve – Switzerland
Tel: +41 22 907 7070
Fax:: +41 22 907 7071
Info@qnb.com.qa

Indonesia
Subsidiary
QNB – Kesawan
QNB Kesawan Tower, Parc 18
Jl. Jendral Sudirman Kav. 52-53, 12190
Jakarta – Indonesia
Tel: +62 21 515 5155
Fax: +62 21 515 5388
www.qnbkesawan.co.id

Qatar National Bank S.A.Q.
P.O. Box 1000,
Doha, Qatar

Tel: +974 4440 7407
Fax: +974 4441 3753

qnb.com.qa