MOODY'S

Rating Action: Moody's upgrades Oman to Ba2, maintains positive outlook

15 May 2023

New York, May 15, 2023 -- Moody's Investors Service (Moody's) has today upgraded the Government of Oman's issuer and long-term senior unsecured ratings to Ba2 from Ba3 and maintained the positive outlook. Moody's has also upgraded the Government of Oman's senior unsecured medium-term note program rating to (P)Ba2 from (P)Ba3.

The upgrade reflects the improvements in Oman's debt burden and debt affordability metrics during 2022, mainly as a result of the large oil and gas revenue windfall, which increase the sovereign's resilience to potential future shocks. Importantly, the strengthening of the fiscal metrics was supported by the government's spending restraint and its decision to use the fiscal surplus and previously accumulated fiscal buffers to pay down debt, which in Moody's view demonstrates an improving track record of fiscal policy effectiveness and governance strength.

The positive outlook captures the prospect that the improvements in the government's debt metrics will be sustained over the next few years, despite lower oil prices, through maintenance of spending discipline and further implementation of fiscal and structural reforms.

Today's rating action also applies to Oman Sovereign Sukuk S.A.O.C, a special-purpose vehicle domiciled in Oman, whose obligations, in Moody's view, are ultimately the obligation of the Government of Oman. The entity's backed senior unsecured ratings and its backed senior unsecured medium-term note program rating were upgraded to Ba2 and (P)Ba2 from Ba3 and (P)Ba3 respectively.

Oman's local currency (LC) and foreign currency (FC) country ceilings were raised by one notch in lockstep with the sovereign issuer rating upgrade. The LC country ceiling at Baa3, two notches above the sovereign issuer rating, incorporates the economy's heavy reliance on a single revenue source, the government's large economic footprint, and Oman's track record of high external imbalances, partly mitigated by predictable institutions and moderate political risk. The FC country ceiling at Ba1, one notch below the LC ceiling, reflects relatively modest transfer and convertibility risks, supported by the sovereign's robust foreign-currency buffers and Oman's track record improving fiscal policy effectiveness, set against its high, albeit declining, level of external indebtedness.

RATINGS RATIONALE

RATIONALE FOR THE UPGRADE TO Ba2

DEBT METRICS IMPROVED SIGNIFICANTLY DUE TO A LARGE OIL REVENUE WINDFALL AND SPENDING RESTRAINT

Increase in global oil demand and prices since the trough during the pandemic has generated a large revenue windfall for Oman, turning its fiscal deficit of 3.2% of GDP in 2021, and nearly 12% of GDP on average during 2015-20, into a surplus of 3.4% of GDP in 2022. Moody's estimates that nearly all of the fiscal improvement during 2022 was due to higher hydrocarbon revenue, which rose by more than 30% and amounted to an equivalent of 26% of GDP.

However, the fiscal improvement was also supported by the government's spending restraint, which helped to maximize Oman's fiscal surplus. The government, in turn, used the surplus to pay down more than 15% of its outstanding debt during the course of 2022. As a result, the government debt burden declined to 40% of GDP (123% of revenue) in 2022 from 61% of GDP (186% of revenue) in 2021 and the all-time peak of 68% of GDP (235% of revenue) in 2020, returning below pre-pandemic levels. Furthermore, its stock of foreign-currency denominated external debt declined to 30% of GDP in 2022 from 46% of GDP in 2021 and more than 50% of GDP in 2020.

Despite the large cyclical rebound in revenue during 2022, the government maintained spending discipline, in contrast with other previous episodes of rising oil prices, including during 2018. The increase in non-interest government spending, excluding expenditure related to oil and gas production, was limited to an increase in the domestic fuel subsidy, the negative fiscal impact of which was easily offset by significantly higher oil revenue. Most of the spending related to oil and gas production was removed from the budget during 2021-22, and is now the responsibility of Energy Development Oman (EDO). EDO, a state-owned holding company, retains some of the oil and gas revenue that previously flowed into the budget in order to cover its own spending needs, but can also borrow, which can reduce the negative fiscal impact of a temporary decline in oil prices.

Since 2018, the government cut non-interest spending, excluding oil and gas related expenditure and the fuel subsidy, by more than 9% (equivalent to more than 9 percentage points on non-hydrocarbon GDP), thereby demonstrating an improving track record of fiscal policy effectiveness. Furthermore, the government underscored its improving policy effectiveness by the decision to reduce its outstanding debt by repaying maturing loans and bonds and through eurobond buy-backs during 2022. During the first quarter of this year, the government reduced its debt by close to another 6% compared to the outstanding amount at the end of 2022.

Moody's assesses that the government's change in conduct of fiscal policy during periods of high or rising oil prices denotes an improvement in fiscal policy effectiveness and governance that will further support Oman's credit profile in the medium to long term. This improvement was also underpinned by the introduction of medium-term fiscal planning and the implementation of new non-hydrocarbon revenue measures, although at a slower pace and with relatively smaller fiscal impact compared to some of Oman's regional peers.

RATIONALE FOR MAINTAINING THE POSITIVE OUTLOOK

PROSPECT THAT FISCAL STRENGTH IMPROVEMENTS ARE SUSTAINED IN THE MEDIUM TERM

Based on Moody's assumption that oil prices average $80-85/barrel during 2023-24, the improvement in Oman's fiscal strength metrics will likely be sustained over the next few years provided the government remains committed to fiscal spending restraint. The approved 2023 budget targets a modest 4% increase in non-interest spending, excluding oil and gas related sending and the fuel subsidy. The next update of the Medium-Term Fiscal Plan, to be published later this year, will provide further clarity regarding the government's fiscal strategy beyond the current fiscal year.

The medium-term fiscal outlook remains exposed to declines in global oil demand and prices given the sovereign's heavy economic and fiscal reliance on the hydrocarbon sector, as was underscored by the past eight years of high oil price volatility and the subsequent very significant erosion of the government's balance sheet. Furthermore, while Oman's government liquidity and external vulnerability pressures have diminished substantially since 2020, the sovereign remains susceptible to a potentially large and sudden increase in its funding needs whenever oil prices decline significantly, which is also likely to be accompanied by a tightening of financing conditions facing the government.

Oil prices that Moody's assumes over the next couple of years afford the government additional time to advance its structural economic reform agenda initiated in 2020, increasing the likelihood that Oman's vulnerability to potential future declines in global oil demand and prices will be reduced to a point consistent with a higher rating level. The ongoing reforms include strengthening of public finance management through the introduction of the treasury single account, improving tax administration to reduce the tax gap, a gradual broadening of government non-hydrocarbon revenue streams, improving efficiency of Oman's public pension and social security system, better targeting of social spending including subsidies, and advancing economic diversification by improving Oman's business and investment environment.

The planned development of a large green hydrogen production capacity in Oman could, if successful, contribute to mitigating the sovereign's longer-term credit risks stemming from global carbon transition. However, Oman's relatively limited proved hydrocarbon reserves compared to most regional peers, estimated at around 15 years of production for crude oil and natural gas condensate, are a distinct source of a longer-term downside risk, in particular if the established track record of the one-for-one rate of replacement of extracted barrels with new reserves cannot be maintained.

ENVIRONMENTAL, SOCIAL, GOVERNANCE CONSIDERATIONS

Oman's ESG Credit Impact Score is highly negative (CIS-4), reflecting very high negative exposure to environmental risks and moderate institutions and governance strength that tempers the sovereign's ability to respond to negative environmental risks.

Oman's very highly negative exposure to environmental risks, reflected in its E-5 issuer profile score, mainly relates to carbon transition due to its very high economic and fiscal dependence on the hydrocarbon sector, and a high degree of water stress. The oil and gas sector accounted for around 30% of GDP, nearly 80% government revenue and 58% of exports of goods and services in 2018-22. Oman is one of the world's most arid states, and rapid economic and population growth in recent decades has further increased challenges surrounding water sustainability. A large portion of Oman's water is produced by desalination plants, which are energy intensive and vulnerable to oil spills, although Oman's access to relatively cheap energy partly mitigates this risk.

Exposure to social risks is moderately negative (S-3 issuer profile score). The main source of pressure arises from the labor market due to the current and expected rapid population and labor force growth over the coming decades and high expectations of the native population for the provision of services and employment by the government. The effectiveness of labor market nationalization policies in controlling the unemployment rate among citizens will remain the key policy challenge and an important driver of social risks in the foreseeable future, although a relatively large share of expatriates in the overall labor force partly mitigates these risks.

Oman's G-2 issuer profile score reflects its improving track record of fiscal policy effectiveness and gradually improving capacity to adjust to adverse environmental, or possibly social, trends and potential future shocks.

GDP per capita (PPP basis, US$): 37,784 (2021) (also known as Per Capita Income)

Real GDP growth (% change): 3.1% (2021) (also known as GDP Growth)

Inflation Rate (CPI, % change Dec/Dec): 3.8% (2021)

Gen. Gov. Financial Balance/GDP: -3.2% (2021) (also known as Fiscal Balance)

Current Account Balance/GDP: -4.9% (2021) (also known as External Balance)

External debt/GDP: 92.9% (2021)

Economic resiliency: baa3

Default history: No default events (on bonds or loans) have been recorded since 1983.

On 10 May 2023, a rating committee was called to discuss the rating of the Oman, Government of. The main points raised during the discussion were: The issuer's economic fundamentals, including its economic strength, have not materially changed. The issuer's institutions and governance strength, have materially increased. The issuer's fiscal or financial strength, including its debt profile, has materially increased. The issuer's susceptibility to event risks has not materially changed.

FACTORS THAT COULD LEAD TO AN UPGRADE OR DOWNGRADE OF THE RATINGS

Increasing confidence that the improvements in the fiscal metrics achieved during 2022 will be sustained in the medium term would likely prompt an upgrade. Such confidence would be underpinned by the continuation of fiscal reforms supporting further structural improvements in the non-hydrocarbon fiscal balance, reflecting a diminishing exposure to cyclical declines in oil demand and prices and to longer-term global carbon transition risks. A migration to a significantly higher rating level over time would likely reflect a combination of a further significant strengthening of the government balance sheet and a significant expansion of the government's non-hydrocarbon revenue base accompanied by an increase in non-hydrocarbon sector trend growth, jointly pointing to greater level of economic and fiscal diversification and the sovereign's declining reliance on the hydrocarbon sector.

Given the positive outlook, a downgrade in the near term is unlikely. Nevertheless, a significant and durable reversal of the improvements in the sovereign's fiscal strength metrics achieved in 2022 would exert negative pressure on the rating. Such pressure could result from a large and persistent oil price shock unmet by an equally large fiscal adjustment, and/or from a significant reversal of the non-oil fiscal adjustment implemented by the government in recen years. Such a reversal would increase Oman's exposure to potential future declines in oil demand and prices, increasing the likelihood that government and broader public sector debt rises again significantly if oil prices decline in the medium term. In the longer term, materially slower progress in implementing further fiscal reforms and advancing economic and fiscal diversification than Moody's currently expects would also likely trigger negative rating migration, in particular if accompanied by increasing evidence that global carbon transition is accelerating significantly compared to Moody's current baseline expectations and/or by evidence that Oman's capacity to replace extracted oil with new proved reserves has materially declined.

The principal methodology used in these ratings was Sovereigns published in November 2022 and available at https://ratings.moodys.com/rmc-documents/395819. Alternatively, please see the Rating Methodologies page on https://ratings.moodys.com for a copy of this methodology.

The weighting of all rating factors is described in the methodology used in this credit rating action, if applicable.

The local market analyst for these ratings is Alexander Perjessy, +971 (423) 795-48.

REGULATORY DISCLOSURES

For further specification of Moody's key rating assumptions and sensitivity analysis, see the sections Methodology Assumptions and Sensitivity to Assumptions in the disclosure form. Moody's Rating Symbols and Definitions can be found on https://ratings.moodys.com/rating-definitions.

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Moody's general principles for assessing environmental, social and governance (ESG) risks in our credit analysis can be found at https://ratings.moodys.com/documents/PBC_1288235.

At least one ESG consideration was material to the credit rating action(s) announced and described above.

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