MOODY'S

Rating Action: Moody's upgrades Oman to Ba1, changes outlook to stable

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New York, December 07, 2023 -- Moody's Investors Service (Moody's) has today upgraded the Government of Oman's long-term issuer and long-term senior unsecured ratings to Ba1 from Ba2 and changed the outlook to stable from positive. Moody's has also upgraded the Government of Oman's senior unsecured medium-term note program rating to (P)Ba1 from (P)Ba2.

The upgrade reflects Moody's expectation that the further improvements in Oman's debt burden and debt affordability metrics during 2023 will last, as the government's actions amplify the oil prices windfall gains through spending restraint and prioritization of debt repayment. A lower debt burden increases the sovereign's resilience to potential future shocks, and the improving track record of fiscal prudence and policy effectiveness increases the likelihood that the stronger debt burden and debt affordability metrics will be maintained in the next few years even if oil prices become less supportive.

The stable outlook captures the balance of risks at the Ba1 rating level. Oman's still heavy economic and fiscal reliance on the hydrocarbon sector exposes the sovereign to a potentially large and protracted deterioration in its fiscal and external accounts in case of a decline in global oil demand and prices. Upside risks are related to the government's improved reform momentum since 2020 and its efforts to increase economic and fiscal diversification, which support the prospect that, over time, Oman's reliance on hydrocarbons will decline.

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 Ba1 from Ba2 and to (P)Ba1 from (P)Ba2, respectively.

Oman's local currency (LC) and foreign currency (FC) country ceilings were raised by one notch. The LC country ceiling at Baa2, 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 material external imbalances, partly mitigated by predictable institutions and moderate political risk. The FC country ceiling at Baa3, 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 the economy's overall high, albeit declining, level of external indebtedness.

RATINGS RATIONALE

RATIONALE FOR THE UPGRADE TO Ba1

DEBT METRICS IMPROVED FURTHER AMID SUPPORTIVE OIL PRICES AND SPENDING RESTRAINT

Oman's fiscal and external sector metrics continued to benefit from supportive oil prices during 2023. Moody's estimates that the government's fiscal balance remained in a robust surplus of around 3.5% of GDP (including oil revenue transferred to the Petroleum Reserve Fund) following a surplus of 7.5% of GDP in 2022, the highest surplus in 10 years, and a deficit of 3.1% of GDP in 2021. While most of the fiscal improvement during 2022-23 was a result of higher hydrocarbon revenue, the government's spending restraint and the value-added tax introduced in April 2021 contributed to maximizing the fiscal windfall. Moody's estimates that the increase in non-interest expenditure excluding spending related to oil and gas production during 2022-2023 (equivalent to around 2% of 2023 GDP) was broadly offset by the increase in non-hydrocarbon revenue.

As during 2022, the government continued to prioritize debt reduction. Moody's estimates that during 2023 the nominal value of Oman's outstanding government debt declined by at least 11% (equivalent to $5 billion of mostly external debt) after falling by 15% (or $8.2 billion) in 2022. As a result, the debt burden likely declined below 38% of GDP by the end of 2023 from 40% of GDP at the end of 2022, the lowest debt-to-GDP ratio since 2016 and close to half its peak in 2020. This additional reduction in debt further increases Oman's fiscal space and its fiscal resilience against potential future shocks.

Some of the government debt reduction during 2022-23 was facilitated by a delegation of previously on-budget spending related to oil and gas production to government-owned Energy Development Oman (EDO), which in turn financed some of this spending from own borrowing. Nevertheless, EDO's debt increased by only around $2 billion (or 2% of GDP) in 2023 after remaining unchanged in 2022 (excluding the shareholder bridge loan from the government) indicating that only a small portion of the government debt reduction has been achieved at the cost of rising broader public sector debt.

Moody's believes that the government's adherence to fiscal prudence and its prioritization of debt repayments during the period of supportive oil prices in 2022-23 increases the likelihood that the improvements in the government debt metrics will be sustained in the medium term even if oil prices continue to moderate in the next few years. Moody's assumes that oil prices will average $80-85/barrel in 2024-25 before declining gradually to the medium-term fundamental range of $55-75/barrel. Under these baseline assumptions, Moody's projects Oman's government debt burden to decline to around 35% of GDP in the next three years.

On the external side, Moody's estimates that Oman's current account balance remained in surplus during 2023 (around $2 billion or 2% of GDP), following a surplus of 5% of GDP in 2022. This has allowed the government to pay down $4 billion of its external debt without causing a significant reduction in central bank foreign-currency reserves, which declined to $16.1 billion at the end of September 2023 from $17.6 billion at the end of 2022. Under its baseline oil price scenario, Moody's expects Oman's current account to remain in a small surplus during 2024-25 before returning to a small deficit in 2026 due to lower oil prices.

RATIONALE FOR THE CHANGE OF OUTLOOK TO STABLE

STILL HEAVY RELIANCE ON HYDROCARBONS BALANCES IMPROVED REFORM MOMENTUM

Credit risks at the Ba1 rating level are broadly balanced. 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 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. Structural reforms also include improving transparency and provision of economic statistics, such as quarterly GDP estimates.

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, are a distinct source of a longer-term downside risk, in particular if the current one-for-one rate of replacement of extracted barrels with new reserves cannot be maintained.

ENVIRONMENTAL, SOCIAL, GOVERNANCE CONSIDERATIONS

Oman's CIS-4 indicates the rating is lower than it would have been if ESG risk exposures were not present. Oman's main exposure is to environmental risks, especially carbon transition, due to its economic and fiscal reliance on hydrocarbon production, and physical climate risks, due to its arid climate and scarcity of freshwater resources. Carbon transition risks are partly mitigated by the ongoing economic diversification efforts, while the risks related to water stress are mitigated by seawater desalination supported by availability of domestic energy resources. However, Oman's moderate institutions and governance strength, which captures some weaknesses in policy effectiveness, may hamper the sovereign's ability to respond to negative environmental and social trends.

Oman's E-5 score reflects its exposure to carbon transition and physical climate risks. Carbon transition risks stem from the sovereign's economic and fiscal reliance on the hydrocarbon sector, which contributed on average around 30% of GDP, 58% of total exports and 80% of government revenue during 2018-22. Oman is also one of the world's most arid states and rapid economic and population growth in recent decades have increased challenges surroundin water sustainability. Risks related to water scarcity are mitigated by Oman's capacity to meet 15-20% of its freshwater demand from seawater desalination, which – while vulnerable to potential attacks and oil spills – is supported by the country's access to ample domestic energy resources.

Oman's S-3 score reflects social pressure that 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 socia 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 score reflects a well-defined institutional framework that supports monetary and macroeconomic policy effectiveness within the limitations imposed by the economy's heavy reliance on hydrocarbons and the country's relatively concentrated decision-making structure. Fairly robust control of corruption and enforcement of contracts is balanced by the absence of strong civil society institutions and generally slow dispute resolution. Fiscal policy effectiveness has been improving, but remains constrained by the government's social commitments, which represent the key impediment to the sovereign's ability to adjust to adverse social and environmental trends and external shocks.

GDP per capita (PPP basis, US$): 38,699 (2022) (also known as Per Capita Income)

Real GDP growth (% change): 4.3% (2022) (also known as GDP Growth)

Inflation Rate (CPI, % change Dec/Dec): 1.9% (2022)

Gen. Gov. Financial Balance/GDP: 7.4% (2022) (also known as Fiscal Balance)

Current Account Balance/GDP: 5% (2022) (also known as External Balance)

External debt/GDP: 63.9% (2022)

Economic resiliency: baa3

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

On 04 December 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 not materially changed. 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

Steadily diminishing vulnerability to cyclical declines in oil demand and prices and to longer-term risks stemming from global carbon transition would, over time, exert upward pressure on Oman's credit profile, allowing for migration to higher rating levels. Such pressure would likely be reflected in declining non-hydrocarbon fiscal and current account deficits, underpinned by a material expansion of the government's non-hydrocarbon revenue base and growth in non-hydrocarbon exports, and a trend improvement in non-hydrocarbon sector growth, jointly pointing to reduced economic and fiscal reliance on the hydrocarbon sector. In the meantime, further strengthening in the government's debt metrics through continued fiscal prudence and improving non-oil revenue generation could prompt an upgrade.

A material and durable reversal of the improvements in the debt burden and debt affordability metrics achieved during 2022-23 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 policy adjustment, or from a significant reversal of the fiscal adjustment implemented by the government in recent years, increasing Oman's exposure to potential future declines in oil demand and prices. In the longer term, materially slower progress in implementing further fiscal reforms and advancing economic and fiscal diversification than Moody's currently expects would constrain and possibly exert negative pressure on the rating, in particular if accompanied by growing evidence that global carbon transition is accelerating compared to Moody's current baseline. Evidence of a significant tightening of financing conditions facing hydrocarbon producers, when investors begin to price in risks related to accelerating carbon transition, would also exert downward pressure on the rating.

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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