Moody's

Rating Action: Moody's changes the outlook on Oman to positive, affirms Ba3 rating

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New York, October 06, 2022 -- Moody's Investors Service ("Moody's") has today changed the outlook on the Government of Oman's issuer rating to positive from stable and affirmed its long-term issuer and senior unsecured ratings at Ba3. Moody's also affirmed the Government of Oman's (P)Ba3 senior unsecured medium-term note program rating.

The change of outlook to positive reflects the strengthening of Oman's debt burden and debt affordability metrics during 2022, mainly as a result of elevated oil prices, and the prospect that this improvement could be sustained in the medium term. Balance sheet repair that has already taken place this year restores the fiscal space that the sovereign had lost during 2020. Meanwhile, the prospect that oil prices remain elevated for the next few years affords the government additional time to advance its fiscal and economic reform agenda, increasing the likelihood that Oman's structural vulnerability to cyclical declines in oil prices and its exposure to longer-term global carbon transition risks will be reduced.

The affirmation of the Ba3 ratings reflects Moody's view that, despite the fiscal and current account improvements since 2020, Oman's structural vulnerability to potential future declines in oil demand and prices remain very high, exposing the sovereign to reversals of the improvements in government debt and debt affordability metrics and to a sudden re-emergence of government liquidity and external vulnerability pressures under adverse global circumstances, such as a next negative oil price shock.

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 affirmed at Ba3 and (P)Ba3, respectively.

Oman's local currency (LC) and foreign currency (FC) country ceilings remain unchanged. The LC country ceiling at Ba1, two notches above the sovereign issuer rating, incorporates the economy's heavy reliance on a single revenue source and a track record of high external imbalances, partly mitigated by predictable institutions and moderate political risk. The FC country ceiling at Ba2, one notch below the LC ceiling, reflects relatively modest transfer and convertibility risks, supported by the sovereign's robust foreign-currency buffers, set against Oman's track record of weak, albeit improving, fiscal policy effectiveness and its high level of external indebtedness.

RATINGS RATIONALE

RATIONALE FOR THE CHANGE OF OUTLOOK TO POSITIVE FROM STABLE

REVENUE WINDFALL FROM ELEVATED OIL PRICES PROVIDES SCOPE FOR SUSTAINED IMPROVEMENT IN SOVEREIGN BALANCE SHEET

A surge in oil prices since 2020 has generated a large revenue windfall for Oman, turning its large fiscal deficits in the past, averaging 9.6% of GDP during 2014-21, into a material surplus. Based on the assumption that oil prices average $105/barrel in 2022, Moody's estimates that Oman's full-year fiscal surplus will be close to 6% of GDP this year, offering the government an opportunity to reverse some of the balance sheet deterioration it has sustained since 2015.

The government has already used some of the revenue windfall, in addition to its fiscal reserves accumulated in the Petroleum Reserve Fund, to pay down outstanding debt, reducing the nominal level by $6.5 billion (or 7.5% of 2021 GDP) between December 2021 and August 2022. This net debt reduction balances $4.5 billion of new borrowing in the early part of the year against the repayment of $9.3 billion of loans and bonds maturing in 2022 ($2.2 billion of which could have been repaid in 2023 at the borrower's discretion) and the pre-payment of $1.7 billion of debt maturing in 2023 or later, including through a $700 million eurobond buy-back completed in July.

Based on the expectation of no further net borrowing later this year, consistent with the projected fiscal surplus and no significant debt maturities, Moody's forecasts that Oman's government debt will decline to less than 45% of GDP (119% of revenue) by the end of the year from 63% of GDP (186% of revenue) in 2021. This reduction in the debt burden is below the level at the end of 2019 (52% of GDP), more than fully reversing Oman's loss of fiscal space sustained during 2020 and increasing the sovereign's resilience ahead of the potential next oil price shock.

PROSPECT THAT OIL PRICES REMAIN SUPPORTIVE AFFORDS ADDITIONAL TIME TO REDUCE STRUCTURAL VULNERABILITIES

Although Moody's expects oil prices to remain volatile and eventually decline to $50-70/barrel in the medium term, the agency's near-term assumption is that the geopolitical risk premium due to the military conflict in Ukraine will keep oil prices elevated during the next two years, staying above the medium-term fundamental range well into 2024. Based on these assumptions, Oman's fiscal balance will likely remain in surplus for the next two years, facilitating a further decline in the government debt burden. Moody's baseline projections are based on the expectation that, in line with the latest version of its Medium-Term Fiscal Program, the government maintains its commitment to non-interest spending control (including by progressing subsidy reforms), strengthens non-oil tax collection, and implements the personal income tax on high-income earners staring from 2024.

Supportive oil prices and the related revenue windfall will afford the government additional time to advance its structural economic reform agenda initiated in 2020, increasing the likelihood that the Oman's vulnerability to potential 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 and tax administration, 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. Evidence that such reforms are gaining traction would include further decline in Oman's non-hydrocarbon primary fiscal deficit, narrowing of the non-hydrocarbon current account gap and a sustainable pickup in non-hydrocarbon sector trend growth.

RATIONALE FOR AFFIRMING THE Ba3 RATINGS

CREDIT SUPPORTS AND REFORM EFFORTS BALANCE VERY HIGH EXPOSURE TO DECLINES IN OIL PRICES AND GLOBAL CARBON TRANSITION

Oman's heavy economic and fiscal reliance on the hydrocarbon sector is the key constraint on the sovereign's rating and constitute the main source of downside credit risks. Moody's estimates that in 2022 the hydrocarbon sector will account for more than 40% of nominal GDP, more than 80% of government revenue (equivalent to around 31% of GDP), and 66% of total exports of goods and services (nearly 39% of GDP). As a result, Oman's fiscal and external accounts will remain exposed to the risk of a sudden and potentially very large fiscal deterioration and re-emergence of liquidity and external financing pressures whenever global oil demand and prices decline significantly, as they did in 2015 and 2020.

Over time, Oman's heavy reliance on the oil and gas sector and high sensitivity of its fiscal and external sector metrics to oil price fluctuations underpins the sovereign's very highly negative exposure to carbon transition and limits the scope for a substantially higher rating. Without a transformation of Oman's economy and government revenue base, the shift towards lower reliance on hydrocarbons over the next several decades and, eventually, net zero targets for a large part of the world would put significant downward pressure on Oman's credit profile. In the meantime, Oman's financing conditions are likely to be increasingly shaped by prospects that such a transformation is underway and investors' assessment of Oman's capacity to respond to carbon transition.

Balancing these structural vulnerabilities, Oman's Ba3 ratings remains supported by the sovereign's high per-capita income, which is twice the Ba-rated median in purchasing power parity-adjusted terms and supports the sovereign's shock absorption capacity. The ratings are is also supported by the availability of liquid sovereign wealth fund assets, which could (and have been) used to relieve government liquidity pressures. The foreign-currency portion of these assets was $13.6 billion (15.9% of GDP) at the end of 2021, only slightly lower than $14.5 billion (16.5% of GDP) before the pandemic. These assets include $9.5 billion managed by the Oman Investment Authority and $4.2 billion managed by the Central Bank of Oman as part of the government's Petroleum Reserve Fund, earmarked for debt repayments. Liquid foreign-currency assets were $12.0 billion in September 2022, marking a decline since the end of 2021 due to a drawdown to repay (and prepay) debt maturities, but are likely to be replenished above $13 billion by the end of the year from the fiscal surplus Moody's expects during the last quarter of 2022.

ENVIRONMENTAL, SOCIAL, GOVERNANCE CONSIDERATIONS

Oman's ESG Credit Impact Score is highly negative (CIS-4), reflecting very highly negative exposure to environmental risks, balanced against moderately negative social risks and its moderate institutions and governance strength, which captures weaknesses in policy effectiveness, that hamper the sovereign's ability to respond to negative environmental and social trends.

Oman's very high 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. 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 moderate (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 moderately negative G-3 issuer profile reflects its track record of relatively weak, albeit gradually improving, fiscal policy effectiveness and represents the key impediment to the sovereign's ability to adjust to adverse social and environmental trends and potential future shocks arising from environmental and social risks.

GDP per capita (PPP basis, US$): 32,347 (2021) (also known as Per Capita Income)

Real GDP growth (% change): 3% (2021) (also known as GDP Growth)

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

Gen. Gov. Financial Balance/GDP: -3.7% (2021) (also known as Fiscal Balance)

Current Account Balance/GDP: -5% (2021) (also known as External Balance)

External debt/GDP: 93.9% (2021)

Economic resiliency: baa3

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

On 03 October 2022, 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

Increasing evidence that the improvements in Oman's fiscal strength metrics are likely be sustained in the medium term would support an upgrade. Such evidence would include a steady and consistent implementation of the government's fiscal and economic reform agenda, reducing the sovereign's exposure to future declines in global oil demand and prices while also building a track record of improved policy effectiveness and better overall institutional capacity to absorb shocks. Over the longer term, materially diminished exposure to oil price fluctuations would provide a path to substantially higher rating levels, likely be reflected in a trend decline in the non-hydrocarbon (primary) fiscal and non-hydrocarbon current account deficits, a further significant expansion of the government's non-hydrocarbon revenue base, and a trend improvement in non-hydrocarbon sector growth, jointly pointing to material progress in achieving greater economic and fiscal diversification.

The positive outlook indicates a downgrade in the near term is unlikely. However, materially slower progress in implementing fiscal adjustment or reversals of already implemented fiscal consolidation measures would exert downward pressure on the rating by increasing the likelihood that government and broader public sector debt rises again significantly when oil prices decline in the medium term. A downgrade would also be likely prompted by reemergence of significant government liquidity and external vulnerability pressures, most likely triggered by significantly lower oil prices than Moody's currently expects. An acceleration in global carbon transition and/or a significant tightening of financing conditions facing hydrocarbon producers, as investors begin to increasingly price the related risks, would also exert downward pressure on the rating.

The principal methodology used in these ratings was Sovereign Ratings Methodology published in November 2019 and available at https://ratings.moodys.com/api/rmc-documents/63168. 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 this rating 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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