

Oman's financial troubles will test the GCC

Blog post by Practice Lead Thomas Gratowski, 18 June 2020

Oman's new sultan faces a potential binary choice. The 65-year-old Haitham bin Tariq, who acceded to the throne in January, knows that the rial's peg against the US dollar has guaranteed financial stability for decades. But he has also pledged to continue his predecessor's independent foreign policy. The country's long-time leader, Qaboos bin Said, sought to maintain good relations with all countries of the region and acted as a mediator in various conflicts. He often drew the ire of Saudi and Emirati leaders in particular for his friendly relations with Iran and opposition to the blockade of Qatar. The Trump White House too has taken a more distant approach towards Muscat, which during the Obama administration helped to establish diplomatic channels between the US and Iran. With a deepening economic crisis in Oman, it seems increasingly likely that either the peg or its independent foreign policy is unsustainable. Haitham's choice who is in the midst of consolidating power will have far reaching implications for his country and the region.

The new sultan inherited public finances that have deteriorated sharply since the 2014/15 oil price drop. The budget deficit in 2016 reached more than 20% of GDP and never came even close to being balanced in the years since. Net debt rose by a staggering 70% of GDP, while attempts to diversify the economy largely failed. One rating agency after another downgraded the sultanate to junk status in the last 18 months. But this was before the coronavirus pandemic. The budget shortfall is expected to widen to 17% of GDP this year - and the current account deficit won't be much smaller. Further ballooning debt will be the consequence. Dwindling assets recently led the government to announce the consolidation of its two sovereign wealth funds under one roof, the Oman Investment Authority. The new fund is estimated to control about \$18 bn, most of which could be depleted within one year. The central bank's FX reserves, which barely cover the country's narrow money supply M1, won't be enough to maintain confidence in the peg. The country has de facto been shut out from international capital markets.

Without external support, a devaluation plus a subsequent debt crisis seem nearly unavoidable. But the question where money should come from is a difficult and political one. This is why the country has sought to avoid a bailout and the conditions that come with it. But as money is running out now, it has few good options left. Despite Muscat's good relations with the West, an IMF programme would be a tough pill to swallow. Haitham knows that his country needs to reform the public sector and diversify its economy away from oil. But he also fears that the fund's standard medicine would enrage his support base and possibly stir a revolt. The Trump administration's lukewarm approach towards Oman means any bilateral assistance from Washington would likely be insufficient. Even so, Muscat appears unwilling to anger its traditional allies by seeking assistance from China, which recently invested \$10.7 bn in a port in Duqm.

In sum, support from fellow Gulf neighbours seems the only viable option - but one that is not without implications for the region. Riyadh and Abu Dhabi secretly welcomed the death of Qaboos as an opportunity to draw the sultanate closer into the anti-Iranian camp and transform its role from mediator to bystander. Oman's sympathies for Qatar have also annoyed the blockading

nations. But Muscat's trust towards Abu Dhabi, which is questioning its sovereignty over territory in the north and maintains a strong military presence in the south due to the Yemen war is particularly low. Muscat has also no illusions about the strings attached to Saudi-led financial assistance for Bahrain. This explains why it has reportedly reached out to Qatar and Kuwait. Both are financially strong and in many foreign policy matters much more closely aligned with Muscat. Doha's and Kuwait City's ability to force their will on the sultanate is also much more constrained. But choosing those two would further cement the deep split running through the GCC. Omani officials have previously voiced fears that their country too could be blockaded like Qatar should it further move away from the Saudi-Emirati bloc. In other words, the GCC as an organisation might not survive. This leaves a combination of Saudi, Kuwaiti and Qatari support as perhaps the most "Omani" solution. It could also be a first step to salvage the GCC as an economic bloc. Negotiating such an assistance package could be Haitham's first major test.