



Economic Crisis in the Gulf - Lessons learnt

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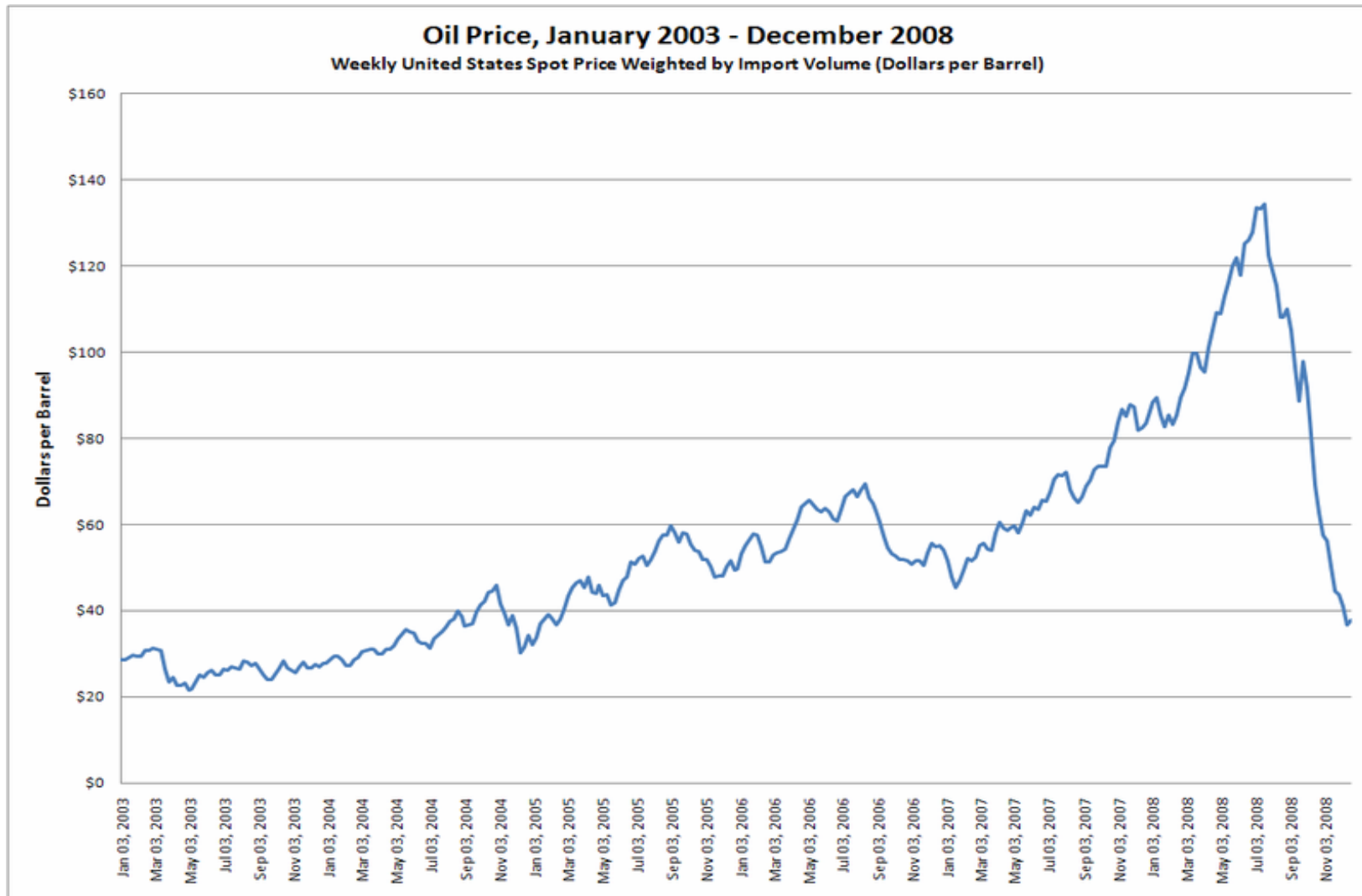
Today's Coverage

- The Boom Period in the Gulf.
- The Pace of Growth.
- Impact of the Global Financial Crisis.
- Major Causes of the Crisis.
- Speculation & Capital Flow.
- Role of Regulatory Framework.
- Inconsistency in Investment Incentives.
- Transparency & Corporate Governance.

The Boom Period in the Gulf

- GCC has been one of the fastest growing Economies in the world due to boom in Oil and Gas Revenues coupled with Real Estate & Investments during 2004 – mid 2008.
- In 2008, a barrel of Oil reached almost US\$ 140.
- The GDP growth averaged 6% per annum leading to '*Anything-is-possible*' attitude.
- Dubai took the lead & chose a high speed growth strategy within the GCC region.

The Boom Period in the Gulf



The Pace of Growth



- **Dubai's Growth was based on Diversification from Trade-based, Oil-reliant to Service & Tourism oriented Economy giving boom to the Real Estate / Property Sector.**
- **Dubai's major Economic Mix during the Boom:**
 - **Property / Construction: 23%**
 - **Storage / Re-Exports: 15%**
 - **Financial Services: 11%**
 - **Trade 6%**
 - **Oil & Gas 6%**
- **Dubai Financial Market (DFM) was established in 2000; during last Quarter of 2006, the trading volume stood at about 400 billion shares worth US\$ 95 billion.**

The Pace of Growth



- The Large scale Real Estate Development Projects led to Construction of some of the tallest *Skyscrapers* including Emirates Towers, Burj Al Arab & Burj Dubai.
- Much of Dubai is Artificial & based on Illusion: The *Palm Islands* portraying Palm Tree, *World Islands* depicting map of the Globe, the Indoor *Ski Slope* in the midst of Desert & so on..
- Dubai has also become synonymous with *Excess*: building the Tallest Tower in the world, most Expensive Luxury Hotels, Largest Shopping Malls etc.
- A Subsidiary of Dubai World (DP World) purchased the British Ports operator P&O in 2005, thereby becoming the 4th largest Ports Operator in the World.
- Dubai became an apt symbol of recent over-extension of *Capitalism*.

25:67 Those who, when they spend, are not extravagant and not niggardly, but hold a just (balance) between those (extremes); Surah Al Furgan (The Criterion).

بِسْمِ اللَّهِ الرَّحْمَنِ الرَّحِيمِ

وَالَّذِينَ إِذَا أَنْفَقُوا لَمْ يُسْرِفُوا وَلَمْ يَقْتُرُوا وَكَانَ بَيْنَ ذَلِكَ قَوَامًا ﴿٦٧﴾

Derivatives - The Ticking Time Bomb



Impact of the Global Financial Crisis

- The *Global Crisis*, which began with a decline in the Real Estate values in the US had its effect.
- Dubai's fall began with the *Outflow of Capital*, as Investors anticipated adverse impact of the global crisis on emerging markets as well.
- The *Collapse* of non-tradable sectors esp., Real Estate & Construction was Swift.
- Property Prices in Dubai fell by as much as 50% just in few months of the Crisis. This is the highest fall in the world (Knight Frank Global House Price Index).
- About 40% of Office Space is Empty. (Bloomberg).
- The *Economy Slumped* from the second half of 2008.
- Many Projects put on hold or *abandoned* due to lack of easy Finance & grim future prospects. Nakheel, part of Dubai World, alone put Projects worth US\$ 108 billion on hold. (MEED Projects).

Impact of the Global Financial Crisis

- Despite this, Government continued denial of the *Downturn*. During early Nov. 2009, it was announced that the worst was over in case of Dubai World's Financial Problems.
- Barely two weeks after this, Dubai World, on Nov. 26, announced that it was seeking a *Debt Standstill* for US\$ 26 billion repayment on its US\$ 59 billion Debt until May 2010.
- This surprise announcement echoed across Global markets indicating counterparty Risk for European & Asian Banks that lent to Dubai World.
- RBS is the largest underwriter of Loans to Dubai World, whereas HSBC has the largest absolute exposure in the UAE. (Source: J P Morgan).
- Asian Banks have Billions of Dollars exposure to UAE entities but it represents small percent of Bank Assets.

Impact of Dubai World's Announcement

- Dubai World's total Debt is about US\$ 59 billion.
- In case of Default, it would be the largest after the Argentine Debt Crisis of US\$ 100 billion in 2001.
- Standard & Poor's (S&P) downgraded six Dubai Government related Entities.
- Dow Jones Industrial Average fell 155 points or by 1.5%.
- European Stocks went down.
- Oil Prices plunged.
- Dubai's Stock market had a continued drop.
- *Wharton Professor Richard Herring* said, Dubai is a *Classic Bubble*, where Low Interest Rates caused Real Estate Boom the same way it did in the US & when the Oil Prices fell drastically, the Revenue estimates from these projects had to be slashed leading to overall decline in Prices.

Dubai Debt concerns spread beyond Dubai World

- **Dubai Holding (another flagship Company owned by Dubai Govt.) sold its stake in Egyptian Investment Bank EFG Hermes.**
- **EMAAR Properties, Arab world's biggest Developer dropped a proposed Merger with three entities owned by Dubai Holding.**
- **Istithmar World, a Dubai World Company, sold its Hotel in Manhattan (New York) in a foreclosure auction for US\$ 2 million. (Reuters).**
- **In MEED's latest survey of 25 major Construction Companies in Dubai, conducted early this month, reported Govt. clients remain unable or unwilling to pay their Bills.**

Major Causes of the Crisis

- **Volatility of Dollar (5 out of 6 GCC Currencies are Pegged to the Dollar).**
- **Crash of Equities / Stock market.**
- **Liquidity Squeeze / Capital Outflows.**
- **Global Real Estate Crash.**
- **Aviation & Tourism slump.**
- **Lower volumes of World Trade.**
- **Speculation & Greed.**
- **Weak Regulatory Framework.**
- **Inconsistent Policies.**
- **Lack of Transparency & Governance.**

Speculation & Capital Flow

- **Majority of Projects were bought by Investors with *Speculative* mind rather than the End-users.**
- **Speculation led to extravagant rise in the Property Prices leading to unusually higher returns to the Investors.**
- **Such Returns incentivized Investors to bring in Capital from their countries by even selling existing businesses and properties.**
- **Banks also gave an *uncontrolled Financing* to the Investors as well as Developers & ended up in heavy exposures.**
- **All the Stakeholders got into a *Greed Mode*.**

102:1 The mutual rivalry for piling up (the good things of this world) diverts you (from the more serious things),

102:2 Until ye visit the graves. Surah Al Takasur (The Piling Up)

بِسْمِ اللَّهِ الرَّحْمَنِ الرَّحِيمِ

أَلْهَنَكُمْ التَّكَاثُرُ ﴿١﴾

حَتَّىٰ زُرْتُمُ الْمَقَابِرَ ﴿٢﴾

Regulatory Framework

- **During the early boom, there was a complete lack of Regulatory Framework.**
- **Such a loose control led to uncontrolled growth of the Real Estate / Property sector & allowed even smaller players to enter into the market.**
- **Lack of Regulations coupled with Greed allowed even very low Income earning segment to invest into the Property market.**
- **Incentives like Residence Visa also brought Non-residents into the market (with no clarity).**
- **Government established the Real Estate Regulatory Authority (RERA) in July 2007 (almost peak in the sector), when almost all the major players and projects were launched and people & Banks had invested significant amount of money into this sector.**

Inconsistent Investment Incentives

- **Ownership of a Freehold Property did not guarantee a Residence Visa but many people believed that it did even though there was no specific law dealing with the issue.**
- **There was lack of clarity on the validity of Residence Visa and when it will be available to the Investors.**
- **Once it was clarified that Resident Visa for Freehold buyers are subject to conditions, which include that one cannot seek employment or run a business & it was assumed that the buyer had sufficient funds to support himself.**
- **At one point of time, the Incentive was withdrawn by the Government.**
- **When a negative impact was felt, the Residence Visa incentive was revived for limited validity and exorbitant costs of Renewals.**

Transparency & Governance

- **Lack of Proper Controls & Regulations led to massive Frauds & Embezzlements.**
- **Nakheel part of Dubai World disclosed a Fraud of US\$ 11.9 million (Case in Dubai Criminal Court). Senior Management including the MD & his Deputy involved.**
- **Deyaar Development, a Public Company, reported a Fraud / Embezzlement of US\$ 26 million. CEO & very Senior management involved.**
- **Suspicious Funds started pouring in (although Central Bank had strict regulations controlling Money Laundering).**
- **In the absence of RERA until July 2007, Developers were allowed to use a Project Collections for further investments / expansions thereby increasing the Risks of losses of Customers' money.**

Lessons Learnt

- *Any Kind of Excess is harmful.*
- *Heavy Borrowings / Leverage has very high Risk.*
- *Investments made without proper Feasibility and Real End users do not last for a longer term.*
- *Speculations and Greed are the key factors of eventual financial disasters.*
- *Carelessness must be avoided by carrying out Due Diligence in its true sense.*
- *Reality on Ground must be faced instead of adopting an Ostrich like approach.*
- *Confidence is a good characteristic but Over-Confidence becomes a Killer.*
- *Assumptions should be Realistic (Assuming that any Government backed Entity or Project is Guaranteed by the Government results in eventual Losses).*

3:14 Fair in the eyes of men is the love of things they covet: Women and sons; Heaped-up hoards of gold and silver; horses branded (for blood and excellence); and (wealth of) cattle and well-tilled land. Such are the possessions of this world's life; but in nearness to Allah is the best of the goals (To return to).

بِسْمِ اللَّهِ الرَّحْمَنِ الرَّحِيمِ

زُيِّنَ لِلنَّاسِ حُبُّ الشَّهَوَاتِ مِنَ النِّسَاءِ وَالْبَنِينَ وَالْقَنَاطِيرِ الْمُقَنْطَرَةِ مِنَ
الذَّهَبِ وَالْفِضَّةِ وَالْخَيْلِ الْمُسَوَّمَةِ وَالْأَنْعَامِ وَالْحَرْثِ ۗ ذَٰلِكَ مَتَاعُ الْحَيَاةِ
الدُّنْيَا ۗ وَاللَّهُ عِنْدَهُ حُسْنُ الْمَقَابِلِ ﴿١٤﴾

Surah Al Imran (The Family of Imran)

Thanks very much

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