# Financial Crisis: Dubai Bubble Burst

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You know about Dubai's economic crisis. But do you know the background to – and fallout from – the crisis?

A Brief History

Historically, Dubai had an oil-based economy.

But because Dubai's oil reserves were declining, the government – led by Sheikh Muhammed Al Maktoum – decided to diversify into other areas, especially tourism and commerce. See this and this.

That's why Dubai built the world's only 7 star hotel, a series of luxury islands, and the world's largest tower.

But the global property bubble is bursting.

As I wrote last December:

> Housing bubbles are now bursting in China, France, Spain, Ireland, the United Kingdom, Eastern Europe, and many other regions.
>
> And the bubble in commercial real estate is also bursting world-wide. See this.

But Dubai got hit the hardest.

As Bloomberg notes:

> Dubai suffered the world's steepest property slump in the global recession, with home prices dropping 50 percent from their 2008 peak, according to Deutsche Bank AG.

As the CBC notes, things went South quickly in Dubai:

> Hundreds of billions of dollars worth of building projects were delayed or cancelled. Thousands of jobs disappeared.
>
> Dubai, playground of the über-extravagant, suddenly found itself facing the very real possibility that its biggest state-owned company, Dubai World, could go into bankruptcy. It warned it was having trouble making debt payments on $59 billion US — money borrowed to pay for all the excess.

Global Impact

The CBC also notes that Dubai World has holdings worldwide:

> Dubai World is Dubai's main holding and investment enterprise, but its holdings range far beyond the Persian Gulf area …
>
> Another Dubai World holding — DP World — operates Centerm, a container terminal in Vancouver's inner harbour. DP World acquired the terminal when it bought the marine terminal assets of P&O Ports in 2006, and plans to spend $140 million to expand it.
>
> That purchase also gave it ownership of many key U.S. ports — something that raised national security concerns in the U.S. Some American legislators didn't like the idea that U.S. ports would be controlled by Middle Eastern state-owned enterprises. DP World subsequently sold its U.S. port assets.
>
> In Britain, another Dubai World subsidiary, Leisurecorp, bought the Turnberry Resort in Scotland in 2008 — home to the 2009 British Open — for more than 50 million pounds.
>
> In the U.S., Dubai World's investment arm, Istithmar World, bought the luxury retailer Barneys New York in 2007 for almost $1 billion US. There were reports earlier this year it was trying to unload the retailer as the luxury market unwound and Istithmar racked up big losses from the global financial meltdown, but Dubai World's chair denied it.

In addition, Bloomberg notes that India might be effected by Dubai's economic problems:

> About 4.5 million Indians live and work in the Gulf region and remit more than $10 billion annually, according to government data. The turmoil may affect remittances, said Thomas Issac, finance minister of the southern state of Kerala, which accounted for about a quarter India's migrant labor in 2005…
>
> Remittances from the Middle East account for about 25 percent of Kerala's economy, Issac said

The Royal Bank of Scotland is Dubai's biggest creditor, with $2.3 billion, or 17 percent, of Dubai World loans since January 2007. HSBC, Europe's biggest bank, has the "largest absolute exposure" in the U.A.E. with $17 billion of loans in 2008

Yves Smith notes that Dubai's default caught creditors by surprise:

> I got a message from someone who was on the conference call [with Dubai government officials]… Some European banks may be on the wrong side of this trade. As readers may know, EuroBanks went into the crisis with even lower capital levels than their US counterparts, and have taken fewer writedowns of their dodgy exposures:
>
>> The standstill announcement…was a massive surprise. One could sense the panic in those asking questions….this could be the turning point in spreads and could be viewed similar to the Russian debt crisis in 1998 or the Bear situation in 2007…based on companies and the accents of the people asking questions, it

> is obvious European institutions will be hit hard…Dubai made this announcement at the beginning of a four day holiday, so there will be little news until next week…There is another wave of pain out there. This information does not seem to be making its way to other markets. It will.

Zero Hedge has a good roundup of statistics regarding the biggest creditors of the United Arab Emirates, of which Dubai is a part:

> Creditors:
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> Of United Arab Emirates (By Origin via Credit Suisse citing Bank for International Settlements):
>
> United Kingdom: $50.2 billion
> France: $11.3 billion
> Germany: $10.6 billion
> United States: $10.6 billion
> Japan: $ 9.0 billion
> Switzerland: $ 4.6 billion
> Netherlands: $ 4.5 billion
>
> Of United Arab Emirates (By Entity via Credit Suisse, citing Emirates Bank Association):
>
> HSBC Bank Middle East Limited: $17.0 billion
> Standard Chartered Bank: $ 7.8 billion
> Barlays Bank Plc: $ 3.6 billion
> ABN-Amro (RBS): $ 2.1 billion
> Arab Bank Plc: $ 2.1 billion
> Citibank: $ 1.9 billion
> Bank of Baroda: $ 1.8 billion
> Bank Saderat Iran: $ 1.7 billion
> BNP Parabas: $ 1.7 billion
> Lloyds: $ 1.6 billion

The Associated Press has additional details.

Bloomberg notes that Dubai's default might increase risk aversion of investors to emerging markets:

> "We're bound to see a rise in risk aversion," Arnab Das, the London-based head of market research and strategy at Roubini Global Economics said in an interview. "The Dubai situation signifies that although the major central banks around the world have stabilized the financial system, they can't make all the excesses simply disappear."
>
> India's stocks, currency and bonds fell on concern investors may shy away from riskier emerging market assets over losses stemming from the turmoil in Dubai. India's benchmark stock index dropped 1.3 percent yesterday, while the rupee lost 0.5 percent.

Zero hedge also notes:

- UBS speculates that (among other possibilities) $80-90 billion (which is already over 100% of GDP) may be a low figure for Dubai's debt and that significant "off-balance sheet" amounts might explain the restructuring attempt

- The Dubai government is on holiday (Eid Al-Adha) until December 6th

- Abu Dhabi's Sovereign Wealth Fund (generally thought to command upwards of $500 billion) may have significantly less available. (Rumors of $125 billion in 2008 losses abounded last year). Bloomberg quotes sources to the effect that Abu Dhabi SWF's AUM has been "overstated, sometimes by as much as 100 percent."

British prime minister Gordon Brown has indicated how serious the situation is:

> "Clearly the restructuring announcement has caused disruption and uncertainty in world markets," Brown's spokeswoman Vickie Sheriff told reporters in London. Brown's "view is that U.K. banks are well capitalized having undergone rigorous stress testing," she said.

And the Associated Press is asking whether Dubai's default will cause another financial panic.

The numbers involved are not that great for most creditors – on the order of hundreds of millions of dollars.

But the sense of shock and loss of confidence – when many had optimistically believed that the world economy was out of the woods – could indeed be profound.



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