

Dubai Crisis & Kerala

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INTRODUCTION

The world is a strange place and becoming stranger day by day. One thing however, is for sure - it's becoming more globalized, integrated and most importantly, more interdependent. The world is moving towards transnational economy rather than international economy. Transnational economy is the border less economy, characterized by flow of trade and factor of production across national borders, So when the financial system of one country is disturbed, other systems in the country are likely to have proportionate impacts simultaneously. [Refer Exhibit - I] Recent global financial crisis that began like a tiny spark in the US housing finance market in 2007 spread like a wild forest fire that first engulfed the US, then the Western economies and eventually the rest of the world. The crisis impacted the deepest and most wide spread economic meltdown that the world had faced since the great depression. While most global economies have been struggling from the global financial crisis which also impacted the UAE, Dubai has consistently fulfilled most of its promises. In addition to the delivery of Dubai Mall- one of the world's biggest malls, the Government also opened the Dubai Metro, the region's first urban mass transit system. It presented to the world- the tallest man made tower Burj - Khaleefa. All this happened at a time when the global economy was struggling to move forward.

STATEMENT OF THE PROBLEM

Dubai Government admits that it has problems and will have to go through a period of recession. Stronger measures are being taken and the Emirates will continue to be a strategic trading hub between the East and the West. As a strategic measure, on Wednesday 25th November 2009, the Government of Dubai announced, through its Department of Finance, the restructuring of Dubai World, saying it intends to ask all providers for Dubai World and Nakheel to “stand still” and extend maturities until at least May 30, 2010. Dubai world has a portfolio strategically important. Business and the restructuring will address financial obligations and improve business efficiency for the future- the statement said. The stand still period for negotiation debt and restructuring of Dubai world and Nakheel could potentially leave the Dubai Government in a better position to support its other government related companies- John Tofarides (Banking Analyst). Dubai world was established under a decree ratified on 2nd march 2006 by Sheikh Mohamed Bin Rashid Al Maktoum, Vice President and Prime minister of the United Arab Emirates and Ruler of Dubai. He also holds the majority stake in Dubai world. On 2nd July 2006, it was launched as a holding company with more than 50000 employees in over 100 cities and the globe. The group now has extensive real estate investments in the United States, the United Kingdom and South Africa. Dubai world made headlines in March 2008 after its Chairman, Sultan Ahmed bin Sulayem, threatened to take the fund's money out of Europe [Professor David CI March 2008]. Dubai world's threats came shortly after the European Union attempted to layout “a set of principles for transparency, predictability and accountability” for sovereign wealth funds [O'Grady, Sean (26 February 2008)]. On 26th November 2009, Dubai world proposed to delay repayment of its debt [www.meed.Com] which raised the risk of the largest government default since the Argentine debt restructuring in 2001. Dubai World, the investment vehicle for the Emirates, asked to delay payment of the \$ 26 billion of debt for six months. The extent of debt rattled many markets, causing many indices to drop; including oil prices. U. S stocks fell sharply but rebounded from their lows as investors concluded that the damage might be contained. The Dow Jones industrial average also sank. Oil prices plunged as much as 7 percent before recovering some ground later in the day.

2009 DEBT STAND STILL

With the onset of a global recession, Dubai real estate market declined after a six year boom. On November 25, 2009, the Dubai government announced that the company “Intends to ask providers of financing to Dubai World and its

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subsidiary Nakheel to stand still and maturities until at least 30 May 2010. The company has laid off 10500 employees worldwide as the company restructures with the help of Deloitte consultants. At that time, Dubai World has debts of \$ 59 billion, accounting for early three quarters of the Emirate's US \$ 80 billion debt. This includes a US \$ 3.5 billion loan, which the company is unable to repay by its December deadline.

IMPLICATIONS

The impact of the announcement appears to have more effect outside the UAE - Gulf co-operation council than in Dubai. According to Parry Singh, Managing Director of real estate equity fund Red Fort capital: "*The recent crisis will certainly impact the Indian realty sector, which has not even fully recovered from Lehman (Brothers) crisis.*"

Dubai debt crisis has rattled markets across the world as the problem revived worries about the health of the global financial system. Although the exposure of Indian companies and banks to the Emirates is negligible, concerns linger about the fall out on the broader economy. On the strength of the oil boom in the region, Dubai one among seven Emirates of UAE, has been positioning itself as a global centre for finance, trade and tourism due to negligible oil resources at home. During the early years of the current decade, witnessing growing demand for real estate, the Government started marketing housing projects offering 90 years of residence permit. Such a residence offer for investors in housing projects was neither denied by Government nor approved. This led to an unpredictable boom in real estate, attracting rich investors from India, Russia, Europe and other places. Both accounted and unaccounted global money started chasing real estate leading to even "day trading" in real estate. There were even cases of buying in the morning and selling in the evening. Finally, when the global financial system was reached, the Dubai real estate bubble also crashed. The construction driven economy was slowing down with highly leveraged projects. Dubai World, the real estate infrastructure arm of the ruler of Dubai, was excessively leveraged during the boom years and when the demand dis-appeared, had to catch up with debt repayments without positive internal cash flows. When the markets crashed in Dubai, with the threat of Dubai World defaulting on its debt, the direct impact was perhaps felt more in the southern state of Kerala as it sends hordes of workers to the Emirates. Repots CNBC TV 18's Naveen Nair. Economists call Kerala as a money order economy and precisely for this reason, every third house in Kerala has a man working in the Gulf. It is this *malayalees* dream to making it big in the Gulf that was in the line of fire when the markets tumbled in Dubai.

Kerala, where remittances contribute to about a fourth of its economy, will be the worst affected by the Dubai crisis [Geetha Baskaran, GulfNews "India Stocks"]. The following are the impacts:

1. NRI Remittances: Over two million migrants from Kerala are working in the Gulf. There will be increase in inflows in the short term since NRIs may consider India as a safe heaven than domestic bank deposits in UAE and perhaps GCC. However, any protracted crisis can lead to job loss and business closure with impact in the medium term. The UAE contributes to around 13 percent of the overall remittance flow into the country, with as many as 42 percent of the 1.5 million population of Dubai being Indians. In 2008, India revived the highest amount of remittances at 52 bn dollars or 15 percent of the global total - As per World Bank report. This constitutes about 3.3 percent of the GDP. From among 50 lakh Indians who work in the Gulf, the Keralites alone account for more than 20 lakh. They also bring in more than 25 percent of the state's GDP as remittance. Kerala, where remittances contribute about a fourth of its economy, will be the worst affected by the Dubai crisis.

2. Family Incomes- Down - A direct result of the above foreign remittance coming down dramatically would be that the incomes of the families depending on these remittances month after month would be badly hit. The most directly affected would be tens of thousands of families, particularly in the states of Kerala, Andhra Pradesh and Bihar, amongst others.

3. Specific State Economies- Down - Given that the consumption (and investment) economy in states like Kerala is very much dependent on this regular inflow from the gulf region, a sudden closing of the tap could have a devastating short, if not long, term impact on the economies of these states (Kerala, Andhra Pradesh, Bihar).

4. Infrastructure Projects- Down - Any impact on the real estate sector as discussed above will have its reflection on infrastructure projects in the country. In addition to that, many companies from the region, including Dubai World itself are executing several large scale infrastructure projects in the country. Any impact of the current crisis beyond the current deferment or any significant restructuring of Dubai World could impact the schedules of these projects and could throw them out of sync.

5. Gold Prices - Up - This is the only item of the ten listed in the present article that is likely to move upwards as a result of this crisis, and that is no good thing. Gold has been on a wild upward swing in its prices as investors across the world scurry for safer investment options. This crisis will only increase the preference for gold significantly, driving prices up even further. Another interesting tidbit to be kept in mind is that the Gulf region is a major hub of the gold trade. How the crisis will impact gold trade itself remains to be seen.

6. Manpower Placements - Down - Though overshadowed by manpower placements in foreign countries by the IT industry, the Gulf region is still a major market for manpower, particularly for skilled and unskilled labour. Any shake up in the region leading to job cuts or people refusing to work in the region will significantly impact this sector. Similarly, other services exports to the region will also be significantly affected.

7. Local Consumable Items Exports - Down: - Many items of local consumption are exported in large quantities to the expatriate population in the Emirates. These largely include food and cultural items. A major change in employment levels in the region will leave their immediate impact on these exports.

Now, there is a possible silver lining here that the lack of export markets could bring local prices of these items down, cooling down the local markets, which seem to be on fire as far as prices go. But then, the purchasing power may also have vanished from the markets, re-establishing the status quo.

8. Spices Exports- Down - The Emirates region is a significant market for Indian spices. Any financial shakeup in the region could adversely affect the market for these items.

9. Real Estate - Indian property market is very robust and is largely dominated by internal demand. But it impacted the credit flow into the realty sector. Because of the crisis, banks were driven to tighten their credit policy.

10. Stock Market - The Indian stock market was not prepared for two surprises in three days- the Dubai announcement and the Indian GDP results. The day following the Dubai World's statement, markets tanked all over the world. The Bombay Stock Exchange lost 390 points. When the markets opened after the weekend, India's central statistical organization announced that the country's Gross Domestic Product grew 7.9 percent from a year earlier in the July- September period. But for the Dubai crisis, India's markets would have soared much higher on hearing this news. After all, a Dow Jones News weis poll of 13 analysts before the announcement had forecast only a 6.3 percent - considered very bullish.

11. Banks - In recent years, Indian Banks, have made significant progress in expanding their network overseas. According to Times of India, the impact was felt on India's big banks except Bank of Baroda, whose total exposure in Dubai is around 4000 crores.

The RBI has asked Indian Banks to furnish details of their lending to Dubai based firms as a precautionary step. Indian media reported that State Bank of India, which was recently granted a full fledged banking license in UAE, does not have any significant exposure in Dubai yet.

12. Entertainment - The Middle East, particularly Dubai, is the biggest overseas markets for Malayalam film industry, generating almost 50 percent of its international revenue. The crisis rattled Malayalam Film industry. Some concerts and shows were also cancelled.

CONCLUSION

For Kerala, the Middle East has been the backbone of its economy for close to three decades now. The impact of Dubai World being close to bankruptcy will perhaps be felt more in Kerala which accounts for a huge chunk of Indian workers. While the exodus of job losers has not started, it is worrying time for the state's economy. But if the crisis deepens in Dubai World, this could very well leave the state's economy in complete ruins in the coming months.

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Exhibit -1: Financial Crisis- Causes And Effects

Year	Causes	Effect
1764	In 1764, the British Empire enacted the currency Act (Due to shortage of currency to conduct trade, the British Colonies Started printing their own paper money without the presence of common regulations, which resulted in wide spread confusion. The currency act was passed in 1764 to prohibit the issue of new bills and the reissue of existing currency and to control the colonial currency system) As per this act, all the American colonies were debarred from issuing paper currency.	This resulted in decreased money supply and created severe monetary problems in US. This was followed by recession, which sowed the seeds of the American revolution.
1818-1819	Generally referred to as the panic of 1819. It is considered as the first major financial crisis in US. It is characterized by large scale foreclosures, breakdown of various banks and sagging of agriculture and manufacturing industry.	Many industries collapsed and there was wide spread unemployment.
1837-1839	During this period, the US economy witnessed a steep decline as several banks broke down and the paper currency lost significance. Further, as the American banks stopped making payments in Specie (Gold and Silver coins).	The speculative markets were greatly affected.
1857	The failure of Ohio Life Insurance and Trust company resulted in bursting of the European Speculative bubble in US rail roads.	As a result, people lost faith in the US banks within a year, numerous business houses collapsed; there was wide spread unemployment and the urban area witnessed protests.
1873	There were economic problems in Europe, which affected the US as well. In 1873, one of the investments banking companies of the US called Jay coke and Company collapsed.	This had far reaching consequence as Jay coke was not only the main promotes of Northern Pacific rail road. It also managed most of the war time loans of the government. There were major economic problems in the US as many banks failed. Sufficient foreclosures credit was not readily available, businesses collapsed and there was large scale unemployment. US plunged into depression from which it could not recover until 1878.
1893-1895	The crisis of 1893 was triggered by the collapse of Philadelphia and Reading Railroad in the US. In turn, almost 600 banks, 15000 businesses and 74 rail road companies collapses.	The stock market plunged and fearing further damage, the British investors started withdrawing their deposits from the US by selling the US investments in favour of gold. There was exit of gold from the US, which resulted in panic and the US witnessed large scale unemployment and depression.
1907	In 1907, while the US economy was already fragile, the Knicker bocker Trust and the westing house Electric Company failed; thereby triggering a state of economic panic.	Several businesses and the wallstreet brokerage firms collapsed and the stock market prices went down. The depositors sought their money from the banks. While the US Treasury tried to bailout the banks, the number of institutions which collapsed went on increasing.

		However, owing to the combined efforts of the government and the business leaders, the economic condition of the US started improving. A significant development in the aftermath of the crisis was the creation of the Federal Reserve System in 1913.
1939-45(Post World War II Recession February to October 1945)	This was mild downturn of the economy in the US, which lasted for around eight months. During the war, there was a huge demand for goods required for the war. As a result, the US factories and various types of business did well but after the war, all those goods were rendered useless. After the second world war, the demand for goods needed during the war suddenly declined. At the same time, at the end of the war, the soldiers were rendered unemployed. They had to look for new employment.	As a result, there was high unemployment and many business houses/firms collapsed.
1973 (Oil prices shock)	In 1973, during the Yomkippur war, the Arab nations of the organisation of Petroleum Exporting Countries (OPEC), declared that they would no longer supply Petroleum to the US and its western European Allies as they sided with Israel in its clash against Egypt. At the same time, OPEC quadrupled the world oil price as it was a powerful body to fix/decide the world oil price. As the industrialized countries were completely dependent on oil, which came mainly from the countries of Middle East, the western nations had to resort to severe economic policies to tackle the oil crisis. At the same time, Vietnam war was a very expensive commitment for the US.	Resulted in Stagflation and acute fuel shortage in the US. There was inflation and economic recession as well.
1980s (Stock market crash 1980s)	In October 1987, stock market crashed unexpectedly which however, did not have very long - lasting economic consequences.	There was not much damage to economy and the stock market soon started recuperating. However, the savings of the Americans were threatened as the savings and loans gradually began to collapse. The whole nation was in panic, Hot on its heel, there was recession, particularly in those countries, which were closely related to the US. The recession was short lived as the government took timely measures. However by 1990, the economic recession came back. The recession hit most of the western world as the junk bonds collapsed and the stock market crashed in the US.
1991-1998(Regional Economic Crisis)	Chile- Chile experienced severe economic and financial crisis towards the beginning of 1981. In early 1981, when the world economy witnessed recession, the economy of Chile was also badly affected.	Chile suffered huge loss in terms of trends of trade and by the end of 1981, it also witnessed recession which precipitated the banking crisis of 1981-83. More than 30% of the labor force was unemployed and around 55% of the population lived in poverty.
1991-1998(Regional Economic Crisis)	Argentina- In 1991, to control hyper inflation, Argentina fixed its currency's (Peso) exchange rate to the US dollar such that 1 dollar equaled 1 peso.	While the strategy helped in tackling the economy temporarily, it had long lasting impact on the Argentine economy. As the value of dollar rose, so did the value of peso and Argentine exports became expensive as compared to its imports.

	Mexican Peso Crisis- In 1992-93, Mexico had a large current account deficit of \$20 bn. The situation deteriorated and in December 1994, the Mexican government had to devalue the Mexican Peso by 15%. Asian Financial Crisis- The crisis started in July 1997 in Thailand. Many Asian countries including the ones which were earlier referred to as the East Asian Tigers were impacted by the crisis as their currencies, stock markets and the prices of various other assets were badly affected. Russian Crisis:- On August 17, 1998, Russia was hit by a financial crisis which got further aggravated by its global recession of 1998 which was in turn triggered by the Asian Financial crisis of the previous year.	The value of the currencies of Brazil and the European Union (EU) (largest trading partners of Argentina) were much lower than that of Peso. As a result, the Argentine exports became uncompetitive and the economic growth of the country was badly affected. As exports went down, Argentina did not have the requisite fund to repay its debts which were in dollars. As a result, the government spending had to be cut which resulted in reduced salaries of government employees, delayed disbursement of Pension Funds and unemployment as high as 20%. The Argentines suffered terribly as prices rose, jobs became uncertain as there was limited access to money. As a result, Mexico witnessed a financial crisis wherein the inflation was very high and the country plunged into recession. The countries which were most affected were Indonesia, South Korea and Thailand Hongkong, Malaysia, Laos, and Philippines. China, Taiwan, and Singapore was relatively stable. Though Japan was unaffected by this crisis, during this time, it was struggling with its own economic problems. As the market collapsed in South East Asian countries, the US and Europe also got affected. As the world commodity prices were decreasing, those countries which were dependent on the export of raw materials such as oil, were badly affected. Incidentally, more than 80% of the Russian exports comprised of Petroleum, Natural gas, Metals and Timber remained affected. A combination of factors such as reduced productivity and a huge fiscal deficit led to the crisis. Notably, the fixed exchange rate between ruble and the foreign currencies was also high. Despite the assistance from the World Bank and IMF, the economic situation in Russia could not be controlled. By August 1998, the stock bond and Currency market of Russia collapsed. Russia was forced to drastically devalue the ruble to contain the crisis of payment, which was gradually intensified. BY 1998, Russia witnessed an inflation of 84%. Several banks closed down and there were far reaching consequences on Russian Economy.
2000-2001 (Recession)	In 2000-01, there was a mild recession particularly in the US and ED nations. While ED Countries were affected during 2000-01, the US got affected only in 2002-03. At the same time, while Japan too experienced recession, Canada remained unaffected and the Russian economy started recovering.	The recession was triggered by the bursting of the dot com bubble, the September 11 attacks in the US and some disgraceful accounting incidents.
2007 - present	While the financial crisis began in 2007 itself; it manifested only in 2008. It originated in the US when the housing market collapsed, leading to the collapse of many banks in the US and Europe.	As a result, there was a sharp reduction in the availability of credit. The commotion in the US economy impacted the entire world and initiated recession.

Source:- Varavasanthi et al., "Managing crises; Built to Last Companies" Global CEO Nov. 2009 Vol. IX (II).