Unitas Consultancy (A GLOBAL CAPITAL PARTNERS GROUP COMPANY)

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Dubai: Financialization and its Discontents

REIDIN Real Estate Information

Office No. 1706, Indigo Icon, Plot No. F, Jumeriah Lake Towers, Dubai, UAE

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Executive Summary

- "Financialization" is a term that gained popularity in the 1970's after the end of Bretton Woods era, as leverage began to override equity in the financial system. A look back into the United States, reveals that debt levels relative to the GDP has more than doubled in the last 50 years. This phenomena has transpired globally as countries have shifted away from industrial capitalism.

- Talks of a Dubai debt crunch resurfaced during the oil crash, but appear to be exaggerated when compared to the rest of the world. According to the latest findings, direct Dubai debt is relatively conservative at (55%), with the entire UAE even further down the line at 14%. More developed nations such as UK (89%), United States (104%), and Canada (91%) have surpassed these levels, implying that Dubai has room for further expansionary policy as it continues to roll out mega infrastructural projects in the build up to the World Expo 2020. This stance is contrary to what has been adopted by the West, leading to concerns of the "New Normal" rate of growth.

- In the current age of financialization, housing and the real estate sector has been the main absorber of the excess capital in the financial system. In the United States home mortgages account for 70% of the debt levels, which has risen in tandem with the increase of liquidity in the system. A dissection of the UAE's credit by economic activity reveals that except for transportation, sectors that are impacted by financialization have had higher than average growth rates (real estate, financial services, and personal loans for businesses). This has been consistent with what has been witnessed in the global economy; however given the lower base with which Dubai has started from, it is probable that there is further room for growth especially since the percentage spent on infrastructure remains far higher than global standards.

- A look into Dubai's freehold housing supply we can witness a growth in the market capitalization from AED 28 Billion to 485 Billion in the 10 years. Dubai's freehold housing stock is 133% of city's gross domestic product. Whilst this analysis does not factor into account the value of non-freehold real estate, given comparatives, it appears likely that there is room to grow from current levels.

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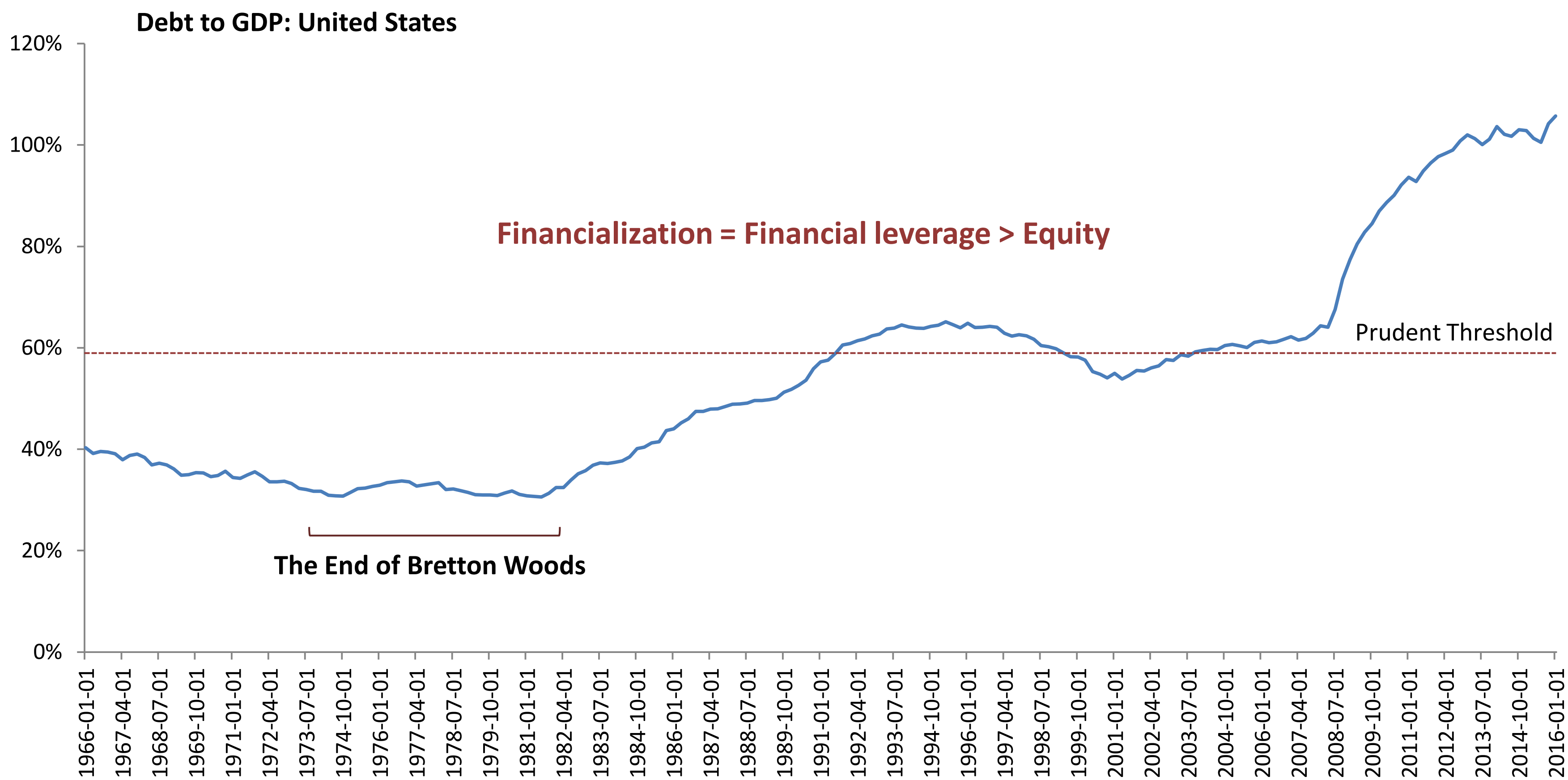
A look into Financialization

"We have this culture of financialization. People think they need to make money with their savings rather with their own business. So you end up with dentists who are more traders than dentists. A dentist should drill teeth and use whatever he does in the stock market for entertainment" - Nassim Nicholas Taleb

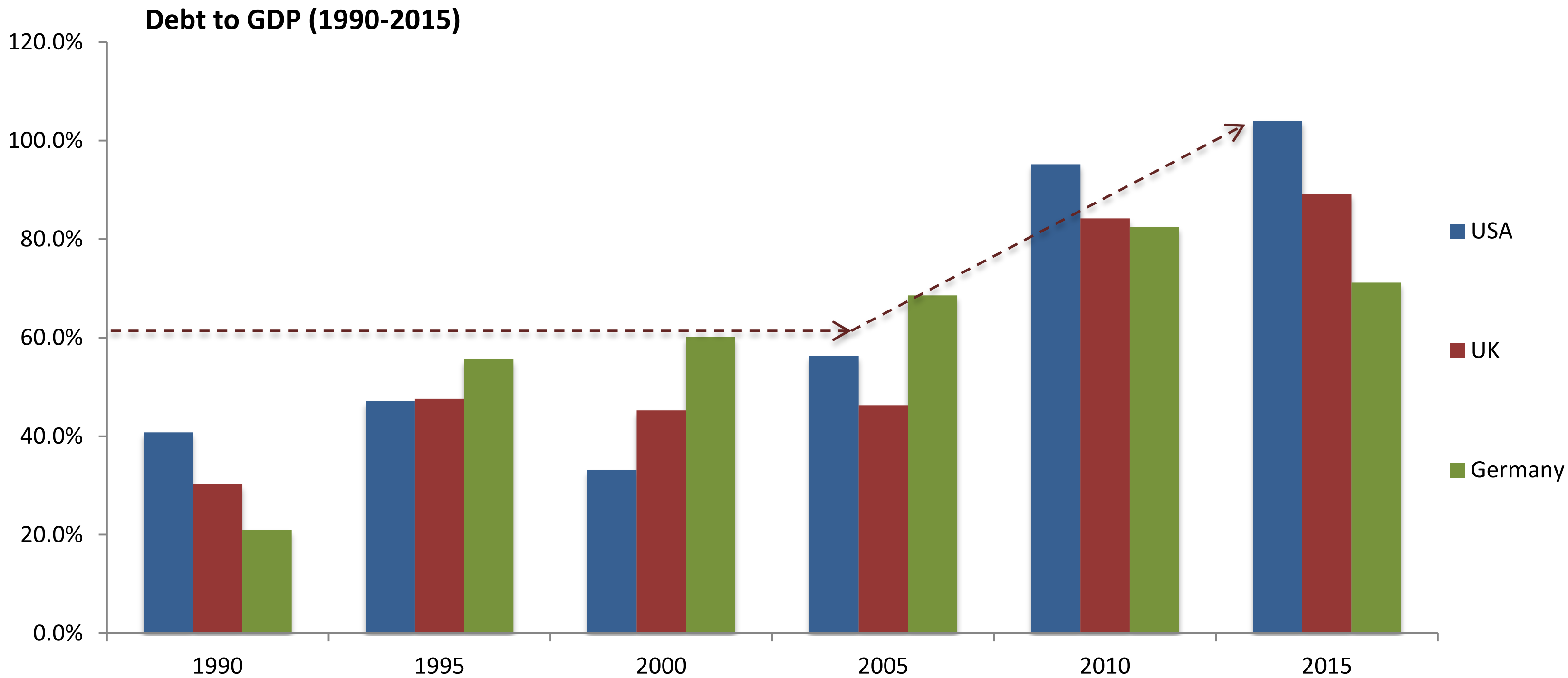
The Financialization of Capitalism: A look in the United States



The above graph highlights the growth of financialization in the US Economy. The Debt to GDP ratio has increased by 2.65 times in the last 50 years. However in the last 10 years it has increased exponentially nearly doubling, sparking concerns of the amount of leverage weighing down on economic growth, and therefore the level of interest rates.

*research.stlouisfed.org

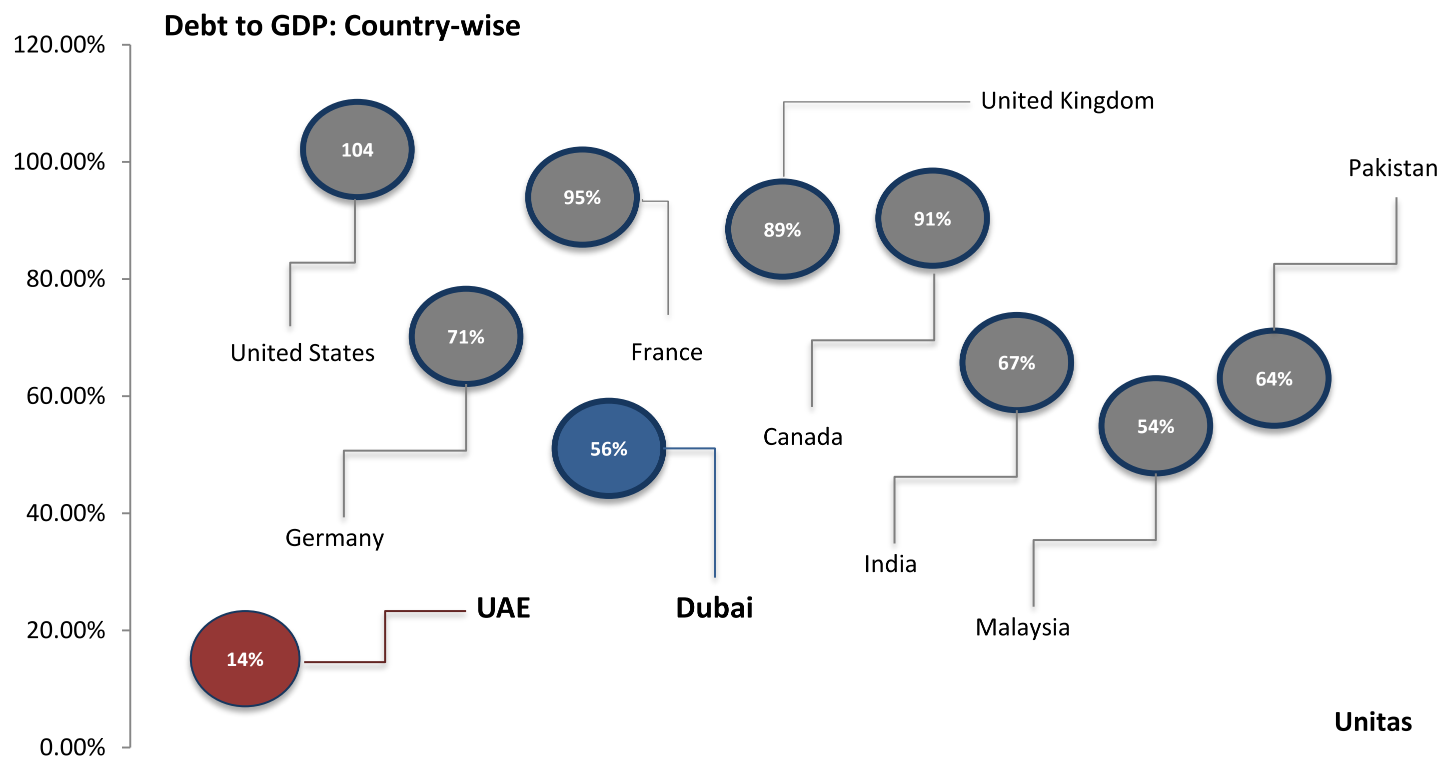
Debt Ratchets Higher Around the World



A look into multiple countries reveals that financialization has gathered momentum over the last couple of decades, pushing debt to GDP ratios much higher than the prudent level of 60%**. The level of financialization initially sparked accelerated GDP growth rates; however post 2008, there has been increasing concern of debt levels in the world economy, especially since the majority of fresh debt proceeds have been allocated to financial assets, sparking fears of a "new normal".**

*World Bank | Trading Economics

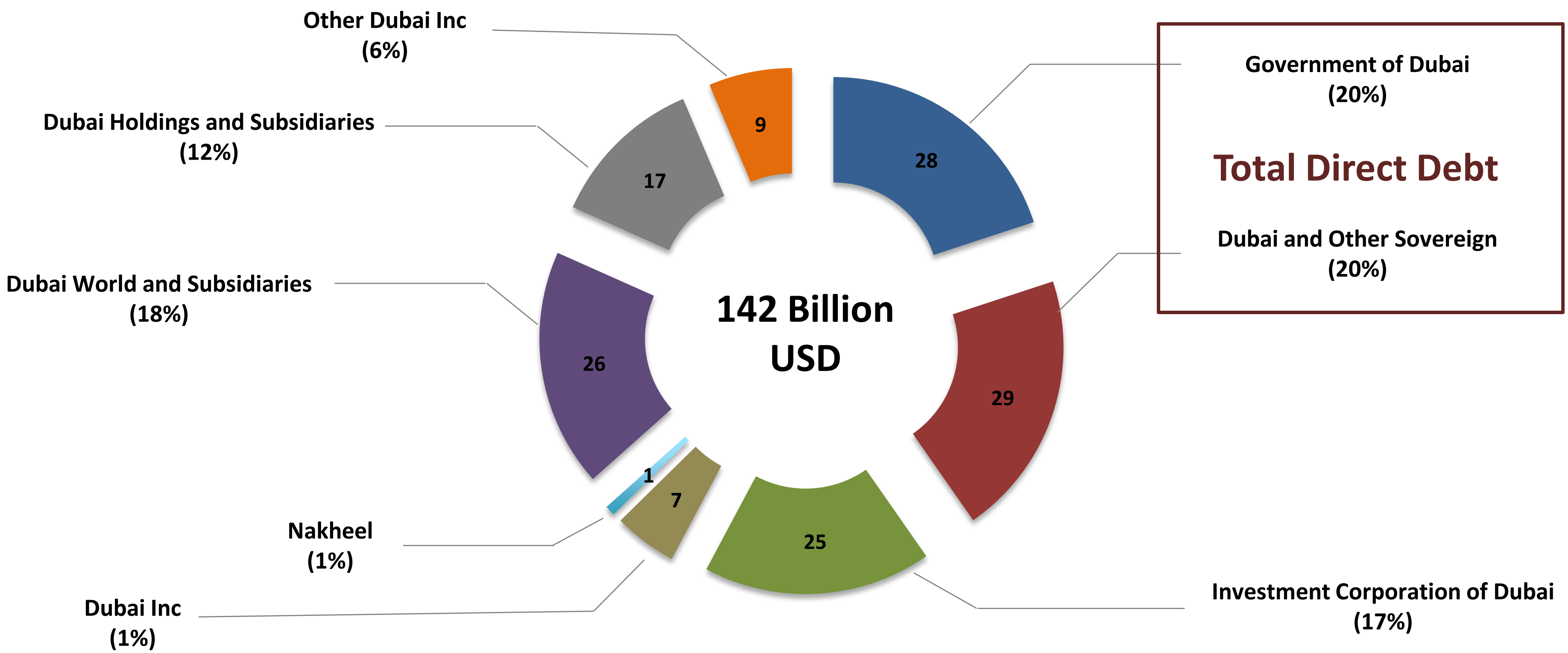
UAE Remains well below Preduent Debt Levels



An analysis of the Debt/GDP ratios' of various countries reveals that the UAE is still significantly under-levered. Its direct Debt to GDP is 14%, whereas in other countries such as UK, US and Canada the ratios are closer to 1:1. This level of debt indicates that in an era of low oil prices, there remains considerable cushion to lever in order to fund infrastructure and related projects. This trend has already started to be witnessed this year with public debt issues from Abu Dhabi, Kuwait, Qatar and Oman already announced and more in the pipeline.

*World Bank | Trading Economics | BAML

A breakup of the Dubai's Debt Pile: Direct and Indirect



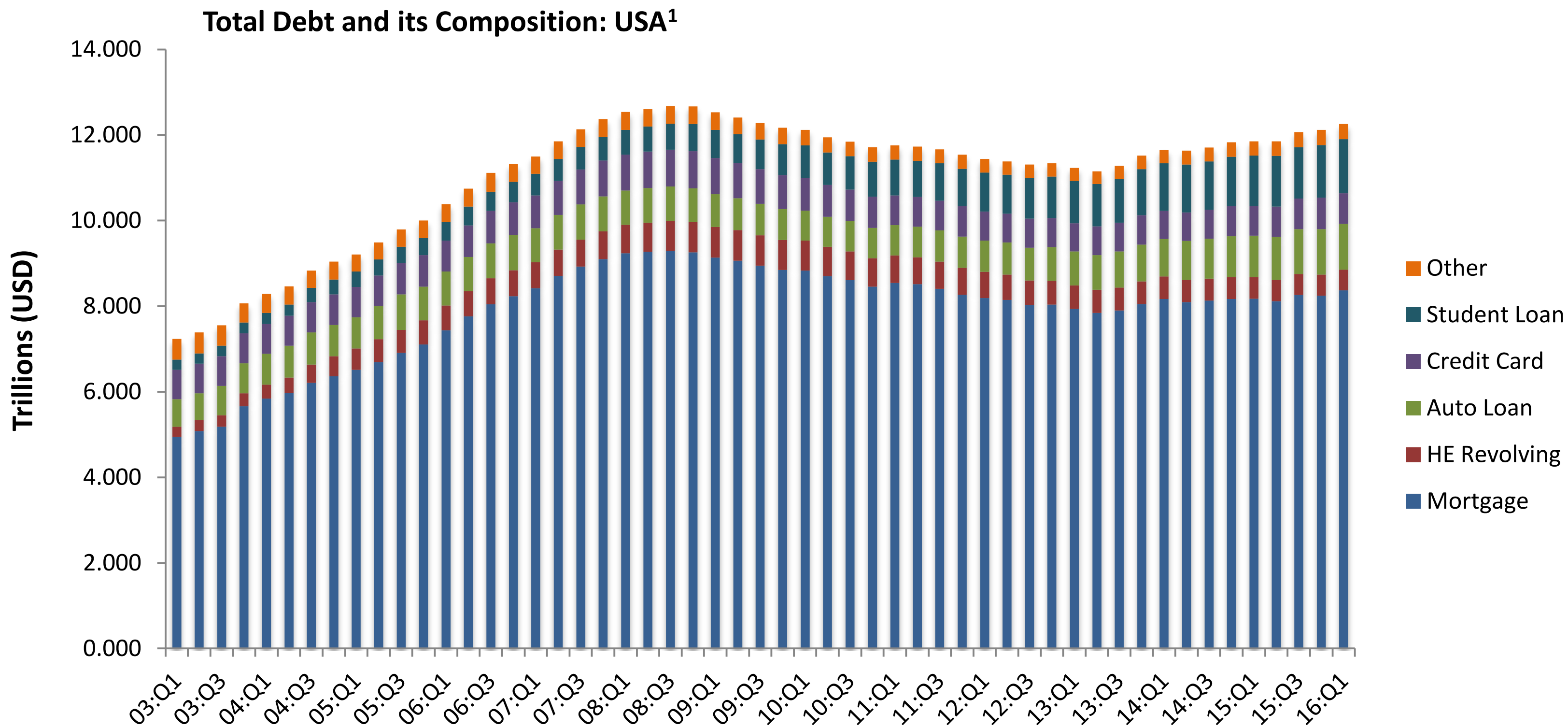
Most countries do not collate data on their gross external debt, consequently not highlighting the accurate amount of leverage in the system. The above chart shows the IMF assessment of Dubai's internal and external debt obligations. If you take into account external debt as well, the Debt to GDP ratio ratchets higher to 132%. Similarly to other countries Debt levels are actually much higher than stated. Whilst this higher level of debt raises concerns, it fails to take into cognizance that this debt levels cover cross border assets and earnings as well leaving considerable cushion to service these levels.

*IMF (2015 Article IV Consultation)

Real Estate and Financialization

"What we define as a bubble is any kind of debt-fueled asset inflation where the cash flow generated by the asset itself - a rental property, office building, condo - does not cover the debt incurred to buy the asset. So you depend on a greater fool, if you will, to come in and buy at a higher price" - James Chanos

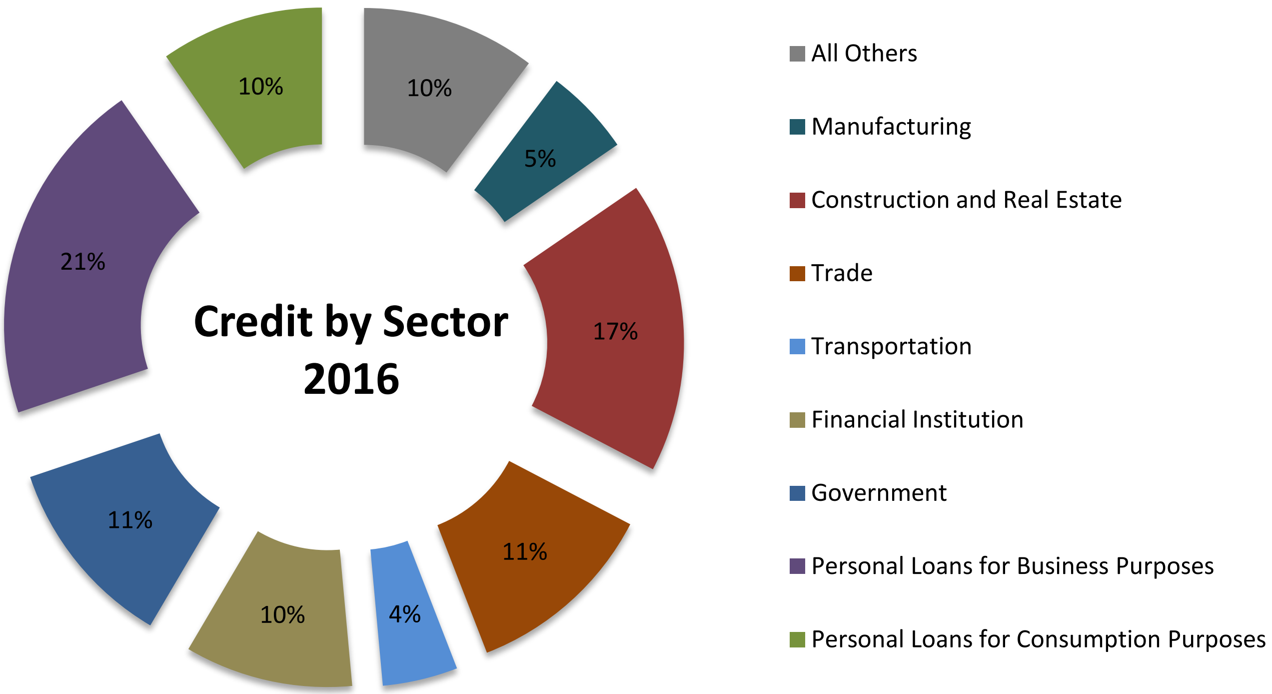
The Money from Financialization is Flowing into Real Estate Mortgages: A Look into USA



In the United States, real estate is the largest asset category for the country, generating most of the economies gains. It has been the major beneficiary for the of the rise of finalization in the form of home loans. Home loans account for close to 70% of debt of the country, as citizens pursue home ownership. This structure of debt is broadly the standard of what is observed throughout the developed world.

[1]FRBNY Consumer Credit Panel | Equifax

UAE Bank Credit to Residents by Economic Sector by Value

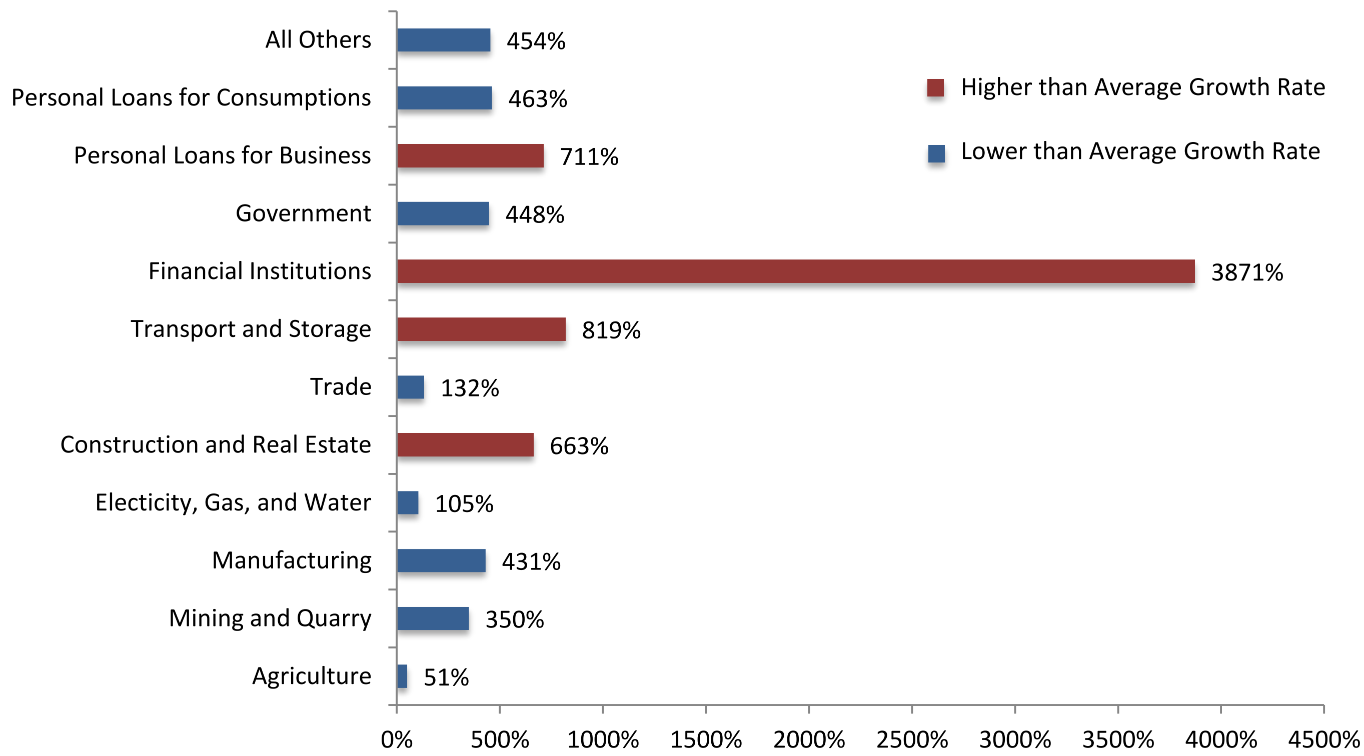


A break up of the UAE central bank credit to economic activity reveals that *Personal Loans for Businesses* and *Real Estate* are the largest sectors. Dubai's real estate market is still heavily driven by investors whose preferred mode of payment is cash. However, as home-ownership begins to contribute a larger portion of the buying pattern, we opine that home loans will account for a larger portion of debt, mimicking that of the Unites States. This anticipated expansion of debt into the real estate sector *ipso facto* implies not only the liquidity that will be made available, but also for an increase in asset values from current levels.

*UAE Central Bank

UAE Bank Credit to Residents by Economic Sector Growth Rate

Change in Bank Credit to Residents by Economic Sector (2004 vs 2016)*



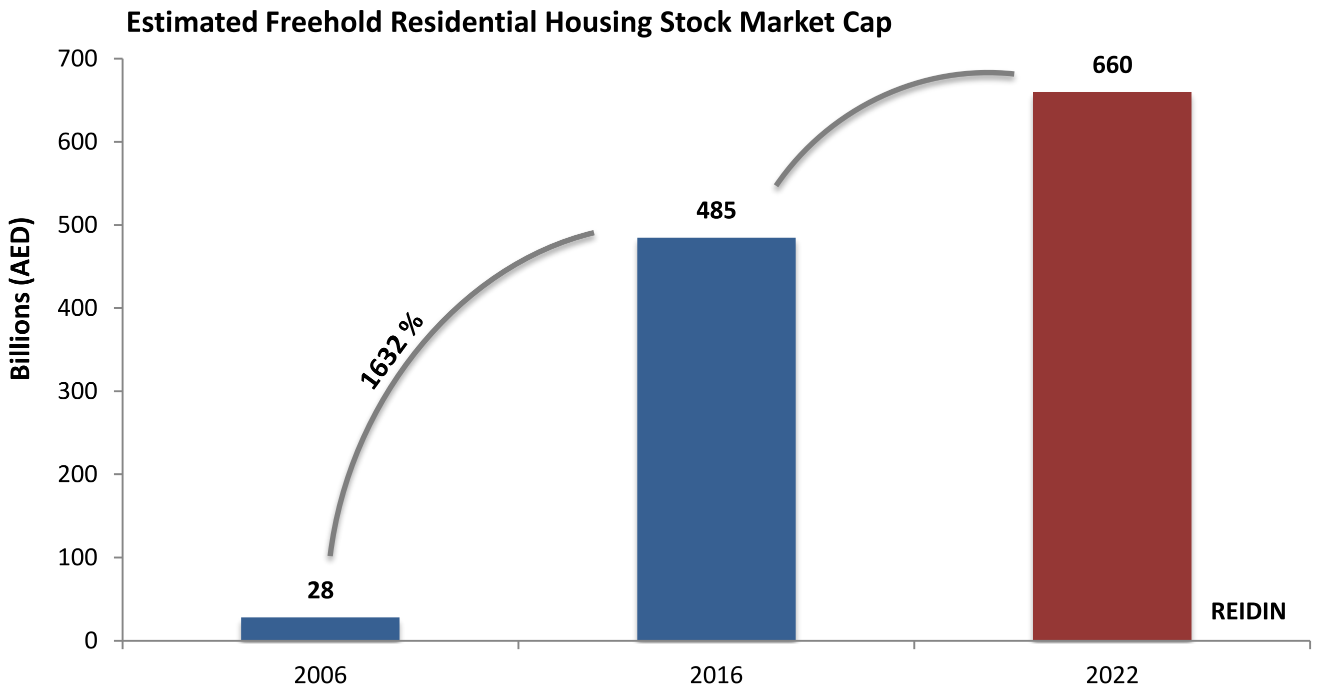
Dubai's expansion began at the inception of freehold in 2002, which lead to an asset boom in the real estate market. The above graph shows the change of credit levels by sector over the last 12 years. We can witness that barring *transportation,* all the other sectors that have higher than average growth rates is a direct causation of 'financialization'; equally important to note that despite the staggering growth rates (which mirrors the growth in developed markets), the absolute low base from which this growth rate accrued, implies that there remains room for further growth.

*UAE Central Bank

Housing Market Capitalization

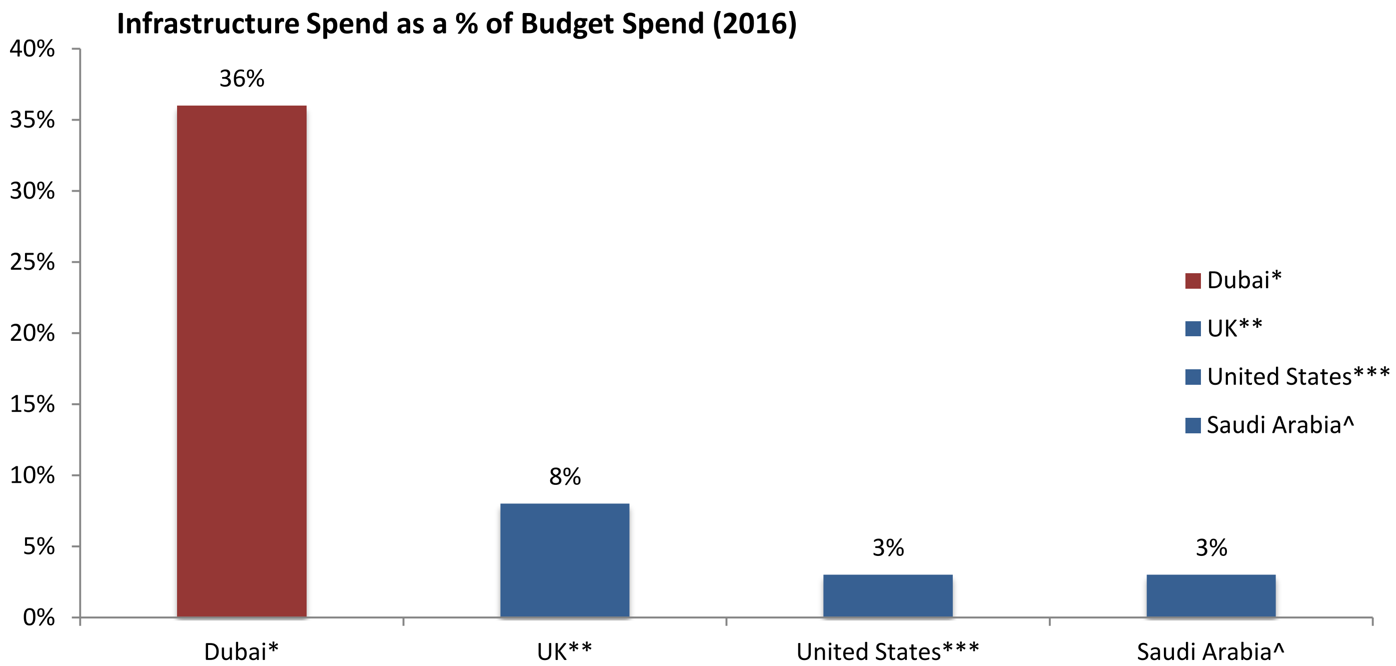
"it is better to be roughly right than precisely wrong" – John Maynard Keynes

Dubai Freehold Housing Market Capitalization



The above graph shows the market capitalization of the Dubai freehold housing market of completed units. In 2006, the market was worth 28 Billion growing a staggering 1632% in a decade. With the projection of projects now launched (there remains a substantial pipeline that has not yet been announced), this market cap is further expected to grow to 660 Billion by 2022; when we project a value to the levels of unannounced stock in master communities that have been launched, this figure further rises to AED 1 trillion.

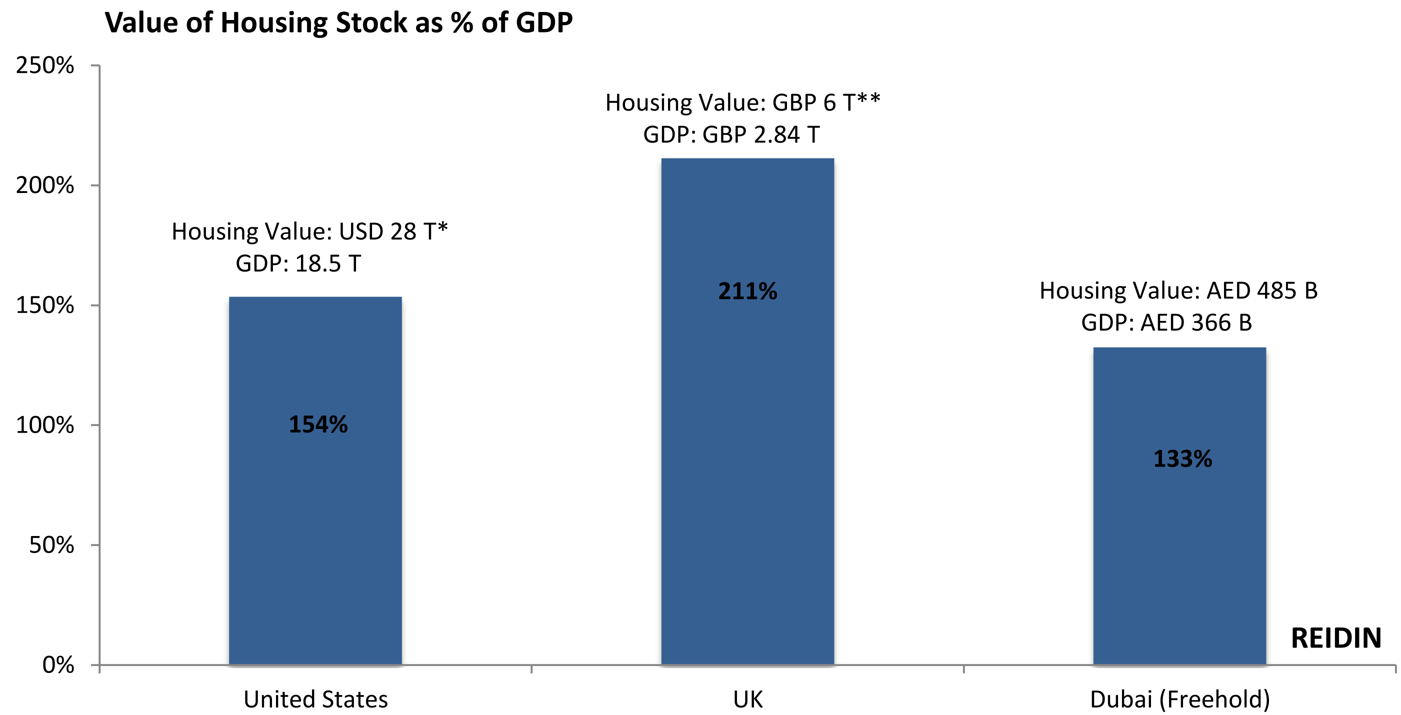
Infrastructure Spend is the Prime Pump of the Dubai Budget



Over the years Dubai has invested a large portion of its budget spend on developing the city's infrastructure. In 2016, Dubai allocated 35% of its budget expenditure, which is 10 times more than most developed countries.

*Infrastructure, Transport, Economics (Government of Dubai Media Office) | **Transport and Housing and Environment (www.gov.uk)
***Transportation and Environment (www.nsidegov.com) | ^Ministry of Finance

Housing Stock valued higher than GDP



The housing market is typically the largest asset of a country's economy. We can witness that in most cases the housing market is worth more than the GDP of the country. **We opine that with debt levels having room to grow, and with rapidly rising population growth rates, it appears likely that although the growth rates of asset values may well be lower than what was achieved historically, there will be an expansion of both the values and the quantum of real estate assets and it is this *prime pump* along with infrastructure spending that will continue to underpin economic growth.**

*Zillow | **Savills

Conclusions

An analysis of the Debt/GDP ratios' of various countries reveals that the UAE is still significantly under-levered

In 2006, Dubai's housing market was worth 28 Billion growing a staggering 1632% in a decade

A Look into Financialization

After the end of the Breton Woods era, debt levels within the economic system of most countries began to ratchet higher outpacing the equity. This phenomena is known as the start of 'financialization'.

A snapshot of the direct debt levels as percentage of GDP of a various countries, reveals that UAE is still significantly under-levered (14%). This is substantially lower than countries such as the US (104%), UK (89%) and Canada (91%).

Although Dubai is higher than the UAE, its direct debt levels are still below the acceptable levels of 60%

Real Estate and Financialization

The real estate sector has generally been the main benefactor of the rise of financialization, absorbing the liquidity/debt in the system. In the US, home loans account for 70% of debt levels.

A closer look into the UAE, reveals that the sectors that have been in direct relation to the financialization process as had higher than average growth rates in terms of Bank credit.

Real Estate is the second largest sector by credit activity in the UAE. As home-ownership begins to gather momentum, we opine that the UAE's debt structure will mimic to that of the United States.

Housing Market Capitalization

The Freehold housing supply of Dubai has grown 1632% in terms of market value (28 B – 485 B). With the projection of projects now launched (there remains a substantial pipeline that has not yet been announced), this market cap is further expected to grow to 660 Billion by 2022.

The housing market is typically the largest asset of a country's economy and in most cases is worth more than the GDP of the country

Conclusions

Talks of the Dubai debt crunch began to resurface during the recent oil crash. However, an examination of the debt levels of the global economy, reveals that the UAE and Dubai are still below the acceptable threshold.

As Dubai continues to push foreword with an expansive fiscal policy, it appears likely that there is room in the system to accommodate this fiscal stance, despite the fall in oil prices.

This expansive stance in infrastructure spending, appears to be the *prime pump* that will accelerate the growth of the economy and in particular the real estate sector.

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Indigo Icon, 1708
Jumeirah Lake Towers,
PO Box 500231 Dubai,
United Arab Emirates
Tel. +971 4 447 72 20
Fax. +9714 447 72 21
www.globalcappartners.com
info@gcp-properties.com

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Concord Tower, No: 2304,
Dubai Media City,
PO Box 333929 Dubai,
United Arab Emirates
Tel. +971 4 277 68 35
Fax. +971 4 360 47 88
www.reidin.com
info@reidin.com

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