

Built on Sand

It Is Not Just in the Middle East that Debt Levels Are Looking Shaky

Dubai's fall from grace has been quick, yet not unexpected. Over the past few years, as ski slopes were constructed in the desert, islands created and taller and taller structures built, commentators questioned the sustainability of the Emirate's economic growth.

Dubai's ambitions are not confined to real estate; it has big ambitions to become the leading financial centre within the Gulf Cooperation Council (GCC). However, these ambitions may have to be put on hold, not because of the debt of Dubai World, but because of how the issues surrounding it were handled. In November 2009, with the four-day Eid holiday about to start (and the US Thanksgiving holiday coinciding), a brief message stating that Dubai World was seeking a standstill agreement on its liabilities under its lending arrangements was made. Then silence.

For Dubai, which has in the past been a master of PR, with a strong grip and understanding of its importance, this was not handled in the same assured manner as its past performances. The lack of communication exacerbated the problem and the long weekend aggravated the situation further. Even when the Dubai markets opened, the announcements coming out of Dubai seemed unclear as the situation actually unfolded.

A TIMELY REMINDER

Other GCC states, with aspirations to host the financial centre of the region, must have realised that this was their chance to shine. The likes of Bahrain, Qatar and Abu Dhabi have designs to become financial centres and all are likely to vie to fulfill their ambition. Abu Dhabi's assistance to Dubai World, in the form of a \$10 billion (£7 billion) injection, could be its way of securing influence in the Emirate and form part of its strategy.

There is, however, a more global effect on what is happening in Dubai. Although, as we now know from the finance minister of Dubai, Dubai

Executive Summary

- ◆ **Government debt is rising to unprecedented levels.**
- ◆ **The influence of the ratings agencies will soon become more evident.**

World's debts are not guaranteed by the Dubai government, the crisis has focused the markets back on to risk and in particular on to sovereign debt.

During the financial crisis, governments across the world have been borrowing vast amounts. In the days following the crisis in Dubai, the cost of insuring Greek sovereign debt surged as the markets focused on the spiralling debt in that country. However, Greece is not alone. The failure of governments across Europe to address the fiscal imbalances within their economies could lead to higher debt costs, as ratings agencies review the creditworthiness of sovereign risk.

In December 2009, a number of euro zone countries had their ratings queried by the ratings agencies.

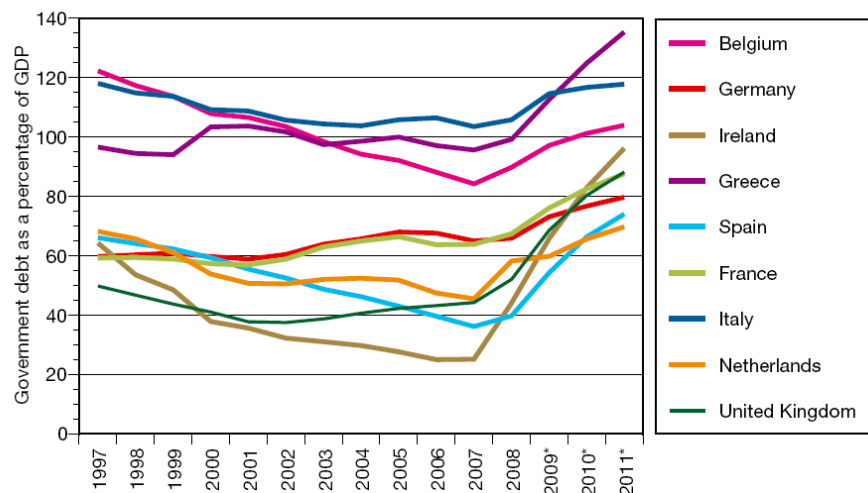
Spain, Italy and Ireland had their ratings put on negative outlook, and Greece suffered the ignominy of having its sovereign risk placed on negative downgrade, which will probably lead to an actual downgrade within 30 days.

The pre-budget report presented by the United Kingdom's finance minister in early December 2009 forecast some truly alarming borrowing. Even taking the government's forecasts, which many believe to be over-optimistic, more than £700 million (€778 million) will be borrowed over the next four years, doubling overall government debt to £1.4 trillion (€1.56 trillion). The painful contraction of expenditure has (some will say disingenuously) been deferred until after the general election that has to be held by June.

At what point will the markets get indigestion from swallowing all this debt? Is it too farfetched to think that some euro zone countries, or even the United Kingdom, could face the humiliation of having the IMF call to prescribe some unpleasant medicine? ♦

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Government Debt for Certain European Countries, 1997–2011 (consolidated gross debt as a percentage of GDP)



*forecast

Source: European Commission, Directorate-General for Economic and Financial Affairs