

Dubai Standstill in Debt Repayment: More Manageable For Now

On the eve of the Eid extended holidays, and minutes after the equity markets closed, Dubai government issued a statement that Dubai World and its real estate arm Nakheel will ask all its creditors to 'standstill' and extend maturities till at least 30 May 2010. Though the amount maturing over the next six months is a manageable \$4bn next month (both govt and corporate), and about \$5bn in 1Q-2010, at stake is estimated \$59bn in debt held by the govt controlled holding company Dubai World, and its subsidiaries. On a broader scale, the state is saddled with \$80bn of debt.

So far, only two entities were mentioned – Dubai World and its real estate arm Nakheel. Another subsidiary, however, DP World (including \$3.5bn in bonds) will not be affected. DP World runs 49 ports around the world. In 2006, it ran into trouble with Washington when it bought companies that have stakes in US ports.

Though much has been spoken that the state is running into financial trouble, the fact that it happened hours after a successful issuance of \$5bn debt, certainly took the market by surprise. The immediate challenge is the real estate developer Nakheel's Islamic bond (sukuk) worth \$3.5bn, maturing 14 Dec 2009 – which will determine how things will evolve going forward.

Financial markets took a tumble, with Asian equities falling between 3-5% on Friday. Singapore, Malaysia, and Indonesia (closed on Friday) are likely to play catch up on Monday. Reportedly, European banks have exposures of \$40bn (largely UK). While manageable as compared to the credit crisis losses of almost \$2trn, fear is that global banks recovering from the bloodbath in 2008/09 may not be ready to take another shock.

So, is this Lehman: Round II? Is liquidity seizing up again, or is this more of a credit cycle (which is more manageable from banks' perspective)? What are the estimated losses by global banks? Is Dubai wealthy cousin Abu Dhabi about to bail out its neighbor again? What does all this mean for Asian economies and financial markets?

All Eyes on Abu Dhabi: Why Didn't the Rich Cousin Throw in that Lifeline?

Besides the lack of details at the announcement, it was a bad surprise that Abu Dhabi has allowed its neighbor to take such a route, which will impact the overall UAE risk premiums. On the former, Abu Dhabi has indicated more details to be out this week. On the latter, until the announcement, Abu Dhabi has been rather active in providing financial aid to Dubai. The kingdom has already pumped \$15bn through indirect bank loans since the start of the year. In fact, the rich brother has injected another \$5bn into Dubai hours before the debt restructuring announcement – although it was half of the initial planned size of \$10bn. So, what actually happened?

Constitutionally, each state in the UAE is a separate entity in a loose federation. But the collateral damage on the region means the Abu Dhabi cannot entirely ignore developments in Dubai. A Bahrain state-lender late last week has postponed a planned \$4bn of debt issuance, citing 'unexpected announcement' by Dubai. CDS of Abu Dhabi rose 24bps to 185bps last week, Qatar +17bps to 131bps. In contrast, Malaysia was up only +13bps at 117bps, Korea +11.5bps at 115bps.

Over the weekend, Abu Dhabi indicated that it would look at Dubai's commitment 'case-by-case' basis. It would be selective assistance in Dubai Inc (quasi-govt companies), instead of a blanket assistance. The official added that Abu Dhabi will 'pick and choose', 'when and where' to assist. More details will be available this week. Well, it appears that the wealthy cousin wants Dubai to bite the bullet and sort out its problem 'internally' (including selling of its overseas assets and debt restructuring), instead of borrowing its way out of the problem. Note that Abu Dhabi is sitting on sovereign wealth funds of more than \$500bn, and net oil revenue of more than \$50bn annually. That means the amount of the coming debt maturity or even into 2010 should not be an issue. The question is whether Abu Dhabi is willing to throw in that lifeline.

At the other end of the equation, it appears that member countries are now communicating to investors globally that there are risks involved in all investments in UAE, even for quasi-sovereign companies. And, the kingdom is not about to fully bail-out state-owned companies.

Nonetheless, we believe this is not another Argentina of 2001 (when it defaulted \$95bn of sovereign debt), given the financial strength of the kingdom. Indeed, various markets participants have highlighted that 'it is not about the ability but willingness to pay'. Some sort of arrangement will eventually be worked out, delaying repayment or perhaps certain amount of hair-cut. Also, Dubai does have assets to liquidate. Reportedly, sitting on \$90bn of assets, with certain portion in overseas assets. This perhaps explains why Dubai CDS is trading at 530, well below the almost 1000bps at the peak of the financial crisis.

Global Banks Exposures and Second Round Impact

While lacking in details, suggestion is that European banks are the largest creditors, with exposures in excess of \$40bn. The question is will this send the entire system into another tail-spin. Well, we think it is a set-back, but perhaps not fatal. According to wires reports, UAE exposures represent less than 1% of global banks assets. Further, this is more of a credit cycle (while absolute amount is not small), as compared to the liquidity shock post Lehman. Indeed, if anything, it highlights that while the system is stabilizing, global de-leveraging is still working through, and that global economic recovery will be gradual.

Market Action: Going Forward

Until there is greater clarity of the debt restructuring process, or at least till 14 Dec 2009 maturity is out of the way, the market will remain choppy. And, with liquidity scaling back into year-end, we will probably see more risk aversion in the coming weeks. Also, the market is clearly looking for reasons to take profit after the magnificent run since the lows in Mar-2009. One thing we will watching is the overall sum involved, especially banking exposure, it is really \$59bn or perhaps even more. This could change the dynamics significantly.

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