Economic Research

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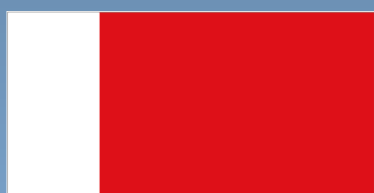
The Emirate of Dubai – An Update



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In a nutshell

- Dubai's property market is struggling to get out of the doldrums after the horrendous crash in 2009. Recent statistics from the house price index (HPI) suggest that prices are still on a downward trend due to continuous incoming supply which we think will continue to exert downward pressure on property prices and rental rates in the coming year. We opine that it will take at least another year before property prices stabilise in the emirate. Notwithstanding this, as there are possible upside risks in other areas of the economy, the prevailing low property prices may provide a good entry point for serious investors into the market.

- Other macro variables such as inflation remained subdued in the absence of demand-driven factors. In 2010, the consumer price index (CPI) rose a marginal 0.55% after rising by 4.03% in the previous year. Weakness in the property sector appeared to be the main driving force behind this anaemic price growth, with rentals (accounting for 38.33% of total CPI) falling by 1.59% during the year. The sub-index of transport prices was the only one which recorded an increase (6.64% in 2010 vs. 4.36% in 2009) following higher fuel and lubricant prices.

- Dubai's fiscal position has yet to significantly improve. The latest budget approved by the Ruler for the year 2011 projects public revenues to climb marginally to AED29.9 billion, while public expenditures are anticipated to decline slightly to AED33.7 billion compared with the amount budgeted for 2010, leading to a deficit of AED3.8 billion.

- Based on the sources of revenue and the current dynamics of the economy, we maintain our projection of a AED5.6 billion deficit for 2011. As this forecast is derived from higher expected revenue (AED33.4 billion as opposed to the government's latest projection of AED29.9 billion), there is a possibility of a slightly larger deficit if actual revenues turn out to be lower (as projected by the government) and expenditures fall somewhat in between the latest estimate of AED33.7 billion and the previous figure in the draft plan of AED41 billion. Notwithstanding this, we are heartened by the government's efforts to keep the budget gap below the 3% threshold.

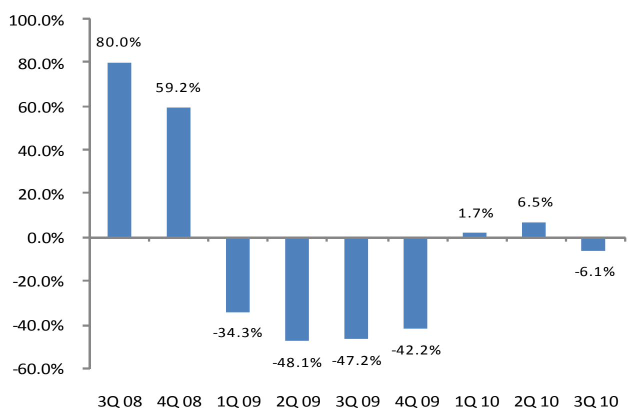
- The positive side of the economy, however, is reflected in the sterling performance of external trade in the first nine months of 2010. Imports, exports as well as re-exports rebounded sharply from the depths ploughed in the previous corresponding period. However, on a quarterly basis, signs of moderation emerged following slower expansion of the world economy. Notwithstanding that, we draw comfort from India (the largest trading partner for Dubai's exports and re-exports market) whose gross domestic product (GDP) growth in 3Q2010 held steady at 8.9% year-on-year (y-o-y) (2Q2010: 8.9%) and is set to reach its target of 8.5% for the fiscal year ending March 2011, portending continued growth for the emirate's foreign trade.

Dubai's struggling property market

Property consultant Colliers International reported another disappointing quarter of decrease in the house price index (HPI) of 6.1% quarter-on-quarter for 3Q2010 (2Q2010: -4.2%). The Apartment index, accounting for 55% of total HPI, fell 6.3% (2Q2010: -4.3%), followed by the Villa (34% of HPI) and Townhouse (11% of HPI) indices which contracted by 4.8% and 9.0% respectively. On a y-o-y basis, the HPI declined 6.1% after rising by 6.5% in the previous quarter (Apartment: -8.8% y-o-y; Villa: 0.8% y-o-y; Townhouse: -10.8% y-o-y).

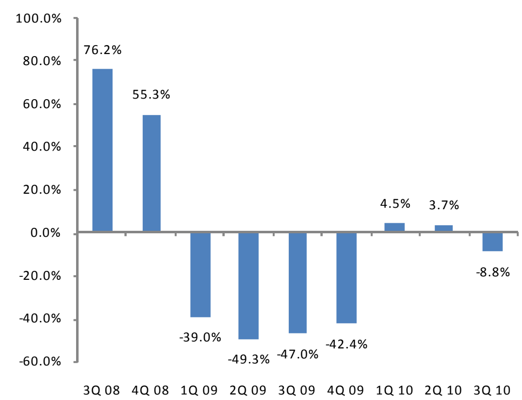
According to Colliers, the fall was largely attributed to seasonal factors as well as conservative lending policies by banks and financial institutions. Nonetheless, the property consultant opines that Dubai Islamic Bank's increased stake in Tamweel Finance (both are the emirate's largest mortgage providers) can appreciably improve access to financing and give property transactions a veritable boost.

Chart 1: House price index (HPI) (y-o-y%)



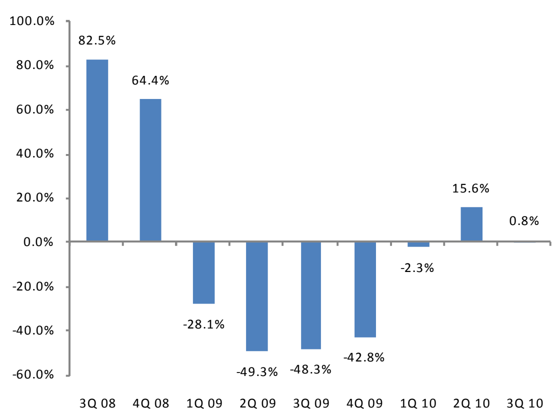
Source: Colliers International

Chart 2: Apartment index (y-o-y%)



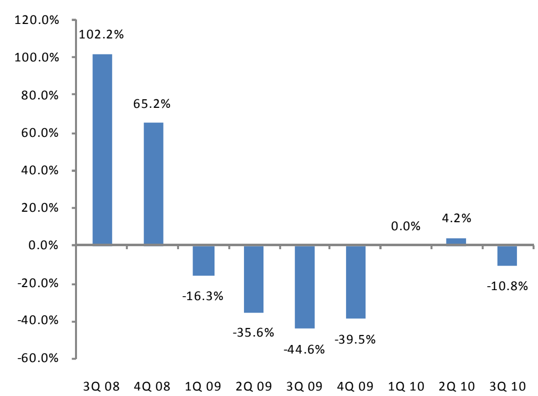
Source: Colliers International

Chart 3: Villa index (y-o-y%)



Source: Colliers International

Chart 4: Townhouse index (y-o-y%)

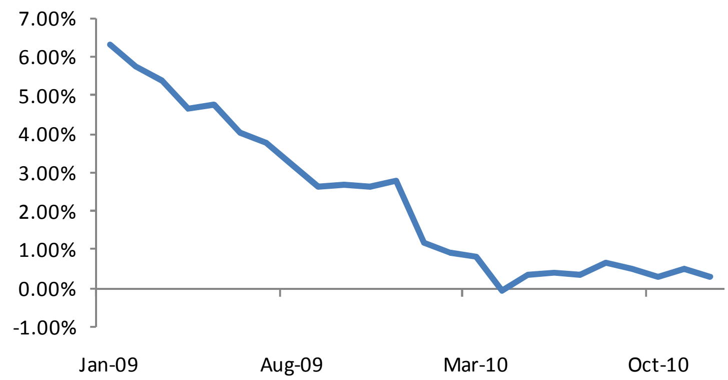


Source: Colliers International

Inflation remained subdued

The extent of price increases has remained marginal with 2010 CPI rising only 0.55% against the 4.03% recorded in the previous year. The CPI's largest component of housing, water, electricity, gas and other fuels, accounting for 43.7% of the total index, fell 1.25% during the year after expanding marginally at 2.41% in 2009 (2008: 5.60% of total CPI). The weak property market appeared to be the main underpinning factor, with rentals (constituting 38.33% of total CPI) falling by 1.59% in the year 2010 (2009: 2.80%). Despite that, the transport sub-index recorded an increase of 6.64% in 2010 (2009: 4.36%) following higher prices in fuels and lubricants for personal transport equipment, which rose by 14.09% (2009: -0.07%).

Chart 5: Consumer price index (y-o-y%)



Source: CEIC

Table 1: CPI changes (2007 = 100)

Expenditure groups	Weight	2008	2009	2010
General index number	100.00	10.77	4.03	0.55
Food and Non-Alcoholic Beverages	11.08	21.06	2.15	1.90
Alcoholic Beverages and Tobacco	0.24	5.65	5.61	0.33
Clothing and Footwear	5.52	19.54	9.86	0.44
Housing, Water, Electricity, Gas, and other Fuels	43.70	5.60	2.41	-1.25
Furnishings, HH Equipment and Routine HH Maintenance	3.34	13.76	3.33	1.10
Health	1.08	6.66	5.31	3.43
Transport	9.08	8.95	4.36	6.64
Communication	6.00	1.71	-0.17	-10.59
Recreations and Culture	4.24	2.85	2.55	0.53
Education	4.09	18.49	18.60	9.04
Restaurants and Hotels	5.48	25.49	7.36	1.43
Miscellaneous Goods and Services	6.15	19.17	3.69	2.09

Source: Dubai Statistics Center

Fiscal position – still in deficit; to be kept below 3%

According to the Department of Finance (DoF), Dubai's latest budget, which was approved by its Ruler for the year 2011, projects public revenues to climb marginally to AED29.9 billion (AED29.4 billion budgeted for 2010; actual figures have not been released), while public expenditures will decline slightly to AED33.7 billion (AED35.4 billion budgeted for 2010; actual figures have not been released), leading to a projected deficit of AED3.8 billion. The government plans to keep the budget deficit below 3% of GDP, in line with international fiscal rules, and has indicated that various government entities have succeeded in guaranteeing a possible current account surplus of AED1.9 billion following the efforts to control direct spending and improve efficiency.

About 24% of total public expenditure in 2011 will be allocated for social development purposes (e.g. health and education), while 22% has been earmarked for the social, safety and justice sectors. Another 23%, or AED7.5 billion, has been allocated to developing and completing pre-approved infrastructure projects that promote economic growth and stimulate flow of local and foreign investments.

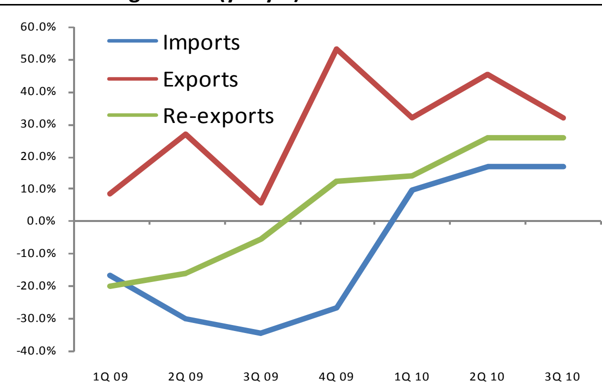
It is worth noting that in November 2010, the government approved a draft plan for the three-year, zero-based budget for the budget cycle 2011-2013, with spending expected to total up to AED122 billion. It was also stated that the estimated spending for 2011 was AED41 billion, higher than the latest government projection.

Based on the sources of revenue and the current dynamics of the economy, we maintain our projection of a AED5.6 billion deficit for 2011. As this forecast is derived from higher expected revenue (AED33.4 billion as opposed to the government's latest projection of AED29.9 billion), there is a possibility of a slightly larger deficit if actual revenues turn out to be lower (as projected by the government) and expenditures fall somewhat in between the latest estimate of AED33.7 billion and the previous figure in the draft plan of AED41 billion. Notwithstanding this, we opine that the government's efforts to keep the budget gap below the 3% threshold are to be lauded.

Direct foreign trade – the persistent glimmer of hope

Dubai's external trade continued to perform well in the first nine months of 2010, thanks to the global economic recovery which began in the middle of last year. Imports, exports as well as re-exports rebounded sharply from the depths ploughed in the previous corresponding period to 14% (9M2009: -28%), 38% (9M2009: 13%) and 22% (9M2009: -14%) respectively. However, on a quarterly basis, signs of moderation emerged following the modest expansion of the world economy - imports, exports and re-exports growth in 3Q2010 accordingly moderated to 16.8% (2Q2010: 17.1%), 32.3% (2Q2010: 45.5%) and 25.9% (2Q2010: 26.0%) respectively. Notwithstanding that, we draw comfort from India (the largest trading partner for Dubai's exports and re-exports market), whose GDP growth in 3Q2010 held steady at 8.9% y-o-y (2Q2010: 8.9%) and is set to reach its target of 8.5% for the fiscal year ending March 2011, portending continued growth for the emirate's foreign trade.

Chart 6: Direct foreign trade (y-o-y%)



Source: Dubai Statistics Centre (DSC)

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