Dubai Desert Miracle Becoming A Mirage (DB, C, MER)

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Home to fantastic palm-shapped man-made islands that can be seen from space, the world's tallest man-made structure and an indoor ski slope in which the snow regularly falls despite outside temperatures can reach as much as 130F degrees, Dubai is a place that has so far managed to routinely surpasses any superlative used to describe it.

But recent developments now suggest that the seemingly non-stop party in the desert could be coming to an end as combined effects of a global credit crisis and Dubai's own hubris fueled excesses are bringing things back down to earth, possibly accompanied by a unpleasant thud.

Dubai's Credit Card Maxed Out

In a recently report, bond rating agency Moody's warned that Dubai's government-controlled companies now owe at least $47 billion. That's more than the gross domestic product of this small Arabian Gulf emirate, which along with Abu Dhabi and five other junior sheikhdoms form the United Arab Emirates (UAE). Moody's has also warned that even if the Dubai economy were to somehow maintain its momentum, debt accumulation would outstrip the rate of economic growth. In the somber words favored by rating agencies, Dubai's "cumulative liabilities are currently rising faster than investments are able to generate returns" according to Moody's.

Dubai Property Market Could Face A Hard Landing

And those returns, which have been built largely on luxury property development, are expected to start heading south soon. Real estate consultant Colliers International is now forecasting a slowdown in the Dubai property market over the next two years as tighter credit conditions and excess supply are expected to put a damper on valuations. News that major Dubai mortgage lenders Tamweel and Amlak where in merger talks and that developers Union Properties and Deyaar were also considering a combination would appear to support Collier's slowdown thesis.

But when one considers just how excessive valuations have become in Dubai, where a penthouse in the proposed Trump International Hotel & Tower on Palm Jumeirah has a suggested selling price of $790 million, the potential is definitely there to transform an orderly slowdown into the mother of all meltdowns once sentiment changes.

Outside Investments Have Gone Sour

While Dubai's best known attempt at investing its property profits outside the emirate ran afoul of U.S. lawmakers when Dubai Ports World attempted to take ownership of key U.S. port facilities, its less well publicized investments have so far produced huge paper losses. A $5.1 billion investment to acquire a 10% stake in Kirk Kerkorian's **MGM Mirage** (NYSE:MGM) has been knocked down by 75% as MGM's shares have slid from $84 to under $19.

A $1.8 billion investment to acquire a 2.2% stake in **Deutsche Bank** (NYSE:DB) is also off 70%, and a $6.8 billion stake in shipping giant Peninsula and Oriental Steam Navigation Co is down 55%. Nervous fixed income traders are now pricing default swaps on Dubai Holding Commercial operations at over 679 basis points, up from 173 basis points at the beginning of May. (To learn more, read *An Introduction To Swaps*.)

Abu Dhabi In No Mood To Bail Out Dubai

One potential solution to Dubai's money problems may lie with its oil-rich neighbor, Abu Dhabi. Flush with petro-dollars, Abu Dhabi could be in a position to extend funds to Dubai. But stung by its own bad investments, Abu Dhabi has lately been pulling in its horns.

Like its counterpart further up the Gulf, the Kuwait Investment Authority (KIA), which made a premature investment in ailing Wall Street giant **Merrill Lynch** (NYSE:MER), the Abu Dhabi Investment Authority (ADIA) also pulled the trigger too soon when it elected to inject funds into **Citigroup** (NYSE:C) last January when Citi's stock still traded around $31. Despite reportedly having a cash hoard in excess of $100 billion, ADIA's risk appetite has shrunk considerably, as it has opted for the super safety of Treasury Bills in recent financial dealings.

The Final Word

News that the UAE has now had to launch its own $32 billion bail-out plan for local banks confirms that even the fantastically wealthy oil-rich Gulf sheikhdoms are not immune to the impact of the global credit crunch which prompted panic selling on their own stock markets. While its unclear how the emergency funds will be used, one thing's for sure: if even they can't turn things around, then what hope is there for the rest of the world's economies?

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Eugene Bukoveczky is a freelance writer and investment researcher. He holds a CFA designation and has spent several decades working in the investment business in places like Toronto, New York, London and Dubai. He currently resides in Nova Scotia, where, when not writing, he devotes his time to chopping wood, growing his own vegetables, riding his bike to the store, and thinking about other ways to reduce his carbon footprint. At the time of writing Eugene Bukoveczky did not own shares in any of the companies mentioned in this article.