Letter from Dubai

By James Hume

We have all seen him – the tightrope walker perilously balanced mid-wire while spinning a couple of plates on long sticks. Will he make it triumphantly to the far side, plates still revolving, to the roars of approval from the crowd below - or will it all end in tears; a chastened individual emerging sheepishly from the safety net conveniently provided? A combination of qualities, including precise balance, complete concentration, confidence and significant levels of courage are needed for success.

Dubai has a similar need for such qualities. As it emerges bloodied but unbowed from a torrid period when it's financial momentum was halted mid-stride by the global financial crisis, coupled with a degree of home-grown hubris, will it get it right this time?

Aspirations dormant for several years are being dusted off and the enthusiasm, 'can-do' attitudes and reach for the seemingly impossible reignited. Anecdotal economic indicators point to a rapid recovery of momentum in Dubai's progress to achieving its goal of becoming the preeminent business hub in the wider region.

Its banks' capital adequacy ratios, with balance sheets badly affected by losses and write-downs from real-estate development financing, are improving as asset prices recover and UAE Central Bank advances are repaid. Internationally, its credit rating has improved to the extent that current funding from global banks is being rescheduled on favourable terms while further funding is readily available.

Population growth is accelerating, fuelled both by migrants from regional turmoil and more generally, from a growing consensus that Dubai is 'open for business'. The traffic congestion is building again on Sheikh Zayed Road, hotels and restaurants are packed, the queues are beginning to return to real estate developer's offices, and infrastructural investment initiatives abound.

However, these trends, if not carefully managed and controlled, also pose challenges. The potential return of the previous 'boom and bust' property bubble that saw both residential and commercial property values double and sometimes triple in value during the four years to 2007, only to plummet to previous levels is a very real risk – and will not be an easy one to control.

The Central Bank, with marginally less enthusiasm from the commercial banks, has made a valiant attempt to control the leverage available to real estate purchasers seeking finance; however the majority of buyers pay cash. Moves are also afoot to prevent the 'flipping' of real estate –purchase and rapid resale off-plan after payment of only a small deposit; echoing highly leveraged pyramid schemes.

Nevertheless, with large volumes of cash chasing a diminishing supply overhang, it is by no means clear that the real estate market has stabilised. No doubt the police will be happy once their role of de-facto enforcers of the current criminal offence of bouncing a cheque is replaced by more stringent credit analysis by the banks. But the wise will be watching out for a new roller-coaster as prices for real estate across the board accelerate.

As Dubai 'comes of age' in a global context, the internal market mechanisms that have served it well in the past may not necessarily be fit for purpose in the future as it competes as an international player.

For a city of some two million to have four separate financial exchanges - DFM, DGCX, Nasdaq Dubai and DME plus the Abu Dhabi Stock Exchange down the road - is certainly something to be proud of in a local context . But it is somewhat bemusing to global observers who have seen consolidation elsewhere in international markets and interesting to note an additional element of internal competition from the recently proposed financial free zone in Abu Dhabi.

Similarly, there is current uncertainty regarding general access to Microsoft's Skype in the face of the financial imperatives of the Government controlled telecommunication companies, Etisalat and du.

Also, the jury is out as the business community waits for long-promised amendments to UAE Companies Laws, particularly relating to mandatory Emirati majority ownership of non-free-zone companies.

More generally, there are questions as to whether the Companies Law, codified some years ago when many of the current financial structures and contractual relationships were unheard of, is up to the challenges of the current era. The questions remain even though the DIFC Courts have been recently granted a wider remit to deal with commercial matters throughout Dubai.

Now that it has membership of the WTO it is also becoming an increasingly uphill struggle for the UAE and particularly for Dubai to insulate its economic environment and shelter its revenues from true external influence and competition.

Dubai's rapid growth has been fuelled by an injection of skills from a truly global range of nationalities – more than 200 nationalities are now investors in UAE National Bonds. The incomers bring with them challenges to Dubai's social balance – the proportion of Emiratis to foreigners; the relative weighting between various expatriate nationalities and, as Dubai matures as a particularly pleasant global city, the trend for expatriates to prefer permanent residency to short-term assignments.

For Emiratis, forming a relatively small percentage of the residential population, a key Government deliverable is to encourage and support their migration from their preferred Government employment into all levels of commercial enterprises – albeit with the attendant remuneration and work ethic issues.

Further issues relate to the traditional business arrangements of a number of leading Emirati families, under pressure to change to reflect differing generational aspirations and the need for more corporate-type structures – and governance – as vehicles for efficiently raising capital.

For the expatriates, Dubai's challenge is to maintain a reasonable balance between nationalities, limiting the dominance of any particular nationality or ethnicity and thus maintaining the truly global nature of its existence. And for those seeking longer-term residency, the vexed question of freehold ownership of residential properties but issuance of only short-term residential visas continues to irritate.

Other issues requiring careful concentration and balanced responses abound. We all know that Dubai is 'tax-free' – but it's good to know that the fire engine will turn up when needed. Who pays? A torrent of fees for every little bureaucratic service will scarcely be sufficient to fund its planned future growth and related expenditure.

As it matures, can Dubai really remain such a low-tax environment while maintaining its current high levels of municipal service? And will it manage to maintain its conservative culture and traditional values; dress code, sanctity of marriage and so on, surviving the secularity and lifestyles of the tourists that it seeks to entice? And can it really remain so politically tranquil in such a turbulent region?

The prognosis is good. Dubai has the good fortune to be led by a strong, empathetic and visionary leader, who, through a number of thoughtful initiatives has addressed sea-changes in the region – politically, economically and socially in a positive way – and to the benefit of Dubai. Its relationship with the UAE Federal Government is warm, the rule of law is applied without bias, security is subtle but effective, future energy needs planned and scarce resources are husbanded with care while national self-sufficiency and entrepreneurship are encouraged.

Nevertheless, Dubai must continue its balancing act, avoiding the 'boom and bust' of the past. Its challenge is to temper enthusiasm with pragmatic consideration of and attention to the risks involved, implementing effective financial controls as it moves quickly ahead to meet the challenges and opportunities ahead. Like our tightrope walker, Dubai must continue to walk the wire with balance, concentration, confidence and courage – and a large dose of common sense.

Dubai 26 May 2013