AMERICAN UNIVERSITY OF BEIRUT

# IMPACT OF FINANCIAL CRISIS ON ARAB REAL ESTATE SECTOR

by
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AMERICAN UNIVERSITY OF BEIRUT

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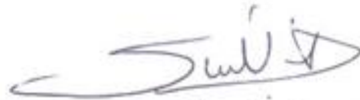
Approved by:



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# AN ABSTRACT OF THE PROJECT OF

Hiba Sami Hamade for Master of Arts in Financial Economics
Major: Financial Economics

Title: Impact of Financial Crisis on Arab Real Estate Sector.

The 2008 financial crisis has had devastating impact on the global economy in general and the real estate sector in particular driving down real estate prices in North America and the Middle East. This project after a general introduction in Chapter I, discusses the causes and effects of the financial crisis in Chapter II. Chapter III highlights the impact on Arab countries. Chapter IV presents a comparison between Dubai and Lebanon. Chapter V concludes with some policy implications.

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*To*

*My Beloved Family*

# CHAPTER I

# INTRODUCTION

Policy makers are expected to learn from previous historical events. The recent financial crisis is similar to the 1929 Great Depression, where by both of them 2007 and 1929 crises were originated in the United States (Dinc and Cura 2011).

The Stock Market Crash in 1929 was the first major crisis in the history of the United States. At that time, most of the banks used the deposits of their customers to invest in the New York Stock Exchange. This resulted in a severe recession known as the Great Depression. After that, the U.S needed around 12 years to recover and return to its original GDP. As a result, the government imposed firm regulations on the financial industry where the government used the Glass-Steagall Act of 1933 that led to the division of banks into categories such as commercial banks, savings, insurance companies and investment banks. Nonetheless, this was the reason behind the creation of the Federal Deposit Insurance Corporation (FDIC) which insures consumers in case of bank runs (Shachmurove 2010).

After 75 years, a major financial crisis took place in the US that spread to the entire world to become a global crisis (Adams 2009). The 2007 financial crisis started in the United States when the sub-prime mortgage crisis took place. Several reasons were related to this crisis some of which are the mortgage lending was not supervised properly, complex financial instruments were developed, investors failed to be aware of the instruments they bought and consumers failed to estimate the risks when buying property with modern mortgages (UN 2008).

The source of this problem can be related not only to monetary excesses but to

new financial technologies and globalization. Nevertheless, no one realized the dangers that will accompany the new financial products. These new financial products led to deregulation and reduction of the governments' interventions (Adams 2009).

The Financial Crisis Inquiry Commission was recognized as "part of the Fraud Enforcement and Recovery Act (Public law 111-21)" and approved by the Congress and the President in May 2009. The role of this Commission was to study the causes of the 2007 financial crisis in the U.S and to present them in a report to the President, Congress and American people. This Commission consisted of 10 members; six of them were selected by the Democratic Leadership of the Congress and the other four were chosen by the Republic Leadership (Angelides and Thomas 2011).

For the Commission to submit a report, the members started to work on case studies related to the roles and performance of the financial firms such as Bear Stearms, Fannie Mae and Lehman Brothers. The committee studied policies that were already approved by the Congress, the roles of the policy makers and regulators, in addition they interviewed witnesses and communities negatively affected by the crisis (Angelides and Thomas 2011).

However, what was surprising is that within the same committee there were different points of views regarding the causes of the 2007 financial crisis. Indeed, it is greatly realized that there is one major report and two other minor reports issued by the United States Financial Crisis Inquiry Commission related to the reasons of the financial crisis (Bradford 2011).

The major report presented the opinion upon which six of the members (Phil Angelides, Brooksley Born, Byron Georgiou, Heather H. Murren, Senator Bob Graham and John Thompson) agreed on. This report stated that the causes behind the house bubble were related to a chain of events that happened through a period of years. These

events were low interest rate, easy credits and irresponsible lending practices led to the presence of "toxic mortgages" (subprime and risky loans). In fact, if the financial institution managers were able to improve the transparency for measuring risk and have a better regulated government, then the crisis would have been avoided (Wallison 2011; Bradford 2011).

As for the second opinion, it was expressed by three members only (Bill Thomas, Douglas Holtz-Eakin and Keith Hennessey) known as the THH agreement which was a disagreement with the majority's opinion. Their narrative stated that the crisis was not related to the lack of regulation but mainly to the failures in U.S. policy and global economic forces. The crisis was related to the excess capital inflows that were poured to the U.S. especially from the oil producing nations. The misidentifying of the risk correlated with the securities by the credit rating agencies resulted in the contraction of financial markets in the economy. When the prices of the assets dropped suddenly, financial institutions faced liquidity problems since their balance sheets did not acquire a high capital relative to the risk, which led to the collapse of the largest financial institutions (Wallison 2011; Bradford 2011).

The third opinion was stated by one member only (Peter Wallison) which opposed the other two narratives. He stated that the crisis was related to the U.S. government housing policies which encouraged consumers of all income levels to own homes by reducing the mortgage lending standards. This path originated 27 million subprime, other risky loans and caused the growth of the housing bubble to an unlimited size (Wallison 2011; Bradford 2011).

According to Peter Wallison in the Financial Issues Outlook issued in January - February 2011, the majority report and the THH opinion were not significant enough, hence they failed to identify clearly the mechanism that lead to the 2008 crisis since the

error was related to considering the large number of loans as a “given”.

However, Peter Wallison (2011) tried to explain the reasons behind the availability of the large number of loans, how this huge number was behind the bubble and how the collapse of the housing bubble led to failure of financial institutions in U.S and around the world.

In each case there was a factor resulting in financial downturn and development of unregulated financial institutions. The main reason for recent financial crisis was the sub –prime mortgages which was based on the assumption that the value of houses will rise only (Shachmurove 2010).

It is well known for every cause, there is an effect so what are the effects of the 2007 financial crisis? When the economy faces recession, depression or financial crisis there are certain characteristics that will indicate the decline in real economy. When the consumers’ consumption decreases the producers will decrease their production. As a result, GDP will fall and unemployment rate will increase. The companies will face decrease in profits and no need for laborers (Dinc and Cura 2011).

Failure of investment bank Lehman Brothers on September 2008, decline in stock prices, banks not lending and decrease in investment are examples for the effects of financial crisis. However, the issue is how did this financial crisis spread and affected other countries? The challenge now is to have policies and regulations in the new economy and across the global financial markets for recovery (Adams 2009).

The financial crisis affected the world’s stock markets, GDP, exports, foreign direct investment and real estate sector. This project will therefore discuss the causes and effects of the crisis. Chapter II highlights the causes that led to the crisis which are mainly related to the low interest rates, housing bubbles and insufficient deregulation and risky products. Due to the crisis, the U.S. suffered from a decrease in investment,

increase in unemployment rate, decrease in GDP and losses in investments banks.

Chapter III shows how the financial crisis impacted Arab countries. The Arab countries were impacted differently based on their degree of integration to the global markets and transmission channels. Financial Markets, Oil, Tourism, Remittances, and non-oil exports were the transmission channels which contributed in transferring the crisis to the Arab countries.

A comparison between Dubai and Lebanon is laid down in Chapter IV. Dubai was a case in point due to the high liquidity and prevailing easy credit conditions. Lebanon on the other hand, was able to overcome the crisis due to the support of the Central Bank and the restrictions on lending loans.

Chapter V concludes by indicating that while Dubai was able to recover from the financial crisis Lebanon is experiencing a slowdown in its economic activity.

# CHAPTER II

# CAUSES AND EFFECTS

According to Winston W. Chang (2010), the 2007 - 2010 financial crisis which is known as the “Great Recession” was the harshest financial downturn since the Great Depression. Many businesses failed, there were losses in financial wealth and economic activities shrank as a result of the crisis.

According to Katalina M. Bianco (2008), this was a special situation since the downturns were related to credit crunch in the non-banking sectors. The bubble burst which turned out to be a global crisis was the main reason for the 2007 financial crisis. The word crisis holds a certain negative connotation where knowing its reasons and consequences are needed.

The housing bubble is an economic bubble presented in the real estate markets. A sudden decrease in the prices of houses caused a real shock to the investors due to facing high amounts of mortgage debt compared to the properties’ value.

## A. Causes

The main causes for the U.S. housing crisis are:

### *1. Low Interest Rates*

The main cause for the housing bubble was due to a decision taken by the US Federal Reserve related to low interest rates. The Federal Reserve board decided to decrease the interest rates from 6.5 % to 1 % during the period that extended from the year 2000 till 2004. This is considered a long duration for low interest rates; thus the

monetary policy is too loose. In order to explain the case of monetary excesses, we will be using figure 1 (Taylor 2009).

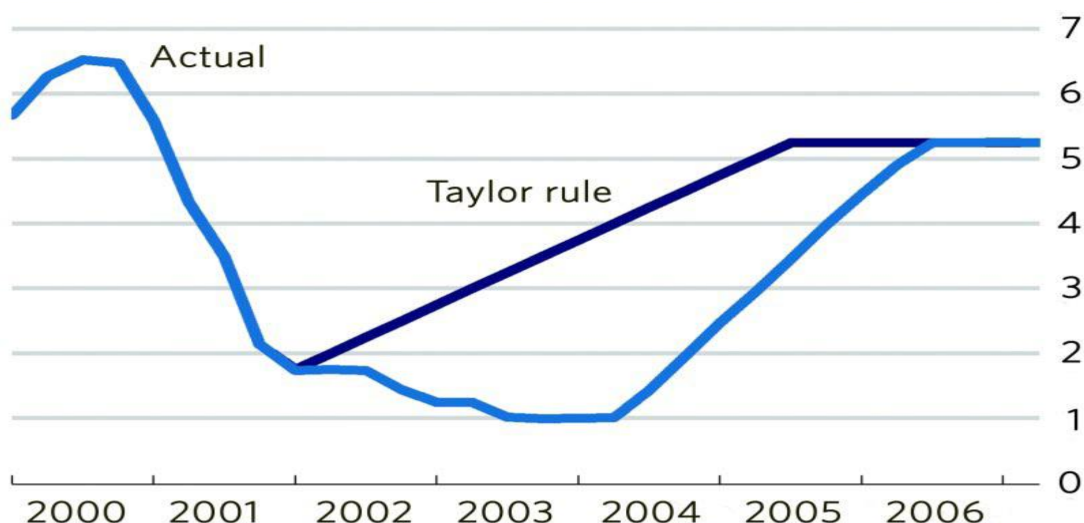



Fig. 1. Federal funds rate, actual and counterfactual (per cent)
*Source*: John B. Taylor. 2007. "Housing and monetary policy." Proceedings, Federal Reserve Bank of Kansas City, 463-476.

In figure 1, we notice two lines; the first one is the Actual line that represents the actual interest rate decision taken by the Federal Reserve. The second line is named Taylor rule by the Economist; this represents how the interest rate line would look like if the Fed tracked the sort of policy it had applied during the past years. If the second line was the case then, we would have saved the world from the housing bubble and led to a suitable economic performance rather than a crisis. If we compare the two lines, we notice that the Actual interest rate line falls below the Taylor line. Thus having low interest rate decision was a deviation from the actual policy or historical policy of the Great Moderation .This deviation lead to the monetary excesses which was the exact problem of the housing boom leading to the financial crisis (Taylor 2009).

According to John Taylor (2009), this easing policy helped in progressing the

housing boom and bust. His argument was supported by a certain model to show the empirical relationship between the interest rate, housing and what would happen if we followed the Taylor rule in Figure 1. The result of the model is shown in figure 2. Had we applied the Taylor rule, then we would have had the line labeled Counterfactual in figure 2 which is not a major boom and bust. So, we conclude that there is a negative relationship between the interest rate and the housing bubble.

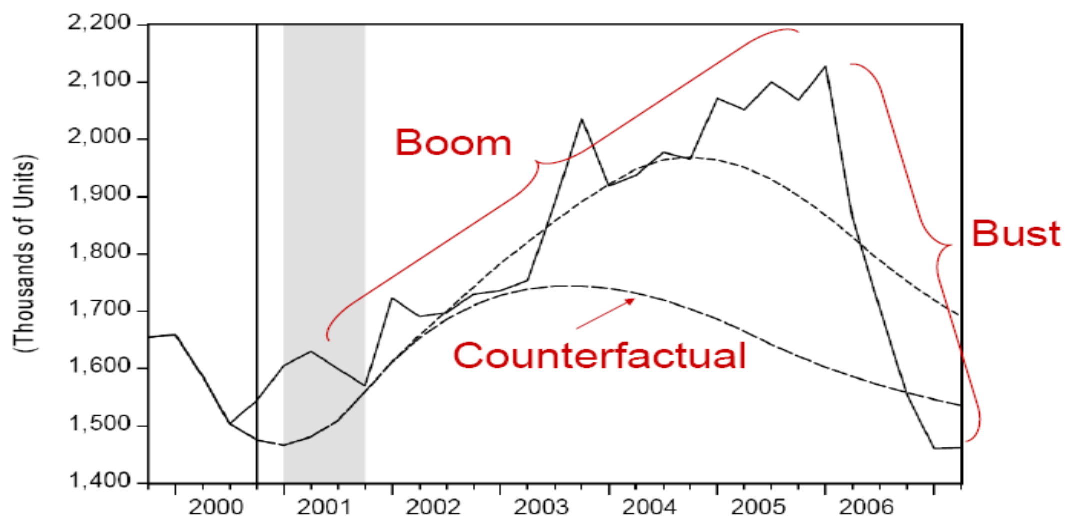



Fig. 2. The Boom-Bust in Housing starts compared with the counterfactual
*Source*: John B. Taylor. 2007. "Housing and monetary policy." Proceedings, Federal Reserve Bank of Kansas City, 463-476.

### *2. Housing Bubbles*

Low interest rates and inflows of foreign money to the U.S created easy credit conditions during the years before the crisis. This opportunity attracted the consumers to use the funds in housing consumption. An increase in borrowing loans for low down payment requirements resulted in an increase in the housing demand driving the house prices upwards to overshoot and reach its peak in 2006. In 2006, the American house price increased by 124%; if we compare the housing prices to the income, the home

price was 4.6 times the household income at the climax of housing bubble in 2006. In 2004, it was 4.0 and during the previous years before 2001, it ranged between 2.9 and 3.1. This indicates that the new home owners are taking large amounts of loans compared to their incomes as a benefit from the increased property value. Suddenly, the house prices dropped and the interest rates increased. The value of the houses became less than the mortgage value and the home owners started to face difficulties in paying back their loan debts. The loans were rearranged to higher interest rates and different payment amounts where the only choice for the subprime borrowers was to leave their homes and stop paying the mortgage. The collapse in the housing bubble resulted in an increase of 30% in the U.S household debt relative to previous years (Chang 2010; Bianco 2008).

### *3. Insufficient Deregulation and Risky Products*

We can notice that deregulations in the mortgage lending process created instability in the financial system. Traditionally, a person who intends to borrow a certain loan needs to visit the bank. The bank in return asks for certain documents, screens the borrower and then approves for lending the loan. The bank used to fund the loans from the deposits available in the bank from their consumers which indicates that the number of loans to be issued is limited. However, changes were introduced and not only banks originated mortgage loans but also brokers helped in this issue. In the year 2004, a study has shown that 68% of the residential loans in the U.S. were originated by mortgage brokers. Then, deregulation led to flexibility in the lending standards where loans were being issued without the checking of the customer's profile (Allen and Carletti 2010).

The continuous increase in house prices and presence of new financial

instruments attracted the consumers to invest in the real estate sector. Subprime loans were the main contributor in the financial crisis. It was stated in the New York Times on September 30, 1999 that the Clinton Administration forced Fannie Mae, the biggest underwriter for home mortgages, to increase the subprime lending. Clinton Administration wanted to provide the low and moderate income people with mortgage loans. The two GSEs (Government Sponsored Enterprises) known as Fannie Mae and Freddie Mac were created in the years 1938 and 1970 respectively by the federal government. Their role was mainly to facilitate mortgage lending and lower the mortgage interest rate. The GSEs used to release "conforming" loans to "prime borrowers" which are guaranteed loans with a certain principal below a certain dollar threshold and to borrowers with a credit score above a certain limit". The GSEs used to buy the mortgage loans known as confirming loans from the banks (Baily, Litab and Johnson 2008).

However, the GSEs wanted to prove their willingness to support the mortgage lending as requested and started to find ways for expansion such as the 'non-prime lending' which consists of the subprime loans and Alt-A loans. A borrower with a poor credit history and pays a higher rate of interest on the loan is a subprime borrower. Alt-A borrower had better credit scores with little or new documentation for income. Then, people who were not able to meet the condition of a conforming mortgage are now able to take advantage of this opportunity and have a home even if they lack income or guarantee to repay the loan (Baily, Litab and Johnson 2008).

Also, the GSEs invented a new process known as securitization process where the mortgage loans were being repackaged and sold to investors as MBS (Mortgage – Backed Securities) .

In this way, the GSEs were able to increase their profits since they earned a

higher interest return on the mortgages assets but at the same time risk is being originated, packaged and transferred to other parties. In 2000, 78% of the MBS were issued by the GSEs and recorded a lot of profit. But in the year 2006, issuance of the MBS was not restricted only for the GSEs. 44% of the MBS were issued by the GSEs and other financial institutions such as Lehman Brothers, Merrill Lynch and Bear Stearns, private banks and brokers contributed for issuing MBS subprime and Alt-A loans (Baily, Litab and Johnson 2008).

Securitization process was controlled by the GSEs only; however, in the year 2000 changes occurred where securitization was spread in the market and shared by other financial institutions. Securitization was limited only to conforming loans but in the year 2006 the rate of securitization increased to 81% involving the subprime and Alt-A loan in the process (Baily, Litab and Johnson 2008).

Deregulation made the banks, brokers, private sector commercial and investment banks and other financial institutions to invent new financial instruments in order to facilitate the lending process and transfer loan-able funds to other parts of the world. An example of such instrument is the CDO (Collateralized Debt Obligation) which was a new way for securitizing subprime mortgages. A CDO is a combination of different tranches of MBS and asset –backed securities (ABS). The MBS is related to actual mortgage payments whereas the CDO is related to the securities that collected the mortgage payments which mean “re –securitized existing securities”. Then we are packaging different types of risks into one single package. The competition among investors and institutions to generate profits caused them to forget to apply the risk management rules and assess the risk accompanied with these instruments. These new instruments were the source of profits one day, but due to their complexity, lack of transparency and mispricing the risk associated were also the source for the August

2007 panic in the financial system (Bianco 2008; Baily, Litab and Johnson 2008).

**B. Effects of Financial Crisis**

The 2007 financial crisis turned out to be a global and international crisis. We can measure the severity of this crisis from its dramatic effects. The financial crisis caused the U.S to suffer from June 2007 till November 2008. Investments decreased by 1.2 $ trillions, loss in wealth caused consumption to fall, real GDP decreased by 6 % in 2008 and the worst level was in October. Then, the GDP level started to recover as shown in figure 3. Also, this affected the US unemployment rate which was below 5 % in 2007 and then driven up to around 10% (Mckibbin and Stoeckel 2009; Chang 2010).

Investment level decreased in the developed countries due to the negative impact on Bear Stearns, Lehman Brothers and Merrill lynch, three of the largest investment Banks. The collapse of Bear Stearns in March 2008 resulted in selling the bank to JP Morgan Chase with the help of the Federal government. In September 15, 2008, 613 $ billion debt was recorded and led to the bankruptcy of Lehman Brother's Bank. The Bank of America in 2008 took over Merrill Lynch, the largest brokerage firm (Chang 2010). In addition, the two GSEs:

Fannie Mae and Freddie Mac after providing most of the mortgage loans in the U.S. are now facing a debt of 5$trillion (Dinc and Cura 2011).

After the crisis, the consumers and financial institutions were highly indebted. When the prices of houses were increasing, the home equity loans increased from 627$ billion in 2001 to 1,428 $ billion in 2005.That's why the percentage of US home mortgage debt compared to GDP showed increase from 46% in 1990 to 73% in 2008 (Chang 2010).

Home Equity loans are considered as a second mortgage loan where you can

borrow money to cover your expenses and your house will be considered a guarantee to repay the debt.

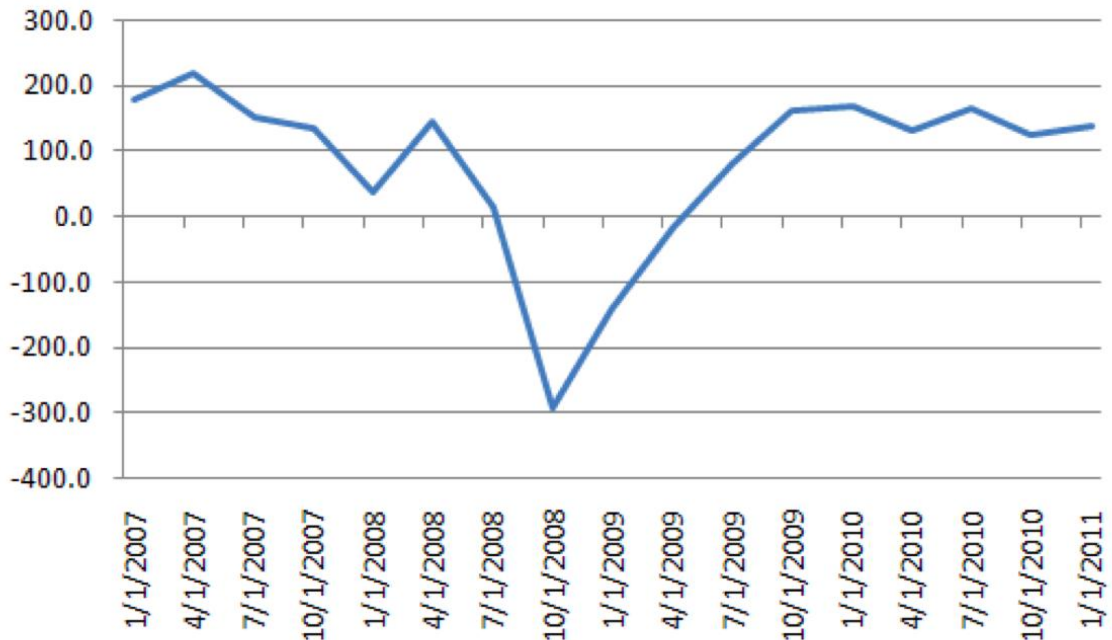



Fig. 3. Changes in U.S. GDP (billion dollars): January 1, 2007 –January 1, 2011
*Source*: Federal Reserve Bank of St. Louis

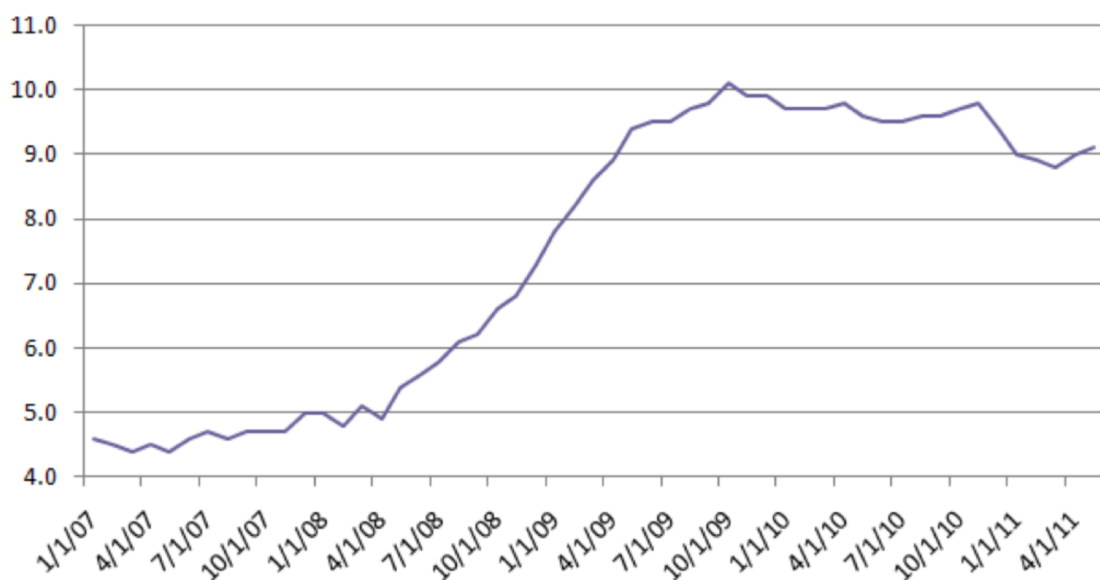



Fig. 4. U.S civilian unemployment rate (in percent)
*Source*: Federal Reserve Bank of St. Louis

As a conclusion, a combination of different factors such as the loose monetary policy, increase in debt instruments and weak regulatory systems created the bubble which led to a financial crisis originated in the U.S and then spread to become a global crisis. These factors are related to macroeconomic factors such as low interest rates and microeconomic factors (Berg 2011). For example, low interest rates effected the global commodity market causing a high increase in the oil prices from 70 to 140 $ per barrel during the period of 2007 till 2008. Once the interest rates went back to normal, the oil prices returned to 60-70$per barrel (Taylor 2009).

The microeconomic factors are more linked to market failures and deficiency in the role of financial regulatory system. Low credit ratings (subprime mortgages) and absence of credit evaluation encouraged households to borrow loans in order to benefit from investment in the real estate sector. Failure to observe the spread of risk associated with the new products led to a systematic risk. Risk –taking and lack of transparency led to increase in the leverage ratios and failure of all institutions dealt with the mortgage loans. Nonetheless, the financial crisis was not limited only to the U.S. but impacted also other parts of the world (Berg 2011).

# CHAPTER III

# IMPACT ON ARAB REAL ESTATE SECTOR

The 2007 subprime crisis can be considered as a “storm” which continued its path to reach and hit the Arab countries. The “degree of openness” by which the Arab countries are connected to the global markets resulted in different impacts. Based on this factor the Arab countries can be classified into three groups:

- *Group 1:* Gulf Cooperation Council (GCC) which includes United Arab Emirates, Saudi Arabia, Qatar, Bahrain and Kuwait .This group is known for its high degree of connection with the global markets and financial systems mainly to oil, gas and petrochemicals. This group is the main channel for extending the crisis due to the presence of an important factor Oil (Mashal 2012).

- *Group 2*: Algeria, Yemen, Sudan and Libya. Mainly, this is a group not directly connected to the global markets but the economies of these countries more focuses on the oil revenues. There is a positive relationship between the fiscal policy and oil prices and based on the revenues collected from oil these countries can allocate its government expenditures (Mashal 2012).

- *Group 3*: Lebanon, Jordan, Egypt, Syria, Tunisia, Jordan, Morocco and Mauritania. This group does not show direct connection to the changes in the global financial markets since their financial sector is more related to the resources of the local lending. However, these countries were affected by the shocks of the global crisis since the exports of these economies depend on the markets of the developed countries, tourism revenues and remittances (Mashal 2012).

According to Professor Nader Habibi (2009), a professor of the Economics of

the Middle East at Brandeis University, the Middle East and North Africa (MENA) region showed certain global economic downturns as a result of the crisis. What were the factors behind these economic downturns? The changes in the oil prices impacted MENA whereas North African nations showed connections to Europe through trade and investment. In addition, the increase in investments in the developed countries was due to the oil rich countries of the Gulf Cooperation Council (GCC).

Transmission Channels helped in transmitting the global crisis to the Arab economies. Arab countries were affected differently based on their links with the transmission channels. Below is the list of the transmission channels:

- *Financial Markets: the first shock resulted from the crisis attacked the stock markets.*

Many investors in the Arab countries were able to invest in the stock markets during the years 2004-7 due to the inflows that came from oil revenues and the earnings generated from their foreign investments. For Example, Jordan and Egypt observed foreign investment inflows to its markets. However, it can be noticed that most of the real estate developers are available in the Arab markets. A decrease in the flow of foreign investments to the Arab markets mainly to the real estate sector was a result of the global crisis. This effected the real estate sector and the construction firms faced shortage which encouraged selling the stocks in order to pay the debts. This lead to a decline in the stock prices as shown in the figure below (Habibi 2009).

Banks in the GCC countries used to have large investments in the stock markets and also private entities borrowed loans to invest from banks. A decline in the stock prices especially during the years 2008 and 2009 made the banks to suffer from loan debts and losses in the asset value.

Fig. 5. Composite index of Arab stock markets
*Source*: SHUAA Capital psc Website; available from http://www.shuaacapital.com; Internet; accessed 20 January 2013.

However, these losses were more severe in the GCC countries than in other Arab countries where the governments need to find ways to support the banking systems (Habibi 2009).

Fig. 6. Composite index of GCC Stock Markets
*Source*: SHUAA Capital psc Website; available from http://www.shuaacapital.com; Internet; accessed 20 January 2013.

- *Oil:* the Oil market contributed in transferring the economic crisis to the MENA Arab countries. After a sharp increase in the oil price, in February 2009 the price declined to reach 39$ per barrel. The OPEC members took a decision to stabilize the price by reducing the oil production in the Arab oil-exporting countries. These factors resulted in reducing oil revenues in the oil –exporting countries and reduced their involvement in investment and tourism sectors in other Arab countries. Then, countries such as Morocco, Jordan and Egypt known as oil importing countries experienced a decline in their investment sector (Habibi 2009).

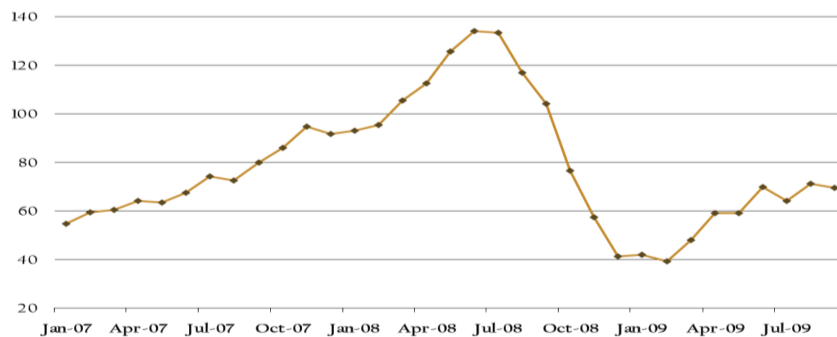



Fig. 7. Price of crude oil in Arab oil-exporting countries (West Texas Intermediate, monthly average $/barrel)
*Source*: U.S. Energy Information Administration (EIA) Website; available from http://www.eia.doe.gov; Internet; accessed 14 January 2013.

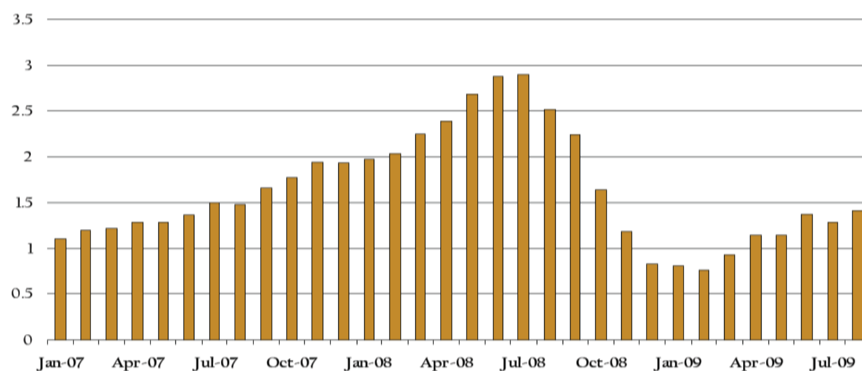



Fig. 8. Arab Oil-exporting Countries: Daily value of oil output (in billions of $)
*Source*: U.S. Energy Information Administration (EIA) Website; available from http://www.eia.doe.gov; Internet; accessed 14 January 2013.

- *Foreign Assets of Arab Investors*: Decline in the value of foreign assets of GCC countries and Libya is a third way for transmitting the global crisis to Middle East. Increase in oil revenues in the years 2003-8 encouraged the Arab Countries to transfer a portion of the revenues into the Sovereign Wealth Funds (SWF).In 2007, Arab SWFs invested in the real estate sector and in financial institutions in the U.S and Europe. However, Arab SWFs faced large losses due to the sudden decline in real estate prices and stock markets in the U.S. especially when they invested in institution such as Merrill Lynch. A decrease in the value of the SWFs caused the governments of the Arab countries to be careful about implementing its development projects (Habibi 2009).

- *Tourism*: Egypt, Morocco, Lebanon, Jordan and Tunisia are some MENA countries which collect revenues from the tourism sector. However, the percentage of foreign tourists decreased after the global recession where revenues in Egypt decreased by 9% and that of Dubai decreased by 16%.As a result, most of the Middle East countries experienced decrease in tourism revenue due to a low percentage of tourists visiting the countries (Habibi 2009).

- *Remittances*: an external finance considered as an income source from migrant workers to their families in the developing countries. This is an important source for income for the Arab countries. However, the global crisis resulted in a decrease in the volume of remittances. For example, Morocco faced a decline of 12.5 % in the remittances. The GCC countries were considered the main source of remittance for Lebanon, Jordan, Egypt and Yemen. The slowdown in tourism and real estate sector lead to decrease the opportunities for jobs for migrant workers (Habibi 2009).

- *Non-Oil Exports*: It has been reported previously that the economic downturn showed declines in tourism, remittance and oil revenues. In addition, we have declines in the merchandise exports of the MENA countries. In the figure below, it

shows comparison of merchandise exports between the years 2008 and 2009. For example, Tunisia, Morocco and Egypt show declines in their exports of agricultural and manufactured products (Habibi2009).

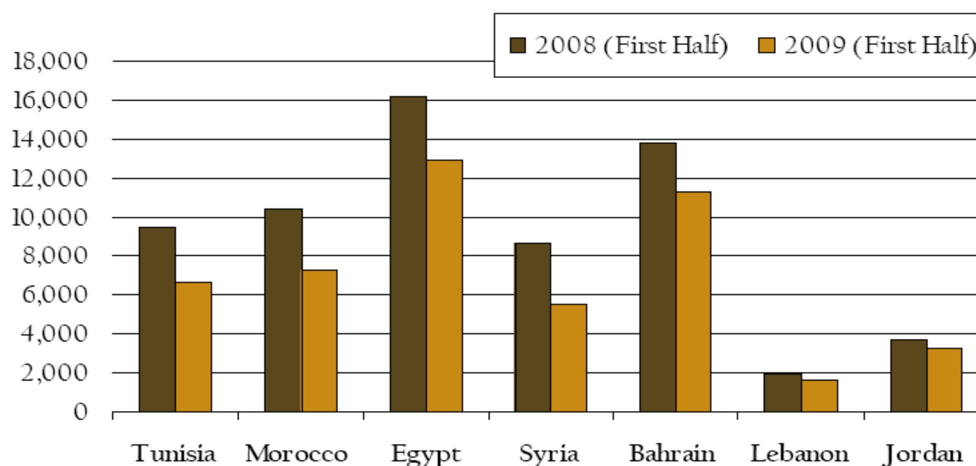
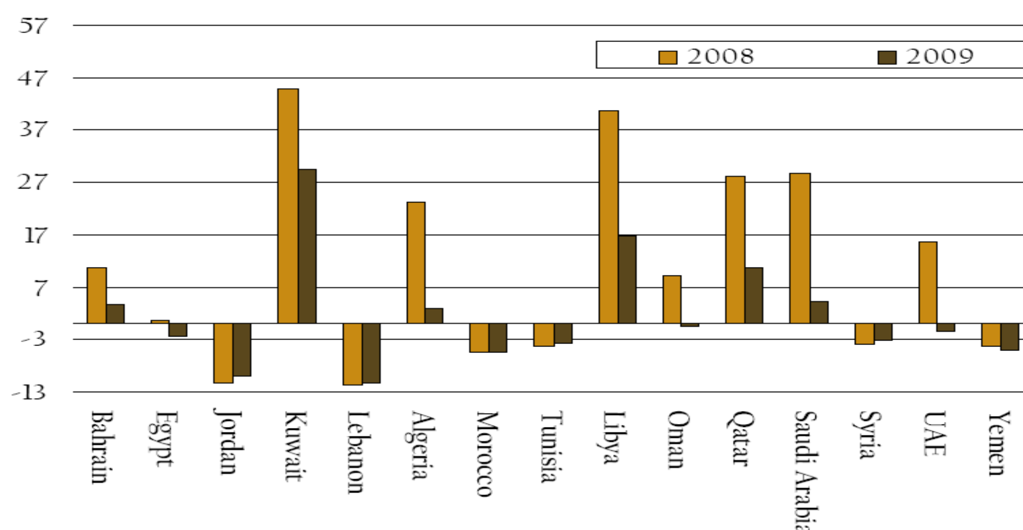



Fig. 9. Merchandise exports of MENA countries, 2008 vs. 2009
*Source*: IMF. 2010. "Direction of Trade Statistics Yearbook". Direction of Trade Series, International Monetary Fund.

In the figure 10, based on the IMF projections, we can notice that the current account balances were not affected a lot due to the decline in the exports of merchandise goods in Lebanon, Jordan, Tunisia and Syria. Comparing the current account balances between years 2008 to 2009, the oil – importing countries show slight changes. However, in oil-exporting countries we can notice sharp declines in the current account balances. For example, the United Arab Emirates shows a shift from a 15.6% surplus of GDP to a 1.5% deficit (Habibi 2009).

- *Market Outlook*: The global crisis affected the MENA region but the harshness of the crisis varies from one country to another. The year 2009 would be challenging to the GCC and each country in the MENA region. A decline in the oil

prices and a fall in the asset prices would affect GCC's export income and trade surplus. However, the GCC countries have passed previously through boom years where the accumulated surpluses can help in balancing the current accounts (Patnaik and Gokhale 2009).




*2009 values are IMF projections
Fig. 10. Current account balances as percentages of GDP
*Source*: IMF. 2009. "World Economic and Financial Surveys". World Economic Outlook Database, International Monetary Fund, October; available from http://www.imf.org; Internet; accessed 14 January 2013.

The GCC was affected the most by the global financial crisis due to the main channel its openness to the global financial markets. During the years before the crisis, GCC countries showed high increases in oil revenues and foreign inflows to finance the expenses of large projects. However, the decline in the oil prices during the year 2008 due to the financial crisis that hit the developed countries led to a decrease in the surpluses of the GCC countries. Also, it affected the liquidity in the business sector in global markets where the investors cannot depend on the external funds to finance their projects. Based on international reports projects which were postponed or cancelled in

the GCC countries during the year 2009 were at an estimate of 575 $billion (Mashal 2012).

UAE (United Arab Emirates) was one of the main economies in the MENA region that was mostly affected. A decline in the flow of foreign investment resulted in a decline in the property values of Dubai. Large real estate firms faced losses and many real estate projects were either cancelled or put on hold during the years 2009 and 2012 due to lack of funds. In addition, it was noticed that during the financial crisis period there was a drop of 40% in the residential rental rates whereas the residential sales prices dropped by 42% (Patnaik and Gokhale 2009).

Kuwait's real estate sector was also affected by the global financial crisis. In January 2009, Kuwait faced a decrease of 29 % in the real estate sector sales volume. Many countries in the MENA region faced slowdown in their economic status however this varied from one country to another based on the relation between GDP and Oil (Patnaik and Gokhale 2009).

Sudan, Algeria, Libya and Yemen (the second group) were not directly affected by the global financial crisis since these countries were not directly linked to the global financial world. The expansion of the crisis to this group was due to the reduction in the demand for oil. Due to the decision taken by the OPEC for reducing the quotas of oil production, Algeria and Libya two members of the OPEC applied this decision. This resulted in a 28% average decline during the year 2009 in the volume of oil exports compared to a 2% decline in 2008 for the countries of this group (Mashal 2012).

However, the activity of non-oil sectors in the economies of these countries showed growth rates in Algeria in the agriculture sector. Libya also experienced an increase in public spending for the infrastructure projects. But, in Sudan, the decrease in

the oil prices and oil revenues affected the non –oil sector. Sudan faced a decline in the growth rate for the economic activity of non-oil sector from 8% to 3.8% in the year 2009 (Mashal 2012).

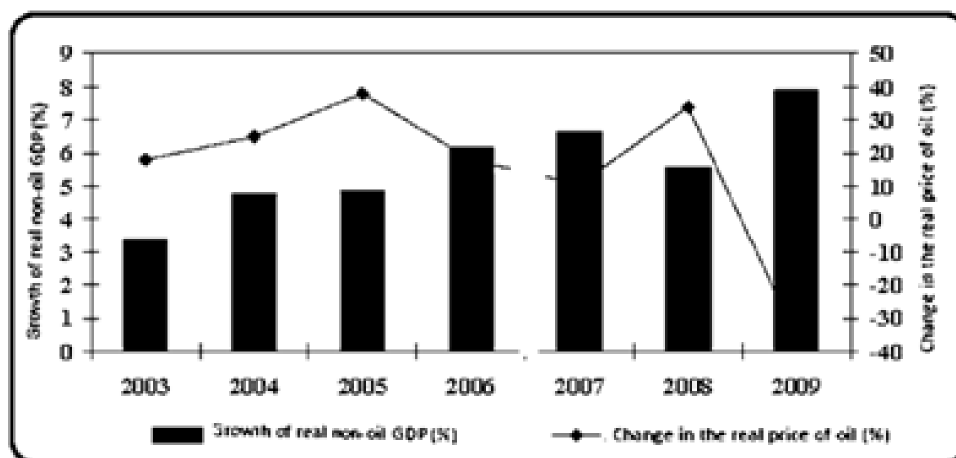



Fig. 11. Comparison of growth of real non-oil GDP for the second group and the change in the real price of oil
*Source*: IMF. 2009. "OPEC Annual Statistical Report." International Monetary Fund Article IV Report and National Sources.

The banking sector and the domestic financial sector were not affected by the global crisis due to the limitations and restrictions available in order to expand to the international markets and abroad investment. However, the economies of the third group countries were connected to the developed countries through the demand of exports and imports in the EU market and United States. The economic activity of third group experienced negative impacts on the flow of foreign investment, decrease in remittances and decline in exports but improvement in the tourism sector. The decline in the export sector has impacted on the economic activity of other sectors such as banking sector. Jordan, Tunisia, Egypt and Morocco took certain decisions in the area of monetary policy such as reducing the interest rate in order for banks to encourage

lending to private sector. Tunisia and Egypt also encouraged public spending in the area of fiscal policy through investment in infrastructure projects, education and export subsidies. Also, Jordan, Syria and Morocco encouraged public spending through investment in development projects (Mashal 2012).

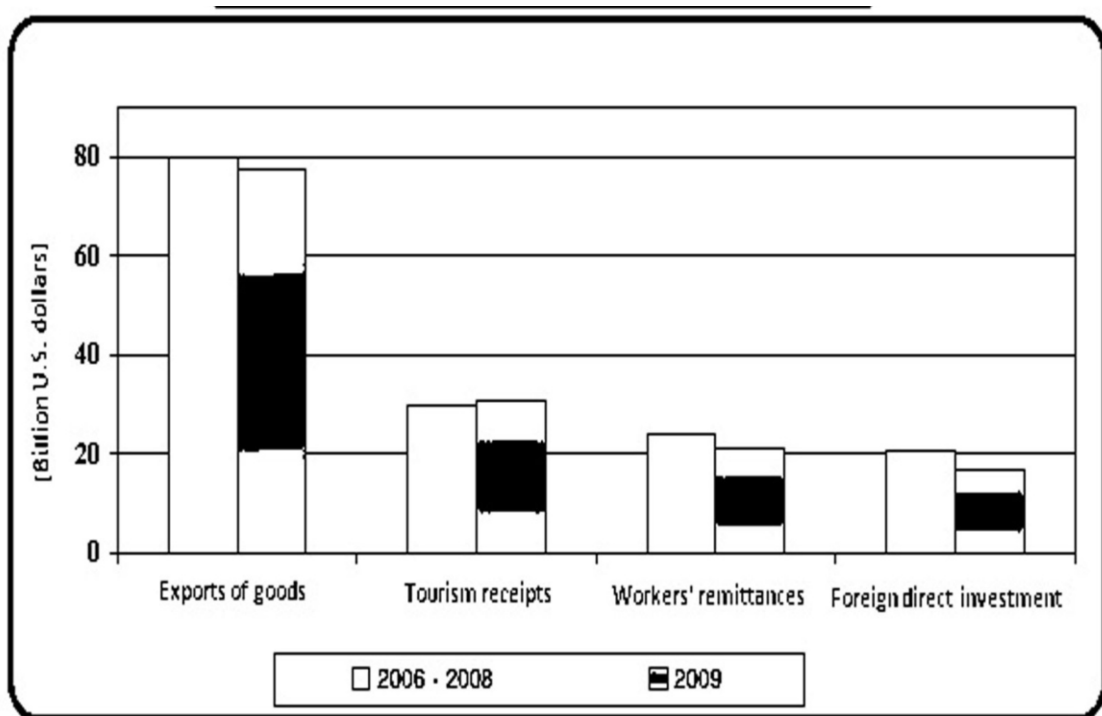



Fig. 12. Some economic indicators for countries of the third group
*Source*: National sources

As a conclusion, we can realize that the performance of the economies in countries related to groups 1 and 2 were more affected compared to the third group due to the changes in the oil prices in the oil sector (Mashal 2012).The below table shows the fluctuation in growth rates during the years 2002 until 2009 where the oil dependant countries were the most affected.

Table 1. Average rates of GDP growth for groups of Arab States at constant prices for the base year 2005=100

| Groups of Arab States | Growth rates of the oil sector for the period | | | Growth rates of non-oil sector for the period | | | Growth rates of GDP for the period | | |
|---|---|---|---|---|---|---|---|---|---|
| | 2002-2005 | 2006-2008 | 2009 | 2002-2005 | 2006-2008 | 2009 | 2002-2005 | 2006-2008 | 2009 |
| The first group | 4.8 | 5.1 | -4.0 | 6.9 | 5.6 | 3.3 | 5.9 | 5.3 | 0.1 |
| The second group | 6.1 | 1.1 | -4.5 | 4.3 | 6.1 | 7.9 | 5.2 | 3.6 | 2.8 |
| The third group | - | - | - | - | - | - | 5.4 | 6.0 | 4.5 |
| Groups of Arab States* | 5.2 | 4.3 | -4.3 | 6.1 | 5.7 | 4.2 | 5.5 | 5.0 | 1.8 |

*Growth rates for the oil and non-oil sector for the first and second group only.
*Source*: AMF. 20009. "Unified Arab Economics Report, and domestic and international sources". Annual Report on Economic Developments in the Arab countries, Arab Monetary Fund.

# CHAPTER IV

# COMPARISON BETWEEN LEBANON AND DUBAI

The global financial crisis hit the Arab countries basically the Gulf region where the real estate projects were either stopped or cancelled. The Gulf real estate markets had seen drop in the real estate sector and prices as well as drop in asset market value and tightening in liquidity conditions whereas, the Lebanese real estate market was able to protect itself from the global financial crisis. The Central Bank of Lebanon was able to control and regulate the banking loans for investment projects. In July 2008, monetary authorities issued circular no. 177 to limit the real estate loans. Banks can give loans for 60% of the value of the project, requesting collateral for such loans. The end users are the real estate buyers and their aim is not to resell their property. Banks continued lending but were more cautious. The Supply and Demand were not halt at all during the crisis but the sector during the months after the crisis passed through a slowdown phase (Bank Audi Report July 2009).

The effects of the crisis varied from one country to another based on the level of development of the banking, financial sector and how the country is connected to the global markets. Certain indicators were referred to in order to recognize the effect of the financial crisis in the Arab countries (Shoufan, Abdul-Khaliq and Abu Shihab 2012).

Economic growth is a macroeconomic indicator used to show the negative impact of the financial crisis. Usually, investors refer to the economic growth rate as an indicator for taking investment decisions (Shoufan, Abdul-Khaliq and Abu Shihab 2012).

From the below table and figure, we notice that the economic growth in

Lebanon increases from 7.6 to 9.3 during the financial crisis period and then decreases to 8. Whereas in the UAE, the economic growth showed a sharp decrease from 6.1 to reach a negative growth rate during the financial crisis period but then started to find ways for recovery during the year 2009. It was difficult to carry out any investment decisions in UAE unlike Lebanon.

Arab countries were classified previously to groups based to their connection to global markets.

UAE was classified to the first group since it is directly connected to the global markets where as Lebanon was classified to the third group. Then, it should have been expected that UAE will face decrease in investments and a decrease in the GDP.

Table 2. The Real Growth of the Group of Arab States

| The state | 2007 | 2008 | 2009 | 2010 |
|---|---|---|---|---|
| Jordan | 8.5 | 7.6 | 2.3 | 3.4 |
| United Arab Emirates | 6.1 | 5.1 | -0.7 | 3.2 |
| Bahrain | 8.4 | 6.3 | 3.1 | 3.9 |
| Saudi Arabia | 2 | 4.2 | 0.6 | 3.4 |
| Kuwait | 4.4 | 5.5 | -4.8 | 2.3 |
| Libya | 7.5 | 2.3 | -2.3 | 10.6 |
| Qatar | 26.8 | 25.5 | 8.6 | 15.9 |
| Oman | 6.8 | 12.8 | 3.5 | 4.7 |
| Algeria | 3 | 2.4 | 2.4 | 3.8 |
| Tunisia | 6.3 | 4.6 | 3.1 | 3.8 |
| Morocco | 2.7 | 5.6 | 4.9 | 4 |
| Lebanon | 7.6 | 9.3 | 9 | 8 |
| Egypt | 7.1 | 7.2 | 4.7 | 5.2 |
| Sudan | 10.2 | 6.8 | 4.5 | 5.5 |
| Syria | 4.2 | 5.2 | 4 | 4.9 |

*Source*: International Monetary Fund

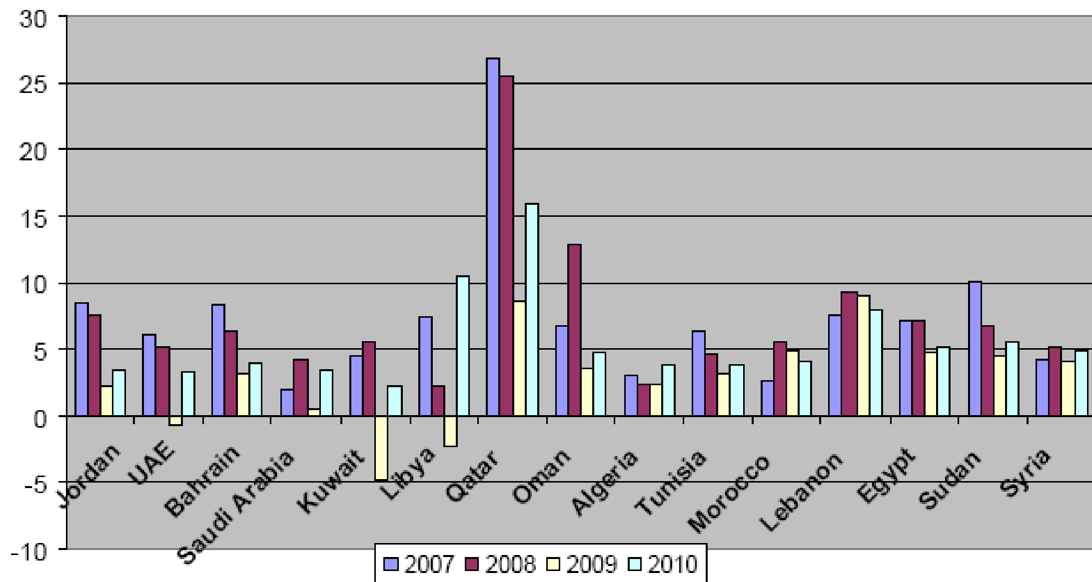



Fig. 13. The Real Growth Rate of the Group of Arab States
*Source*: International Monetary Fund

Inflation Rate is another indicator related to monetary policy which indicates the balance of the public budget deficit (Shoufan, Abdul-Khaliq and Abu Shihab 2012).

According to the below figure and table, we can compare the inflation rate between UAE and Lebanon. UAE's inflation rate changed from 11.1 to 12.3 during the years 2007-08 and then decreased reaching 1.2. On the Other hand, Lebanon showed an increase from 4.1 till 10.8 during 2007-08 and then decreased till 1.2.

Previously, the main reason stated for the financial crisis was due to the low level of interest rates during the year 2006 which resulted in an increase in the demand for house loans. The increase in the demand for loans affected the house prices. We can notice a high level of inflation rate in Lebanon during the financial crisis which indicates an increase in demand for investing projects compared to UAE's inflation rate. However, during the year 2009 in both countries the inflation rate decreased indicating a decrease in the house prices. A solution for financial crisis is by increasing the interest rate level for housing loans. This financial crisis can be positive to Lebanon since it

helped in adjusting the prices of houses to be more reasonable and affordable by buyers. Lebanon showed a slowdown in the investment activity whereas UAE started to show recovery from the financial crisis during the year 2009.

Table 3. Inflation Rate of the Group of Arab States

| The state | 2007 | 2008 | 2009 | 2010 |
|---|---|---|---|---|
| Jordan | 4.7 | 13.9 | -0.67 | 5.5 |
| United Arab Emirates | 11.1 | 12.3 | 1.2 | 1.9 |
| Bahrain | 3.3 | 3.5 | 2.8 | 2.6 |
| Saudi Arabia | 4.1 | 9.9 | 5.1 | 5.5 |
| Kuwait | 5.5 | 10.6 | 3.9 | 4.1 |
| Libya | 6.2 | 10.4 | 2.8 | 4.5 |
| Qatar | 13.8 | 15 | -4.9 | 1 |
| Oman | 5.9 | 12.6 | 3.5 | 4.4 |
| Algeria | 3.6 | 4.9 | 5.7 | 5.5 |
| Tunisia | 3.4 | 4.9 | 3.5 | 4.5 |
| Morocco | 2 | 3.9 | 0.97 | 1.5 |
| Lebanon | 4.1 | 10.8 | 1.2 | 4.9 |
| Egypt | 10.9 | 11.7 | 16.2 | 11.7 |
| Sudan | 7.9 | 14.3 | 11.3 | 10 |
| Syria | 4.7 | 15.2 | 2.8 | 5 |

*Source:* International Monetary Fund

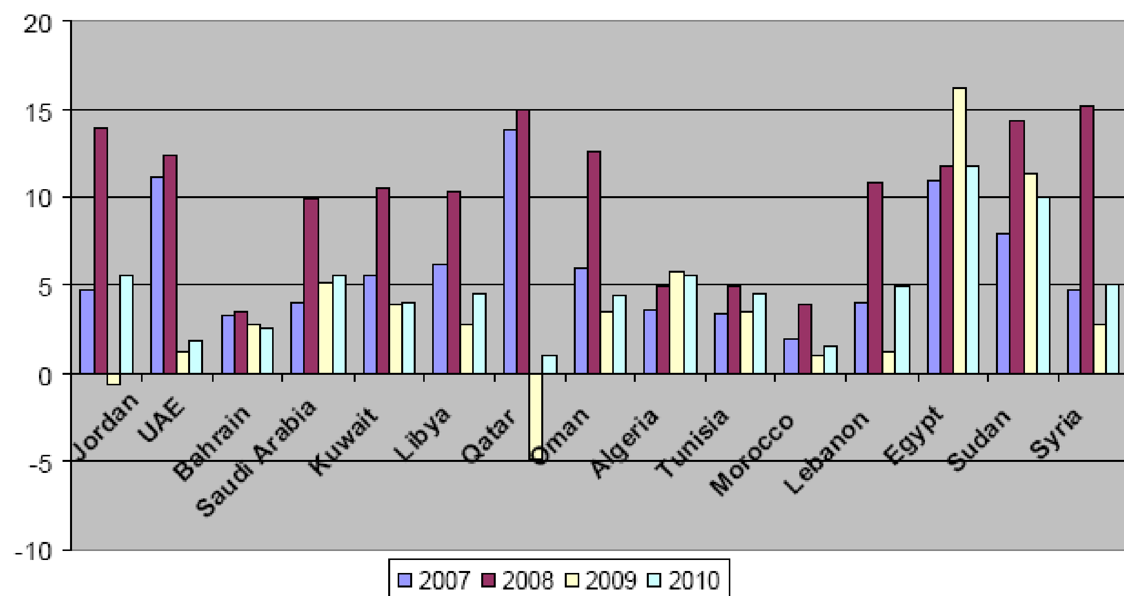



Fig. 14. Inflation Rate of the Group of Arab States
*Source*: International Monetary Fund

The location of Lebanon on the map is strategic since it is connected to the Arab countries, Eastern Europe, Southern Russia and part of North Africa. Lebanon offers opportunities in investment mainly in the tourism and real estate sectors (Choueiri 2008).

Based on the Moet Newsletter issued in December 2009, the real estate sector had passed through a number of fluctuations. During the years 1992-2000, the sector was in poor condition after the fifteen year civil war and the Israeli attack in 1996.During the years 2000-2006, a small construction boom started in the South at the end of Israeli occupation in the year 2000.Changes in the Law N296 which adjusted the 1969 law (N11614) related to the foreign acquisition of property contributed in the growth in the real estate sector. The Law N296 reduced the registration fees for the Lebanese and foreign investors to 5%. Nevertheless, the September 11th, 2001 attacks on the US economy had a positive impact on the real estate sector in MENA region especially in Lebanon. The geographic location of Lebanon encouraged most of the Arab countries to relocate their excesses in the tourism and investment sectors.

The July 2006 war showed a slowdown in the real estate transactions. However, some of the foreign companies that were planning to invest in huge construction projects were not affected.

For example the real estate project done by the “Abu Dhabi Investment House (ADIH)” announced its continuity in the plan for the real estate project and was submitted to Solidere. We started to face a rise in the values of property during the year 2007. It was noticed that a 50 square meter apartment’s cost in the year 2004 was US $60,000; however, in the year 2009 the cost increased to reach US $ 400,000 in Beirut based on the study done by the “Global Property Guide”. This can be due to the rising in the costs of the construction material with the scarcity of land available and the

commitment of investors for maintaining business in Lebanon.

Despite the increase in the value of property during the Financial Crisis period, the real estate sector in Lebanon was able to face this crisis unlike other countries. Most of the Arab investors and Lebanese expatriates redirected their investments from stock markets to real estate sectors (Newsletter 2009).

Based on the Credit Libanais Research unit (2008), the below table shows the development of the values of the property transactions by region from the year 2004-July 2008 to reach its peak in the year 2007 and then start having corrections in the prices of houses.

Table 4. Value of Property Transactions-LBP Million

| Cities | 2004 | 2005 | 2006 | 2007 | July - 2008 |
|---|---|---|---|---|---|
| Beirut | 1,630,782 | 1,618,008 | 1,614,857 | 2,354,434 | 1,377,321 |
| Baabda | 1,037,877 | 1,114,181 | 1,090,202 | 1,388,449 | 1,155,994 |
| Metn | 625,808 | 1,001,334 | 776,418 | 1,016,764 | 908,313 |
| Keserwan | 368,972 | 459,077 | 537,712 | 587,116 | 557,582 |
| Bekaa | 148,253 | 122,270 | 140,537 | 177,962 | 162,442 |
| North One | 176,522 | 185,214 | 206,636 | 269,024 | 197,885 |
| South | 175,310 | 255,193 | 179,934 | 273,556 | 216,469 |
| North Two | 88,358 | 137,285 | 103,107 | 129,470 | 133,443 |
| Nabatiyeh | 53,846 | 68,688 | 60,345 | 96,774 | 66,181 |
| Mount Lebanon | 42,334 | 18,710 | 22,875 | 35,508 | 35,551 |
| **Total** | **4,348,063** | **4,979,962** | **4,732,623** | **6,329,056** | **4,811,181** |

*Source*: Bank Audi. 2009. “Real Estate Registry”. Audi Saradar Research Development.

The pie chart in figure 15 indicates the distribution of values of the property transaction based on the region during the year 2008.

In order to evaluate the achievement of the Lebanese Real Estate Market during financial crisis, we need to have a look at the demand and supply.

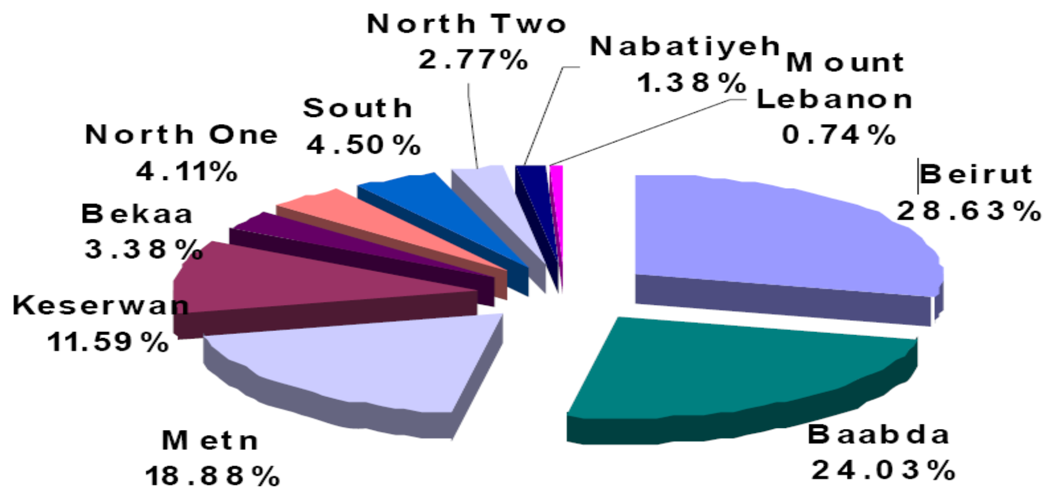



Fig. 15. Value of Property Transactions by Region – As at End of July 2008
*Source*: Bank Audi. 2009. "Real Estate Registry". Audi Saradar Research Development.

Based on Bank Audi's Report (2009), the demand for investment depends on foreigners such as the Arab countries, Lebanese expatriates and Lebanese residents. Factors which encouraged investment in Lebanon are: being a touristic country, increase in liquidity due to increase in the oil prices from 2003 till 2008, the real estate registration fees was lowered for foreigners from 16% to 5% and foreigners can invest up to 3000 square meters of land freely without prior approval from Lebanese authorities.

Most of the Lebanese expatriates are scattered in all countries of the world mainly in the Arab and Gulf countries. Lebanon basically depends on the local lending, touristic and remittances revenues as stated in previous chapter. During the financial crisis period, Lebanon is the country which mostly benefited. Most of the people preferred to enjoy tourism in Lebanon instead of going to the US countries. The expatriates were able to accumulate large amounts of wealth during their work outside Lebanon. Due to the harsh hit to the GCC countries mainly Dubai, the expatriates decided to return back to their home Lebanon which led to increase in the flow of

remittances to Lebanon. The remittances have shown an increase of 18% on average per annum in Lebanon during the financial crisis period. Most of the expatriates and Arab foreigners decided to expand their investment projects and buy houses in Lebanon. However, during the year 2009, a slowdown of economic activity was experienced due to the decrease in the flow of remittances and decrease in the oil revenues (Bank Audi Report 2009).

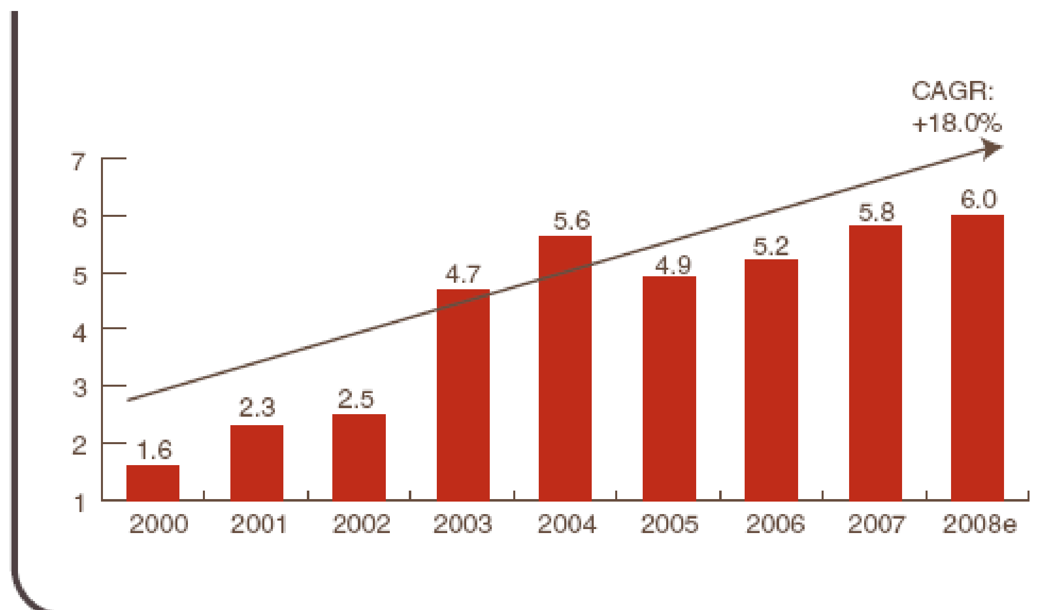



Fig. 16. Remittances to Lebanon (US$ billion)
*Source:* World Bank. Bank Audi's Research Department.

Based on Bank Audi's Report (July 2009), the demand side as shown in the figure below determined an increase of 17.6% average growth of the value of real estate transactions and increase of 10.9 % of number of sales transactions. This increase is due to the interest of most of the Arab countries and foreigners to invest in a less risky asset in Lebanon. In the year 2009, we found that there was a drop of 6.7% in the real estate sales transaction value.

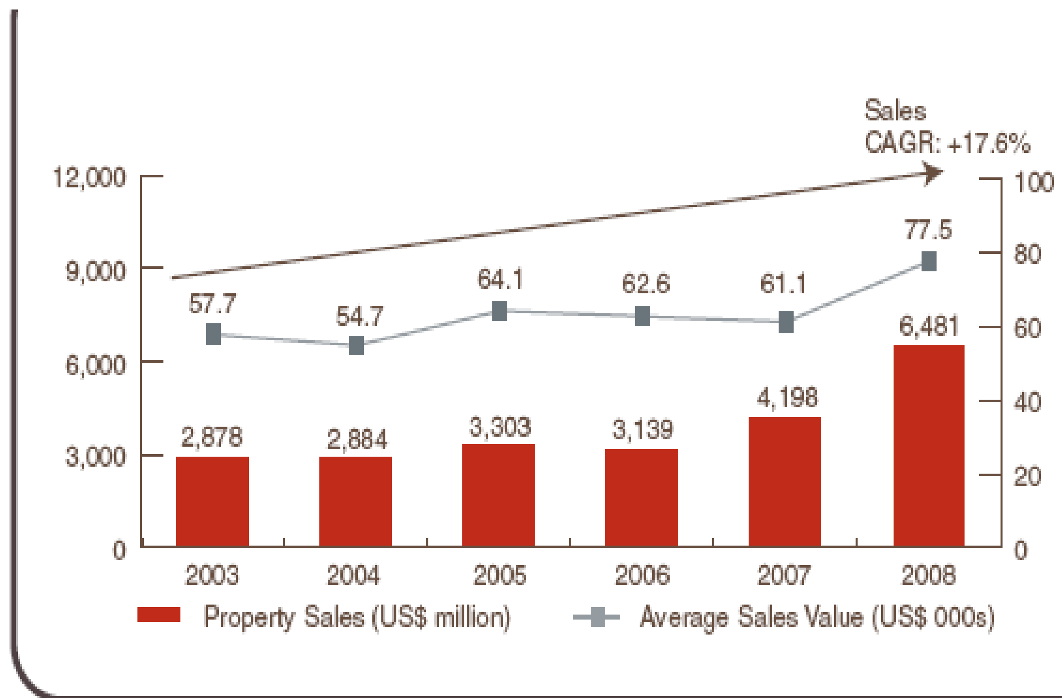



Fig. 17. Evolution of the Real Estate Indicators
*Source:* Bank Audi. 2009. "Real Estate Registry". Audi Saradar Research Development.

Due to the increase in demand for investment, the supply side which is responsible for the construction permits and cement deliveries (a construction indicator) showed an increase of 12.6% and 9.2% respectively. The supply sector tried to catch with the demand by increasing their land spots and launching new projects. In the year 2009, slowdown was observed in the construction permits compared to other years but this does not mean a stop in the activity (Bank Audi 2009).

Lebanon can be considered a case of a country was able to learn from what happened in the U.S.

Lebanon was able to face the financial crisis and the causes stated before regarding the financial crisis did not apply in Lebanon. The Central Bank was able to issue circulars regarding restrictions for lending loans inorder to decrease the number of risky loans. Based on a circular No.313 issued on January 2013, a decision was taken by

the Central Bank to support the banks and financial institutions. The main decision indicates that all banks will be having the opportunity to benefit from the credits of total 2,200 billion LBP granted by the Central Bank against the loans given by the banks on their responsibility to their customers. The Central Bank will be requesting for guarantees from the banks such as bonds representing the total amount of loans granted by the banks to their customers. In this case, the Central Bank will be able to control all kinds of loans, control the interest rate and monitor the collateral for the credits. The aim of the Central Bank is preventing Lebanon from experiencing a case similar to U.S due to increase in risky loans.

As for Dubai which used to be named as "the Monte Carlo or Las Vegas of the Middle East", it passed through a global recession where most of the construction stopped, unemployment level had risen and most of people had to leave Dubai due to losses in their work (Davidson 2009). United Arab Emirates (UAE) consists of the seven emirates: Abu Dhabi, Ajman, Dubai, Fujairah, Ras Al-Khaimah, Sharjah and Umm al –Qalwain (Leemann and Younes 2005).

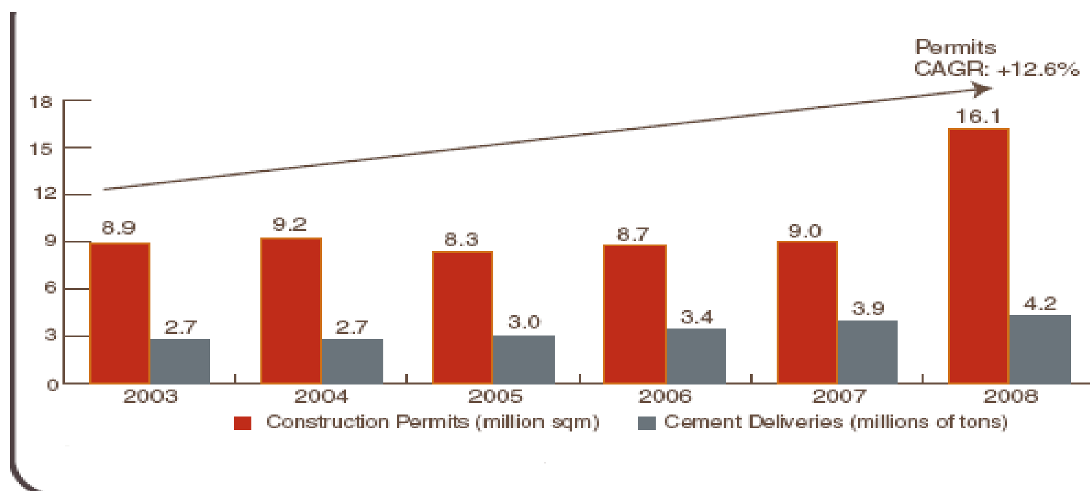


Fig. 18. Evolution of Construction Indicators
*Source*: Order of Engineers of Beirut and Tripoli du Liban. Bank Audi's Research Department

Based on the below table, we can notice that Dubai's land area and GDP classifies it as the second largest emirate in UAE (Renaud 2010).

Table 5. The Seven UAE Emirates around 2007

| | Land area (km$^2$) | Population (thousands, 2008 est.) | GDP 2007, millions UAE Dirhams | Per Capita GDP UAE Dirhams | Per Capita GDP US Dollars |
|---|---|---|---|---|---|
| Abu Dhabi | 67,340 | 1,559 | 400,047 | 267,948 | $72,817 |
| Dubai | 4,115 | 1,593 | 226,513 | 153,256 | $41,649 |
| Sharjah | 2,590 | 946 | 68,463 | 77,622 | $21,095 |
| Ajman | 260 | 237 | 9,525 | 42,522 | $11,556 |
| Ras al Khaimah | 1,700 | 231 | 13,555 | 61,059 | $16,593 |
| Fujairah | 1,150 | 145 | 8,476 | 61,869 | $16,814 |
| Umm al Qawain | 750 | 53 | 3,153 | 60,635 | $16,478 |
| UAE | 77,905 | 4,764 | 729,732 | 162,596 | $44,187 |

*Source*: IMF. "UAE Statistical." Appendix, International Monetary Fund Report

Dubai reached a level where it can be considered as one of the booming economies, a state of 1.4 million people expanding their work in investments. Dubai was able to reach to this extraordinary situation being based on several factors such as: oil incomes were used as expenses for development activities, focus on international services as a major income where this type of industry is known for its diversification of risk since these activities are not connected directly to Dubai. Dubai took advantage of the excess amounts from the Foreign Direct Investment (FDI) which was used for financing the construction. Finally, the centralized decision making structure and the

government's involvement in the economy was an advantage for organizing foreign incoming and private sector investments, those were the main reasons for converting Dubai to a successful city state (Hvidt 2007).

Dubai was known for its high level of connection to the global markets. Most of Foreign Direct Investments form foreigners were attracted towards Dubai sectors. Dubai can be seen as a major region for investments since most of the FDI were used in the Construction Sector (Abdelghalil 2010).

Table 6. FDI inflows into various sector of Dubai (2005-2006)

| | 2005 | 2006 | % change |
|---|---|---|---|
| Agriculture | 16 | 13 | -19% |
| Mining | 1,098 | 1,302 | 19% |
| Manufacturing | 737 | 1,061 | 44% |
| Electricity and Water | 39 | 46 | 18% |
| Construction | 13,239 | 14,652 | 11% |
| Whole sale and retail Trade | 7,939 | 8,696 | 10% |
| Hotels and Restaurants | 3 | 38 | 1,167 |
| Transportation and Communication | 603 | 851 | 41% |
| Financial intermediation and Insurance | 12,931 | 15,025 | 16% |
| Others | 830 | 780 | -6% |
| **Total** | **37,435** | **42,463** | **13%** |

*Source*: Dubai Chamber based on FDI bulletin 2005-06, Dubai Statistic Centre.

Around 80 % of people in Dubai are expatriates which are around 27% of UAEs population.

Dubai reached a level where most of the construction projects are done in Dubai. The table below shows the new projects will take place in Dubai (Leemann and Younes 2005).

Table 7. New Projects –Dubai, UAE 2005

| Project Name | Estimated Cost of the Project (US$ billion) | 2005 | 2006 | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Dubai Maritime City | N/A | | ✓ | | | | | | | | | |
| Dubai International Financial Centre | 1.0 | | ✓ | ✓ | | | | | | | | |
| Dubai Festival City | 1.5 | | | ✓ | | | | | | | | |
| Dubai Pearl Development | 0.3 | | ✓ | | | | | | | | | |
| Green Community Village | 0.2 | | | | | | | | | | | |
| International City | N/A | ✓ | | | | | | | | | | |
| Dubai Marina | N/A | ✓ | | | | | | | | | | |
| Palm Project: Jebel Ali, Jumeirah & Deira | 12.2 | | | | | ✓ | ✓ | | | | | |
| Mall of the Emirates | N/A | | | ✓ | | | | | | | | |
| Dubai Mall | N/A | | | ✓ | | | | | | | | |
| The World | 1.8 | | | | ✓ | | | | | | | |
| Dubailand | N/A | | | | | | | | | | | ✓ |
| Dubai Health Care City (DHCC) | 5.0 | | | | | ✓ | | | | | | |
| Cargo Village Expansion | 0.3 | | | | | | ✓ | | | | | |
| Old Dubai | N/A | | | | | | | | | | | |
| Metrol Line Network | 3.9 | | | | | ✓ | | | | | | |
| Ras Al Khor Bridge | 0.5 | | | | ✓ | | | | | | | |
| Dubai Waterfront | N/A | | | | | | | | | | | |
| Airport Expansion | 0.25 | | | ✓ | | | | | | | | |

*Source*: HVS Research

The factor behind the enormous real estate market boom in Dubai is related to the announcement of freehold ownership in May 2002 .Investors of all nationalities have the right to own properties in specific areas in Dubai and this gives them the advantage of holding a residency status. The factor of openness to the market increased the demand of investors especially from Middle East considering investment in real estate as a safe asset. Below is a figure indicating the top 15 countries of the origin of buyers of Dubai real estate sector (Renaud 2010).

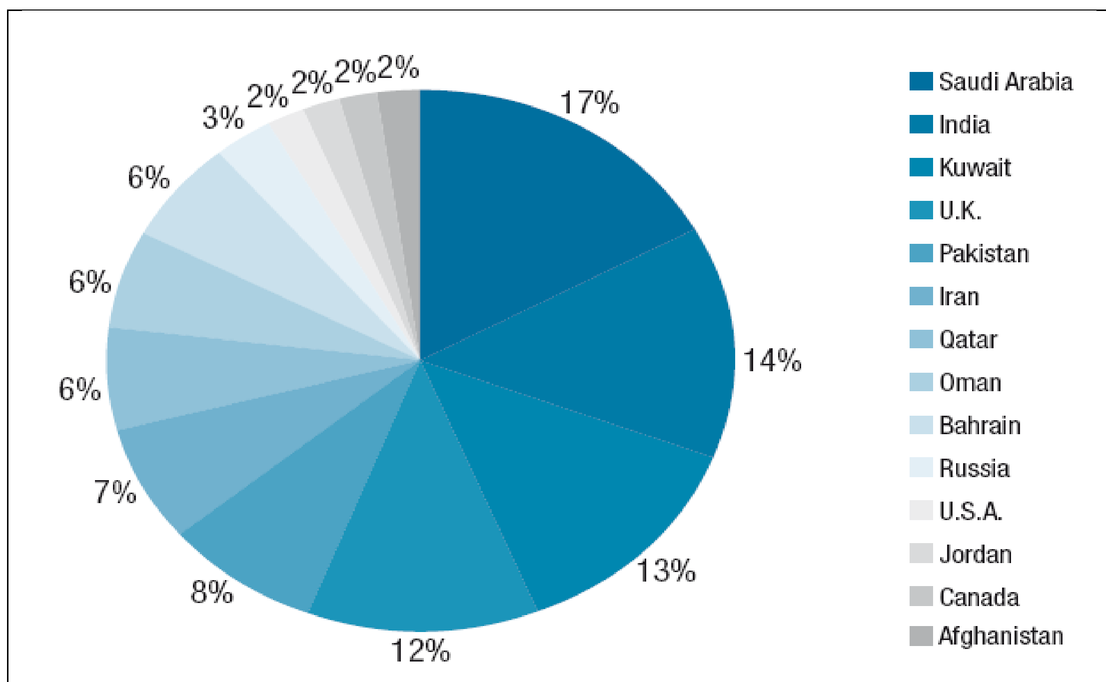



Fig. 19. Buyers of Dubai Real Estate, Top 15 countries in Transaction Value, 2002-2008
*Source*: Christian Ketels. "Clusters and Dubai's Competitiveness". Dubai Economic Council

The increase in demand was accompanied by an increase in the housing supply. Based on a study done by the Dubai Economic Council, below is a list of the Dubai developers indicating the estimated values in billion USD at the peak of the housing bubble (Renaud 2010).

The supply side of Dubai was divided between the Emirates which represent 20% of the total population and the non-national residents due to the openness of the real estate market to foreign investors. Before the financial crisis, the GCC countries faced a construction boom where projects under construction were calculated to reach the amount of 1$US trillion. Most of real estate and construction took place in the UAE. However, the crisis hit Dubai's economy in all its sectors especially the real estate sector where all constructions and projects were put on hold or cancelled. At the end of the crisis, Dubai had to face a debt of 110$bn (Renaud 2010).

Table 8. Major Dubai Real Estate Developers in 2008 –Estimated Value in billion USD

| | |
|---|---|
| Nakheel | 110 |
| Dubai Properties | 95 |
| Emaar Properties | 77 |
| Limitless | 73 |
| Tatweer | 65 |
| Sorouh Real Estate | 40 |
| Tourism Development & Invst Co. | 40 |
| Tamouh | 40 |
| Tameer Holding | 32 |
| Masdar | 26 |
| Sama Dubai | 25 |
| Damak | 20 |

*Source*: Christian Ketels. "Clusters and Dubai's Competitiveness". Dubai Economic Council, 14.

The financial crisis affected Dubai since it depends mostly on foreigners and oil revenues. A decrease in the oil revenues and decrease in the inflows of FDI caused investors to shift to another country resulting in a decrease in the demand. A decrease in the demand led to a crash in the prices, sales decreasing and profit diminishing. We are in a situation with decrease in demand with an excess of supply where the real estate firms such as Nakheel faced huge losses.

The below figure shows based on data collected by IMF, that UAE specifically Dubai was among the three countries which faced decline in its property values (Renaud 2010).

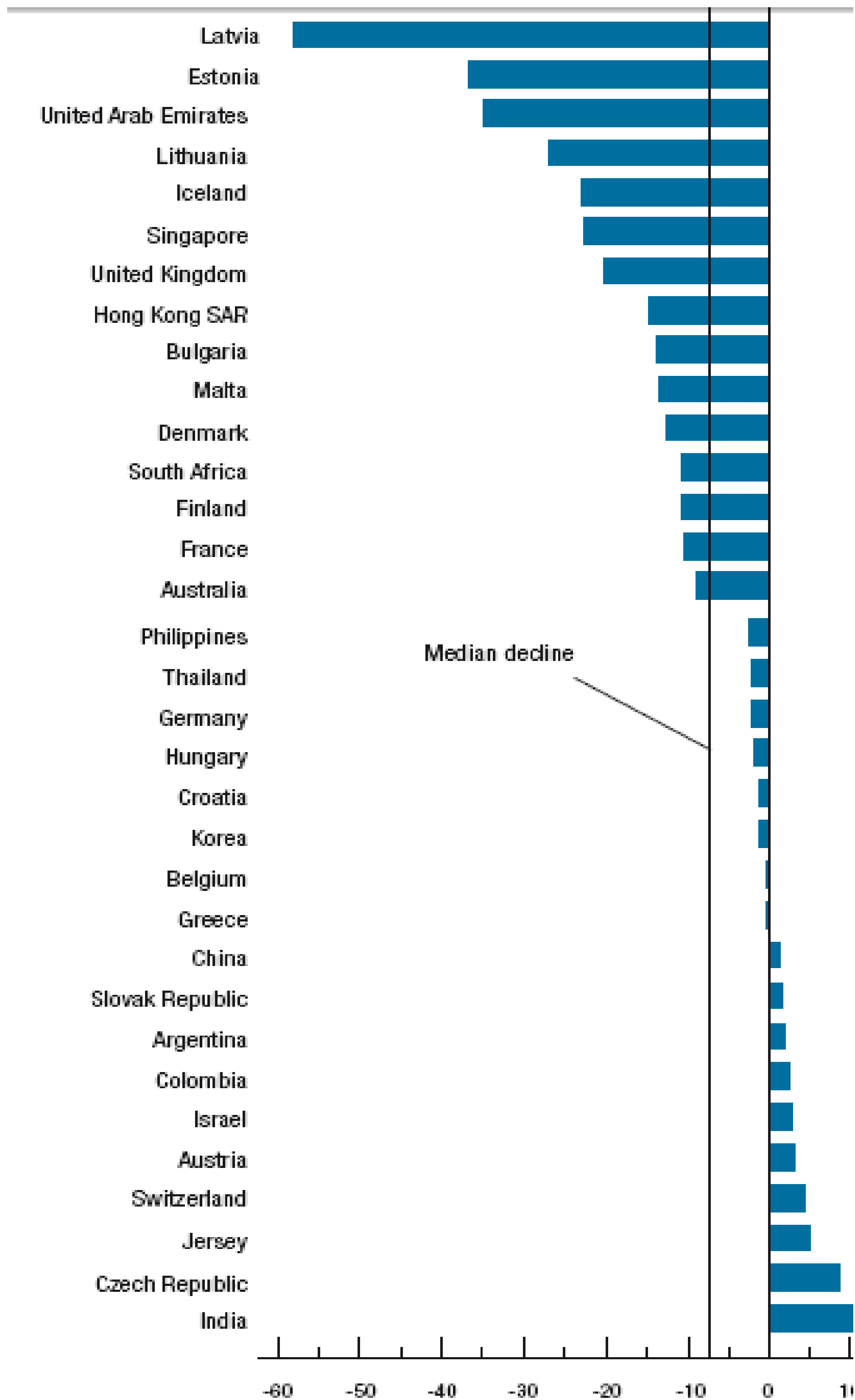



Fig. 20. Declines in Housing Prices across 70 countries in 2009-Q1
*Source*: IMF. 2009. "World Economic and Financial Surveys". World Economic Outlook Database, International Monetary Fund, Box 1.4; available from http://www.imf.org; Internet; accessed 14 January 2013.

In previous chapters, different points of views were stated regarding the causes of the financial crisis initiated in the U.S. How is this related to Dubai? Dubai can be considered a case which experienced the 2007 financial crisis. We can deduce that the causes which led to the financial crisis were: low interest rate, high liquidity, inflows of foreigners from U.S. and other countries, easy credit conditions. Also, most of the investors in real estate sector in Dubai were international investors or speculators which took advantage of easy lending standards. The causes which led to the housing bubble in Dubai were similar to the causes which led to the crisis in U.S. A combination of all the causes stated in the three different points of views can be seen in the case of Dubai.

Also, Dubai can be a case which experienced similar effects of the crisis as in the U.S. Dubai suffered a loss in investments, losses in financial institutions, loss in GDP, unemployment which led to a severe hit to the whole economic activity.

Based on the Bank Audi Report (2009), we notice how the financial crisis affected the GDP of Dubai reaching a negative level. Hence, Dubai needed to find a way to cover the debt and recover from the crisis.

Finally, the financial crisis did not affect all countries the same; it had its negatives and positives.

It had a negative impact on Dubai and a positive one on Lebanon. Dubai can be an example of a country experiencing the 2007 financial crisis whereas Lebanon can be a case of a country which tried to learn from the experience of others and took certain measures to overcome the crisis.

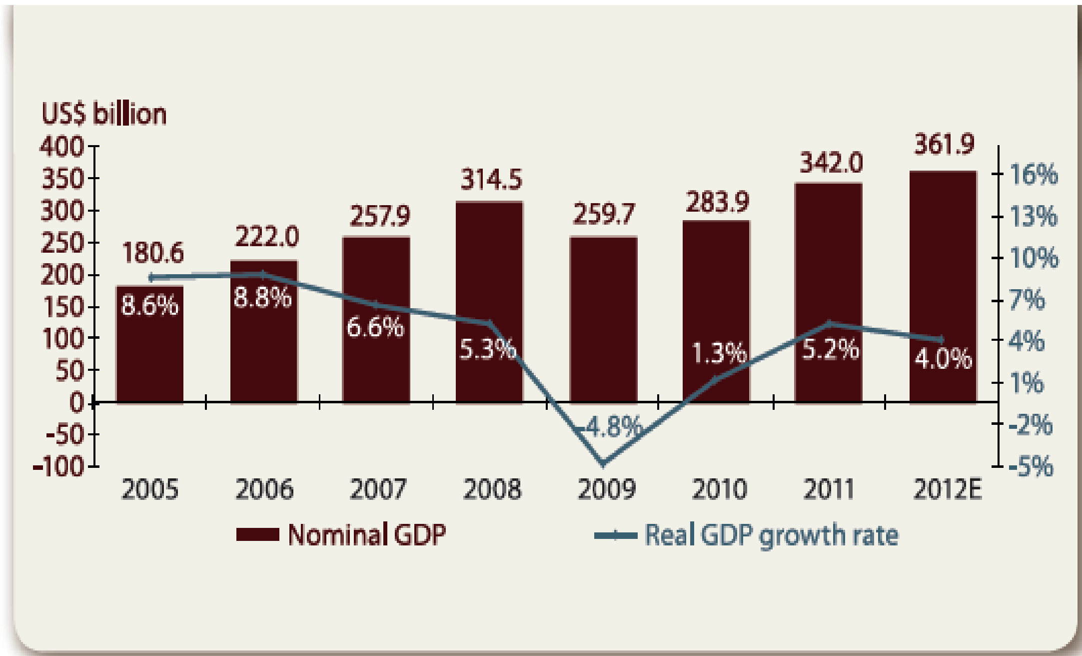


Fig. 21. Effect of financial crisis on Dubai's GDP
*Source*: IMF. Bank Audi's Group Research Department.

# CHAPTER V

# CONCLUSION

The world economy went through a critical period during the "2007-08 financial crisis". The word crisis is from a Greek origin and it refers to a moment in time where there is a turning point and a need to take a certain decision. Hence, what are the solutions to this problem? Will we be facing another crisis again? Moreover, since it is a global crisis we need to have a global solution. The solution might be with greater cooperation among the countries especially those that were less exposed to the crisis helping those who were more exposed. In addition, we need to reach a certain model or system which can predict the challenges the countries might face ahead of time (Bonciu 2008).

The causes and effects of the 2007 financial crisis were discussed in Chapter two. This financial crisis turned out to be global and was transferred from the U.S to the Arab countries through transmission channels as indicated in Chapter three.

The Arab countries were impacted differently due to their direct connection to the global markets and transmission channels. Comparing two countries UAE and Lebanon in Chapter four showed what would happen to a country experiencing a financial crisis compared to a country that was able to overcome the crisis.

Dubai reached a high level in its economic activity in all sectors mainly in its investment sector due to the dependency on oil revenues, inflows from foreigners, overinvestment and risky management decisions (Renaud 2010).

The government of Dubai was surprised by the high level of debt as a result of the 2007 financial crisis. Losses in the tourism sector , increases in unemployment rates,

decreases in oil revenues, declines in FDI inflows, losses in the real estate sector and cancellation of construction projects resulted in losing trust in the whole economic system.

However, Dubai's main issue was to come up with a plan by which they could pay 110$bn worth of debt and be able to deal with the crisis. On December 14, 2009, the Abu Dhabi government supported Dubai with a 10$bn in the form of bonds sold to the UAE Central Bank. Also, on April 2010, the Dubai Department of Finance initiated a debt management office to prepare a financial plan to cover all the debt during the coming years 2011-2014 (Renaud 2010).

Due to this severe bust, the following lessons were learnt from the Dubai crisis: improve regulations for mortgage lending, not to over-invest in private sector relative to the public sector, diversify the economy, create a sound auditing system, reorganize the real estate industry and allocate losses in a transparent way. Since Dubai is directly connected to the global markets, then there is a need to have better supervision and strengthen lending rules for international investors (Renaud 2010).

However, based on the financial times newspaper (2012), Dubai was able to improve its economic conditions by stimulating trade, tourism and capital inflows from different Arab countries due to the Arab spring. Nakheel, the real estate developer which was facing losses during the financial crisis is now planning a series of real estate projects, due to the increase in demand for investment especially from buyers from Saudi Arabia and India. However, the fear now is to face an increase in the property prices which may lead to another crisis.

Based on the Bank Audi Report (2013), Dubai was able to benefit from the "regional turmoil" and from its economic and political stability during the Arab Spring where risk started to appear in other countries in the region. This resulted in increasing:

the flow of visitors to Dubai airport by 13%, the GDP by 4.5% in the year 2012 and high occupancy rates in hotels.

Banks nowadays are strengthening and supervising the lending activity. Some of the bank loans are channeled to the government for public sector investment. The Central Bank was able to adjust the rules for personnel loans by limiting the period for lending to be a maximum of four years and the ceiling of a loan to be "20 times a borrower's monthly salary". The Central Bank of UAE is planning for a set of "liquidity oriented regulations". But the liquidity position of banks nowadays is better especially after increasing the deposit needed as a guarantee for the loan (Bank Audi 2013).

Despite the political and security conditions, Lebanon was able to manage well the 2007 financial crisis. The different point of views regarding the causes of the financial crisis did not apply to Lebanon since this crisis has benefited Lebanon. The Central Bank of Lebanon was able to control the mortgage lending process and made sure that only end users are investing in the real estate sector and not speculators. The economic activity showed positive signs especially in the real estate sector due to the inflows from foreigners and remittances from Lebanese expatriates. However, a risk factor is still available in Lebanon due to the instability in the political situation (Bank Audi's Report 2009).

Lebanon is still able to produce a positive growth rate and is not yet affected by the regional conditions especially the conflicts happening in neighboring countries due to the Arab Spring.

Based on Bank Audi's Report (2013), according to RAMCO Real Estate Advisers some of the indicators such as the number of transactions and construction permits are declining and there is a slowdown in the market but this does not indicate a crisis. Also, the Ministry of Tourism indicated a decrease in the number of tourists. This

slowdown is due to the political, social and security situations Lebanon is going through. Since Lebanon is still attracting large developers to invest, then we are still on the safe side.

Despite all the challenges, the foreign exchange market registered high demand for the Lebanese pound. The foreign assets at the Central Bank cover 83% of the Lebanese money supply which gives the bank the ability to protect the currency and be able to meet the demand of foreign currency in case of renewed pressure. Lebanon needs to work on stabilizing the monetary and financial system in order to face not only short term challenges but also the long term political ones.

As a result, the main feature behind the 2007 financial crisis was the mortgage sector which led to fluctuations in economic activity. The features of the crisis were related to lack of tools for proper supervision and regulation. Due to lack of coherent policies of international standards, this led to bad supervision for large inflows causing a mismatch between the assets and liabilities. Their aim was to look at liquidity only rather than evaluating the whole economic system. The direct connection with global markets accelerated the build- up of risk and made it complex to manage resolving the crisis quickly.

We notice that the Central Bank intervention was needed in order to reinsure trust and confidence in the whole financial system. The Central Bank took the initiative for restricting the lending process based on guarantees and supported other banks by injecting liquidity to have a stable financial system (Igan and Laeven 2010).

Countries need to coordinate together for creating better and transparent policies for stabilizing the financial system and manage assessing the risk at its early stages instead of discovering the problem after facing the crisis.

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