



Dubai makes Mr Darling's sums for the PBR more complicated

It was probably not the best timing to announce a request for debt rescheduling by Dubai World just on the eve of the markets closing for 4 days for the Eid Middle East weekend. But the world's financial markets seem to have taken the hit in their stride so far.

The decision, however, has implications for the world economy in 2010, for some indebted economies and for the Middle East in particular.

For the world economy, it highlights the fact that corporate problems tend to lag the economic cycle and many will reach the surface in 2010 and 2011 when bonds have to be rolled over or borrowing facilities renewed and the easy cash from running down inventories has been absorbed. In most Western economies, corporates have been repaying debt over the past 12 months. This will be less easy in the coming 12 months; with downward pressure on profits as inventories are no longer being run down.

We have consistently warned that recovery from the credit crunch would not be painless, especially in the Western world, and events are increasingly bearing this out. A year ago I wrote about first the financial crisis, then the economic crisis and finally the recovery crisis. It is important that financial markets do not either get overoptimistic in advance of a stuttering recovery – or alternatively that they do not overextrapolate any hiccup into a wholesale downward assessment of growth prospects.

The risk of country default is now becoming clearer. With Dubai likely to have to be bailed out by the other Emirate states, attention will focus on EU member states with debt problems like Latvia, Greece and Ireland. This may well weaken the euro, although any major signs of weakening against the dollar are likely to be used by some of the sovereign funds as an opportunity for asset diversification.

In the Gulf region, a 2010 start to the recovery previously seemed likely. This will now be delayed, with fewer international investors returning to the region.

This leaves the UK economy precariously placed in the run up to Alastair Darling's Pre Budget Report on 9 December. Although a strong Q4 looks highly probable, a weak Q1 2010 also looks likely, as global economies stutter and the impact on the UK is reinforced by the VAT hike back up to 17½%. Logically the Chancellor should announce a serious plan to reduce the Budget deficit to below £60 billion by 2015, which would give him the scope to extend the VAT cut until the recovery has taken root.

If he cannot do this for political reasons, one wonders whether the election might be held a couple of months earlier than 6 May, to prevent the knock on effects of a consumer spending slowdown in the New Year from having worked their way through to the rest of the economy before the vote.

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