Falling world growth rate reflects the impact of US tariffs on Chinese goods, Chinese retaliation, Brexit-related uncertainties and geopolitical tensions arising from US sanctions against Iran.

Growth Slows in Challenging Global Environment

In 2018, Foreign Direct Investment (FDI) capital grew by 41 per cent to AED 38.5 billion (US$10.5 billion), ranking Dubai as 6th among global destination cities for capital investment.

As an open economy, Dubai will benefit from a reduction in trade tensions, but would suffer collateral damage if the current disputes are not resolved.
The current global economic landscape is experiencing both risks and encouraging signs of recovery. This chapter will explore the issues that are impacting macroeconomic developments and share forecasts for 2020.

The rate of growth for global GDP and international trade slowed in 2018. According to the IMF, the outlook for 2019 is for the rate of growth of real output to fall to 3.0 per cent before rising to 3.4 per cent in 2020.\footnote{IMF, World Economic Outlook, October 2019}

On the positive side, in the absence of inflationary pressures across the developed world, monetary policy by the main central banks is likely to remain accommodative. Policy rates should continue to move downwards in the United States, in the Eurozone, Japan and among countries like the UAE whose exchange rate is pegged to the dollar. However, a recovery of global growth in 2020 depends on a resolution of trade tensions between the United States and China. The downside risks for 2020 are high and global growth could be thrown off-course by a number of factors, including a disorderly departure of the UK from the EU and rising geo-political tensions in the Gulf region.

The anticipated recovery in the rate of growth in 2020 for the world economy will not be evenly spread-out as many countries and types of economies face very different demand conditions. In the USA, the current economic expansion is expected to lose momentum yielding slower growth in 2020 while demand will weaken in the Eurozone and Japan. Among the main emerging markets and developing countries, growth in China will slow in response to the negative impact of trade disputes on its exports, India is expected to grow steadily, while Turkey could bounce back after its sharp recession in 2019.

The economies of the Gulf Cooperation Council (GCC) countries and Iraq have seen a recovery of growth in 2018 and 2019 bolstered by higher oil prices, directly benefiting GDP growth in the UAE and Dubai indirectly as regional demand rises. The UAE, and in particular Dubai, attract cross-border capital flows in terms of FDI and portfolio investment. These flows have been facilitated by the growth in Dubai’s role as an offshore financial hub, with the Dubai International Financial Centre now ranked 8th in the world.

Financial markets have been generally stable in the developed world and in the emerging markets, and asset values have recovered in 2019 after significant declines in the last quarter of 2018. The decision of the Federal Reserve to hold back on further rises and to cut policy rates to support the US expansion has supported asset prices. However values remain vulnerable to any failure to resolve trade issues or an escalation of punitive tariffs, an increase in geo-political tensions arising from Iran and the impact on the EU and the world economy of a disorderly Brexit.
In 2018, the expansion of the world economy weakened marginally due to rising interest rates. This disruption was the result of decisions made on policy rates by the Federal Reserve, increasing trade tensions and the imposition of tariffs on a range of goods imported into the United States, and the impact of higher oil prices which persisted until the third quarter of the year. Real global output rose in 2018 at a rate of 3.6 per cent, down from 3.8 per cent the year before. The IMF predicts that the rate of growth will continue to fall to 3.0 per cent in 2019 before rising to 3.4 per cent in 2020. The reduction in world economic growth in 2019 reflects the impact of increased US tariffs on an additional US$200 billion of Chinese goods in May, from 10 per cent to 25 per cent, followed by Chinese retaliation. Brexit-related uncertainties and geopolitical tensions arising from US sanctions against Iran also contributed to lower economic growth, (Figure 1.1).

The recovery of growth in 2020 is predicated on a resolution of trade tensions, a smooth departure of the United Kingdom from the European Union, the stabilization of macroeconomic conditions in stressed countries such as Turkey and Argentina, the continued easing of monetary policy in the United States and by other central banks, and supportive conditions in financial markets. However, the downside risk to rising global growth in 2020 will remain high. Growth in the world economy will not be evenly spread as many countries and types of economies face very different demand conditions.

In 2018, the average price of oil in US dollar per barrel was $68.33 despite weakening considerably after September to the end of the year. The price of crude oil stayed at US$64 a barrel by April 2019 on the back of production cuts by the Organization of Petroleum Exporting Countries (OPEC). Since then, the market has softened as the global growth rate has declined due to the impact of tariffs on China, and its lower growth rate has led to the reduced demand for oil.

Slowing global growth has also reversed the rise in other non-oil commodity prices, particularly base metals. After rising from a low of US$1.93 per pound on January 11th, 2016 copper prices peaked at US$3.30 per pound on June 4th, 2018 and have fallen to US$2.55, a decrease of 22.7 per cent by the end of August 2019. Data from the IMF shows a similar pattern for the prices of agricultural commodities. The Commodity and Food Price Index rose by 3.6 per cent from January to May 2018, but had declined by 9.1 per cent by December and has risen only marginally since then, (Figure 1.2).

Regarding inflation, initially stronger world economic growth in the first half of 2018 and rising commodity prices produced a pick-up in inflationary pressures in some economies particularly the United States. The average annual rate of inflation measured by the CPI rose from 2.1 per cent to 2.4 per cent. Data from the Bureau of Labor Statistics
shows that the rate peaked in July 2018 at 2.9 per cent and has declined to an average annual rate of 1.7 per cent from January to August 2019. Despite a tight labour market, economic growth in the United States is slowing and the weakening global economic environment will rein in any inflationary pressures in the developed economies. In the European Union, the CPI rose throughout 2018 mainly as a result of an increase in oil prices, but core inflation remained subdued. The rate of CPI inflation within the Euro area peaked at an annual rate of 2.3 per cent in October 2018, but has since declined to 1.0 per cent in August 2019 and remains unchanged from the month before.

**Advanced Economies**

After rising in 2017 to 2.5 per cent, the average growth rates in advanced economies have declined steadily to 2.3 per cent in 2018. The IMF expects a further decline to 1.7 per cent in 2019 reflecting growth moderations in the Eurozone, the UK and Japan. Economic growth in the USA rose to 2.9 per cent in 2018 and is expected to decline to 2.4 per cent in 2019 and 2.1 per cent in 2020 as the historic length of the country's expansion weighs against loosening monetary policy and a fiscal stimulus. Growth recovery in the Eurozone and in the United Kingdom in 2020 depends on a smooth Brexit transition and on an ongoing influx of funds from the European Central Bank. In the case of smooth Brexit transition the IMF predicts slow growth of only 0.5 per cent in Germany and effective stagnation in Italy with 0.0 per cent GDP growth while France would grow by 1.2 per cent in line with the average for the Euro area in 2019. Growth in Japan more than halved in 2018 to 0.8 per cent from the year before and the IMF predicts that it will remain sluggish at 0.9 per cent in 2019, before falling to 0.5 per cent in 2020, (Figure 1.3).

**Emerging Market and Developing Economies**

Real output growth among the Emerging Market and Developing Economies fell to 4.5 per cent in 2018 from 4.8 per cent the year before. The IMF anticipates growth to fall further among this group of economies to 3.9 per cent in 2019, before rising to 4.6 per cent in 2020. A major cause of the slowdown is attributable to the imposition of tariffs by the United States on imports of Chinese goods, and when combined with weakening external demand, the result is a negative impact on trade and investment. The Chinese economy, which has been undergoing a process of structural change, while relying on a regulatory tightening to rein in debt, has still been able to undertake a policy stimulus to counteract the external shock from the trade dispute. Chinese growth has fallen steadily from 6.8 per cent the year before to 6.6 per cent in 2018 and is expected by the IMF to fall further to 6.1 per cent in 2019 and to 5.8 per cent in 2020.

India's growth rate fell to 6.8 per cent in 2018, but is expected by the IMF to decline further to 6.1 per cent but...
Economic growth in Turkey fell sharply from 7.4 per cent in 2017 to 2.8 per cent in 2018. The IMF predicts growth to continue falling to 0.2 per cent in 2019. A currency and debt crisis accompanied by rising interest rates pushed the Turkish economy into recession in the last quarter of 2018. But government stimulus efforts are leading to a recovery and the IMF forecasts 3.0 per cent growth in 2020.

The performance of the Gulf Economies — comprising the Gulf Cooperation Council (GCC) countries — Bahrain, Saudi Arabia, Kuwait, Qatar, Oman and the UAE — are tied to the price of oil and the value of the dollar since some of the countries in the region operate currency pegs. The economic performance of Iraq is also tied to the price of oil and the value of the dollar. A steady recovery in oil prices, which began in Q2 2017, has bolstered growth throughout the region. Oil prices rose by 30.9 per cent in 2018 and averaged US$68.33 a barrel compared to US$54 the previous year. But the price has remained volatile throughout 2019.

Higher oil prices in 2018 meant that Saudi Arabia returned to positive real output growth with the economy expanding by 2.4 per cent compared to a fall of -0.7 per cent in 2017. The IMF expects lower growth in 2019 of 0.2 per cent, but rebounding to 2.2 per cent in 2020. Growth rates in Oman, Kuwait, Iraq and the UAE have followed a similar recovery pattern in 2018. The IMF forecasts continued recovery in the rate of growth for the main GCC countries and Iraq in 2019 and into 2020. Iraq, which experienced negative GDP growth of minus 1.7 in 2017 and sluggish growth of 0.6 per cent in 2018, is predicted to experience a strong rebound to 3.4 per cent in 2019 and 4.7 per cent in 2020, (Figure 1.5).

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<tr>
<th>Figure 1.4: Real GDP Growth (%) World and Emerging and Developing Economies</th>
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Source: IMF, World Economic Outlook, October 2019.
The UAE and Dubai Economic Performance

The rise in oil prices and in production has had a positive impact on the UAE’s economy. According to the UAE Central Bank’s 2018 Annual Report\(^2\), growth in the UAE oil sector GDP recovered to 2.8 per cent in 2018 from a decline of the same rate (−2.8 per cent) in 2017. In contrast, the growth rate of the non-oil GDP rose at a softer pace by 1.3 per cent in 2018 compared to 1.9 per cent in 2017. In October 2019, the IMF predicted that economic growth in the UAE would continue to recover to grow by 1.6 per cent in 2019 and by 2.5 per cent in 2020. In the context of the slowdown in the non-oil sectors of the UAE economy and in the international economic environment, Dubai’s real GDP grew by 1.9 per cent in 2018, a sharp deceleration from 3.1 per cent the year before. In the first half of 2019, the expansion of output in the Emirate remained sluggish rising by 2.1 per cent and is expected to be 2.1 per cent for the full year. It is forecast to rebound to growth of 3.2 per cent in 2020, the year Dubai will host Expo 2020. Rising demand from neighbouring GCC economies and Iraq will also underpin an increase in the rate of growth of real output in Dubai, (Figure 1.6).

**Figure 1.5: Real GDP Growth in GCC and Iraq (%)**

Source: IMF, World Economic Outlook, October 2019

**Figure 1.6: Real GDP Growth in UAE and Dubai (%)**

Source: IMF, World Economic Outlook, October 2019, UAE Central Bank, Dubai Statistics Center

Global & Regional Trade

The rate of growth of world merchandise trade volume slowed in 2018 to 3.0 per cent after accelerating the previous year, according to the World Trade Organization (WTO). Trade growth was dampened by new tariffs and retaliatory measures and weakening global demand. The WTO sharply downsized its estimates for 2019 to 1.2 per cent and to 2.7 per cent for 2020, although forecasts are subject to considerable uncertainty as a result of continuing trade tensions between the US and China and between the US and the European Union.

In 2018, the United States moved sharply towards protectionism by imposing new tariffs on steel and aluminum, which affected exports of these products from all countries with a few exceptions, but the new tariffs included exports from the UAE. This was followed by the escalation of a tariff conflict with China, invoking retaliatory measures from that country that have not yet been resolved. This dispute is slowing down world trade and GDP growth with a negative economic impact on all countries. The impact of the US-China trade dispute, protectionist measures imposed unilaterally by the United States administration, and the potential consequences for the economies of the UAE and Dubai are explored in Box 1.1.

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3 https://www.wto.org/english/news_e/pres19_e/pr837_e.htm
BOX 1.1

Impact of USA-China Trade Tensions

Background
Since the start of 2018 the US administration has followed a protectionist policy by imposing tariffs on manufactured goods imported from the rest of the world, in general, and China in particular to correct its trade imbalances. In 2018, the United States had a current account trade deficit in merchandise goods of US$887 billion, of which US$418 of the balance was due to trade with China. These measures have provoked retaliation from China and other trading partners such as the EU resulting in a decline in the rate of growth of world trade and fears of further escalation which have unsettled capital markets.

The United States initially accused China of unfair trading practices and intellectual property theft and subsidizing domestic producer at the cost of foreign competitors and wants China to buy more US goods to reduce the trade deficit. The rapid rise of China as an export engine and its dominance in global value chains, especially in manufacturing, as well as China’s ambition to challenge the US lead in advanced technology and robotics seem to be the key motivation behind the US move in imposing tariffs and limiting access to US technology to Chinese technology companies. This explains the escalated on the dispute to target the expansion of telecommunications provider Huawei.

Timeline
In February 2018, the US imposed 20 per cent tariffs on imports of washing machines and solar panels from China and in March extended these measures by placing duties of 10 per cent on imports of aluminum and 25 per cent on imports of steel on the rest of the world including China and the EU exempting Argentina and Australia. The exemption was widened to Canada and Mexico, partners in the North American Free Trade Agreement in May 2019.

In retaliation China imposed tariffs ranging from 15 to 25 per cent on a list of 128 US exports, mainly primary products worth US$3 billion. After a period of failed talks the United States published lists of targeted imports from China and imposed three further rounds of tariff increases of 10 per cent in 2018 in July, August and September representing a total value of US$200 billion. China retaliated in stages and imposed a tariff of 10 per cent on a list of US goods with a total value of US$60 billion and in May 2019 the United States raised its tariff on the list of imported goods to 25 per cent and has threatened to raise it to 30 per cent and to extend the list before the end of the year.

Economic Impact
The negative impact of the trade dispute goes beyond China and the USA. The escalation of the trade tension has led to volatile financial markets and an increased downside risk to global output and trade growth. The IMF’s recent forecast (July 2019) of global GDP growth was 3.2 per cent for 2019, revised downwards by 0.1 percentage point lower than in its projections in April. The growth of global trade in world merchandise goods slowed to 3.0 per cent in 2018 and the WTO has sharply revised down its estimates for 2019 to 2.6 per cent.

Dubai, as one of the world’s most open economies, is at risk from any downturn in world trade growth resulting from falling demand in its trading partners. In particular, China is Dubai’s top trading partner with merchandise trade valued at AED 139.3 billion in 2018, 11 per cent of the Total Dubai’s trade. The US is Dubai’s third largest partner with trade of AED 80.6 billion, 6 per cent of the total in the same year, (Figure 1).
Indirectly escalating tariffs weaken China’s external demand producing a lower demand for oil, slowing manufacturing activity and disrupting supply chains. The UAE, including Dubai, and China’s economies are interconnected through trade, transport, tourism, private investment, banking, technology and energy supply. These links have created a strong economic interdependence. Approximately 60 percent of China’s exports pass through Dubai’s free zones, heading to Africa or Europe. A slowdown in China’s economy will thus affect Dubai’s shipping, port and free zones activities.

More directly Dubai has also been affected by the global imposition of tariffs of 10 and 25 per cent on imported aluminum and steel products into the United States since the UAE was not one of the countries granted exemption. Dubai is a major exporter of aluminum products to the US and in 2017, before the imposition of the tariff the Emirate exported AED 8.3 billion worth of aluminum products, 16.2 per cent of Dubai’s total export share of the metal. After the imposition of tariffs, from which the UAE received no exemption, Dubai’s exports of aluminum to the US declined by 10.5 percent and was worth AED 2.53 billion at the end of 2018, 15.1 per cent of its total export share, (Figure 2).

Steel is of a lesser importance in Dubai’s exports to the US, but the 25 per cent duty reduced the Emirate’s shipping of this product by 13 per cent from AED 766 million in 2017 to 666 million in 2018, leading to a fall in the share of the US from 14 to 9 per cent in Dubai’s steel and iron exports, (Figure 3).

The UAE can do little to reduce the direct effects of intensifying trade tensions apart from negotiating with the US for a tariff exemption. The indirect consequences could be met by Dubai by pursuing a diversification of its supply chains with other regions. This will be aided by the coming global event that the Emirate will host by next year. Expo 2020 could be a game changer for Dubai’s future source of growth and job generation as it would allow for Dubai to move up the value added manufacturing chain with other countries in Asia and Africa through enhanced regional cooperation.
The trade tensions have had differential effects on trade patterns across the world. In Asia, trade volume growth in both exports and imports slowed considerably with annual rates of expansion of 6.8 per cent and 8.3 per cent respectively in 2017, falling to growth rates of 3.8 per cent and 5.0 per cent in 2018. In contrast, the imposition of tariffs had little effect on trade flows in and out of North America. The volume of trade in exports grew by 4.3 per cent and imports rose by 5.0 per cent, higher rates of growth than witnessed in 2017. The impact of the trade disputes on North American trade are expected to start to have an impact in 2019 with the WTO expecting slower growth of 2.7 per cent in export volume and 3.6 per cent in import volume, although the slowdown in exports on GDP growth is counteracted by continuing growth in domestic demand in the USA.

South and Central America and the Caribbean’s import growth grew strongly by 5.2 per cent while in comparison, export volume growth was almost stagnant at 0.6 per cent in 2018. Export growth is expected to stay at around the same rate in 2019 while import growth is forecast to halve to 2.6 per cent. European trade flows weakened considerably in 2018 with export volume growth falling to 1.6 per cent from 3.7 per cent the year before and import volume growth to 11 per cent compared to 2.9 per cent. Little recovery is expected by the WTO in 2019.

The WTO categorises Africa, the Middle East and the Commonwealth of Independent States, as ‘other regions’. This group experienced steady export growth of 2.7 per cent by volume in 2018, but import volume grew by only 0.5 per cent, (Figure 1.7).

Economic activity in the UAE, and particularly in Dubai, is strongly affected by demand trends in the global and regional economy due to their openness to flows in international trade in merchandise goods and in services such as finance and tourism. Dubai is the fourth most open economy in the world. In 2017, Dubai Statistics estimated the value of the ratio of foreign trade (the value of imports plus total exports), as a proportion of Gross Domestic Product (GDP), at 321 per cent. This ratio is below the exposure of highly open Luxembourg to trade at 415 per cent, Hong Kong at 376 per cent and Singapore at 326 per cent, all in 2018. But Dubai’s value is well above the 162 per cent registered for the UAE as whole, the 67 per cent registered for Saudi Arabia and the global figure of 58 per cent. By this measure, Dubai is the most exposed economy in the Gulf to foreign trade, (Figure 1.8).

**Cross-Border Financial Flows (Offshore financial centers & DIFC)**

Dubai is also an open economy in terms of its participation in global capital markets that serves to attract cross-border capital flows into the Emirate. These include Foreign Direct Investment (FDI), encouraged by the Dubai FDI, an entity of the Dubai Department of Economic Development, portfolio investment flows (equity and debt) and other private capital flows, mainly bank lending. These flows have been facilitated by the growth in Dubai’s role as an offshore financial centre to provide services to residents and non-residents.

Global capital flows increased much faster than world GDP from just under US$4 trillion in 2000, then fell sharply as a result of the global financial crisis and have only partially...
recovered. According to a report by McKinsey the US$4.3 trillion that flowed around the world in 2016 was only a third of the peak of US$12.4 trillion in 2007. The improved global economic environment led to a rise in global cross-border capital flows to 8.0 per cent of world output in 2017, but the uncertain economic environment since then has prompted a repeat downturn of 5.9 per cent in 2018.

The pattern of capital flows has also changed considerably. In 2015, there was a major drop in cross-border bank lending of 0.9 per cent of global GDP, with European banks responsible for much of the collapse. Cross-border bank lending recovered subsequently and has grown at an average rate of 2.0 per cent between 2016 and 2018 Portfolio investment in both equity and debt securities, which is particularly responsive to uncertain conditions, fell to 1.9 per cent of global GDP in 2018, from 3.4 per cent the previous year. Another factor for concern is a decline in the flows of Foreign Direct Investment (FDI) around the world, a driver of future global growth and trade, which have been reduced from 4.1 per cent of global output in 2015 to 2.0 per cent in 2018, financial hub in the Middle East, Africa and South Asia (MEASA) region, has steadily expanded its role and was ranked first in the area as a result of its achievements in 2018. Set up in 2004 the DIFC lies in a strategic location midway between the global financial hubs of London and New York in the west and Singapore and Hong Kong in the east.

The Global Financial Centres Index (GFCI) published in September 2019, is an evaluation of the attractiveness and competitiveness of 104 financial centres worldwide. Dubai was ranked in 8th position globally, up from 12th position in March and from 15th place the year before. This places Dubai’s financial centre rating well ahead of other GCC locations: Abu Dhabi 32nd, Doha 39th, Bahrain 47th, Kuwait City 65th, and Riyadh, 96th. Dubai was ranked in first position in the Middle East and African region.

The DIFC continued to grow strongly and had over US$424 billion assets under management by March 2019. The registration of international companies had reached 2,003 by the first half of 2018 and increased by an additional 14.3 per cent to 2,289 a year later. The expansion has created 600 new jobs, bringing the DIFC’s workforce to over 24,000, and resulting in a 99 per cent occupancy rate of the Centre’s owned real estate. The DIFC has continued to succeed as a magnet for the financial services sector and hosted 671 financial services firms, with an increase

Dubai International Financial Centre

Despite the global slowdown in cross-border capital flows since 2007, the Dubai International Financial Centre (DIFC), acting as an offshore financial hub in the Middle East, Africa and South Asia (MEASA) region, has steadily expanded its role and was ranked first in the area as a result of its achievements in 2018. Set up in 2004 the DIFC lies in a strategic location midway between the global financial hubs of London and New York in the west and Singapore and Hong Kong in the east.

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Figure 1.8: Foreign Trade Ratio to GDP % in 2017-2018

Source: World Bank, Dubai Statistics Centre

Figure 1.9: Global Cross-Border Capital Flows as (% of Global GDP

Source: UNCTAD.

of 11 per cent in the first half of 2018. At the start of 2019, the DIFC announced plans to increase its scale and place an emphasis on attracting fintech companies, both start-ups and companies in more advanced growth stages. The number of licensed fintech companies operating in the DIFC increased from 35 to more than 80 in the first half of 2019. The DIFC received 425 applications from start-ups operating in Islamic fintech, insurtech and broader fintech sectors, for the third series of its DIFC FinTech Hive accelerator programme — a 42 percent increase from the 2018 programme and a three-fold increase from its inaugural cycle in 2017. Approximately half of the applications received for the 2019 programme originated from the Middle East, Africa and South Asia.

**Foreign Direct Investment**

According to the Dubai FDI Monitor, in 2018 AED 38.5 billion (US$10.5 billion) in Foreign Direct Investment (FDI) capital entered the emirate, a rise of 41 per cent over the previous year. FDI, net inflows as a percentage of GDP, in the Emirate stood at 9.7 per cent in 2018 compared with 0.4 per cent in Saudi Arabia and 2.7 in the UAE as a whole; 4.0 per cent in Oman and 18 per cent in the MENA region as a whole for 2017.

The Dubai FDI Monitor recorded a total of 523 projects in 2018, an increase of 43 per cent on the previous year. These data places the Emirate in 6th position in terms of global cities as destinations when ranked by FDI Markets Data and is a significant increase from 10th place in 2017. The Emirate has moved up to 3rd from 4th globally in terms of the number of Greenfield projects initiated.

Dubai’s relative success in attracting external capital contrasts sharply with global investment trends. Global foreign direct investment (FDI) fell by 19 per cent in 2018 to an estimated US$1.19 trillion from US$1.47 trillion in 2017, according to UNCTAD. This brings world spending FDI down to the level experienced in 2009 as a result of the global financial crisis and continues an underlying downward trend which began in 2015. Lower profitability of foreign investment and shifts in global value chains have been blamed for the falling trend. But according to UNCTAD, the 2018 FDI decline also stems from corporate income tax reform in the United States as multinational enterprises began a large repatriation of accumulated foreign earnings. For 2019 there are negative signals for FDI given the slowdown in global growth and trade tensions, although Dubai remains in a strong position to attract FDI positioned between Europe, Africa and Asia. This advantage could benefit the Emirate, which has already bucked global trends in inward capital investment in 2018.

The provenance of international FDI capital into Dubai is concentrated by country in terms of the total capital coming into the Emirate and the number of projects with seven countries dominating. According to data compiled by Dubai FDI Monitor, in 2018, the top five countries accounted for 70 per cent of all FDI capital into Dubai and 51.0 per cent of all projects. The United States remained in the leading position with 37.0 per cent of FDI capital deployed in the Emirate followed by India, 12.0 per cent; Spain, 9.0 per cent; China, 7.0 per cent and the United Kingdom, 5.0 per cent, (Figure 1.10).

![Figure 1.10: Top Five Source Countries FDI Capital % of Total 2018](image)

Source: Dubai FDI Monitor.

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10 https://data.worldbank.org/indicator/BX.KLT.DINV.WD.GD.ZS
Monetary and Financial Conditions in Advanced Economies

Interest Rates

During most of 2018 policy interest rates continued to rise in the United States and the United Kingdom, but by the end of the year the absence of inflationary pressures, evidence of slowing growth and falling equity prices halted the process of normalisation. The Federal Funds rate was raised four times in 2018 from 1.5 per cent to 2.5 per cent in December. This rate stayed in place until July 31st 2019, when fears of a slowdown in the US economy prompted the Federal Reserve to further trim the policy rate to 2.25 per cent. The rate was cut again by an additional 25 basis points on September 19th 2019, (Figure 1.11).

The Federal Reserve took the lead among central banks in the normalisation of interest rates among the advanced economies in 2017 into 2018. The Bank of England followed and raised its policy Base Rate from 0.25 per cent to 0.5 per cent in November 2017 to 0.75 per cent on August 2nd 2018. This year, rates have remained unchanged in the face of increasing uncertainty about the strength of the UK economy after the extension of the Brexit deadline (from March 29th to October 31st, 2019) for leaving the European Union.

In contrast, the European Central Bank has not followed the Federal Reserve in normalizing policy rates. In 2018, growth in the Eurozone slowed down due to a combination of problems, including new fuel emission standards that impacted the German car industry, deteriorating consumer and business sentiment across the region, continuing stagnation in Italy and the negative impact of Brexit created investment uncertainty. In response, the European Central Bank (ECB) maintained its marginal lending facility policy rate, which offers overnight credit to eurozone banks, steady at 0.25 per cent throughout 2018 and into the first nine months of 2019. On September 12th, however, in response to lowered forecasts for growth and inflation, the ECB announced it was loosening monetary policy and reviving its quantitative easing programme by buying €20 billion of bonds per month until inflationary expectations approach 2 per cent. The overnight deposit facility rate offered to eurozone banks, another key policy rate, was cut from minus 0.4 per cent to minus 0.5 per cent as part of the package.

The Bank of Japan has also failed to follow the Federal Reserve and has removed the time limit on achieving its 2 per cent inflation target maintaining policy rates at minus 0.1 per cent during 2018 and 2019. It has signaled that it would consider further stimulatory measures, including more asset purchases and lower rates, if the fall-out from the United State-China trade tensions damage the Japanese economy.

Figure 1.11: Policy Interest Rates in Advanced Economies (%) per annum 2015 to 2019

- **US Federal Funds Rate**
- **Euro Marginal Lending Facility**
- **UK Base Rate**

Source: Federal Reserve, Bank of England, European Central Bank
Equity Prices

The interest rate hikes by the Federal Reserve during 2018 and the trade tensions with China dampened equity prices in the United States and across the world in the last quarter of the year. US equity markets suffered a sharp correction in October 2018 amid fears of higher interest rates. The MSCI World Equity Index peaked in September 2018 and fell sharply on global trade fears and rising bond yields. The Federal Reserve’s decision to hold back on further rises, produced a recovery in 2019, but asset prices remain subject to considerable downside risks. The MSCI World Index, which is dominated by the advanced economies with a weight of less than 12 per cent for emerging markets, fell by 12.1 per cent in 2018 then recovered and has grown by 15.1 per cent in 2019 to-date.

In the United States, the S&P 500 lost over 9 per cent in value during 2018 while the NASDAQ index fell in value by over 5 per cent. In the United Kingdom, which also experienced an interest rate rise in 2018, the FTSE 100 fell by 13 per cent and has risen by over 6 per cent to date. Equity markets in the United Kingdom have been affected by political uncertainty and investor fears over Brexit. In Japan and Germany equity prices also fell in 2018 before recovering in 2019. The Nikkei dropped by nearly 16 per cent and the DAX fell by almost 21 per cent before rising in 2019 to date by 11 per cent and 13 per cent respectively, (Figure 1.12).

The US interest rate hikes by the Fed during 2018 and trade tensions with China dampened equity prices, causing a sharp correction in October 2018 in world’s Equity markets.
CHAPTER 1

Monetary Financial Conditions in Emerging/Developing and GCC Economies

1.14 Monetary conditions tightened in some key large emerging markets in 2018. In India, the Reserve Bank of India (RBI) raised the policy repo interest rate from 6 per cent to 6.5 per cent as the value of the rupee came under pressure and as the US Federal Reserve Board continued to normalize rates. In 2019, as economic growth expectations have weakened, the RBI has reversed and loosened monetary policy by cutting rates four times to a repo rate of 5.4 per cent in September. In Brazil, the central bank began loosening monetary policy in 2018 by dropping its Selic policy rate in two stages from 7 per cent to 6.0 per cent at the end of the year. In the face of poor economic growth the rate was cut by 50 basis points to 6 per cent on July 31st 2019.

In contrast to this general trend, there are some notable exceptions in countries such as Argentina and Turkey, where Central Banks have been forced to raise rates several times in response to both inflationary pressures and depreciating exchange rates. In Argentina, the economy faced worsening problems throughout 2018 with rising inflation which the Central Bank tried and failed to control by raising the TELIQ policy rate in stages to 30.25 per cent, to 40 per cent, 60 per cent and finally to a year’s peak of 68 per cent in October. The balance of payments swung from a surplus to a deficit and rising interest rates in the United States produced a flight of capital from pesos to dollars and Argentina was forced to request a US$50 billion loan from the IMF. Interest rates eased back in early 2019, but the continuation of the economic crisis produced an uptick again and by September 15th the country had imposed capital controls as fears of a sovereign debt default grew and the policy rate stood at 84 per cent.

In Turkey, a major trading partner with Dubai, the Central Bank raised policy rates several times in 2018, to protect the currency in the face of capital outflows in response to a rising rates in the United States, problems in the Turkish economy and uncertainty about the impact of global trade tensions. Turkey had been facing a current account deficit and rising inflation in 2018 and economic growth slowed throughout the year producing a recession in 2019. Inflationary pressures eased in June 2019 and the Central Bank has cut the policy rate from 24 per cent to 19.75 per cent and to 16.5 per cent, (Figure 1.13)

1.15 During 2018 and into 2019 most of the GCC countries central banks closely followed the US Federal Reserve’s lead in the setting of interest rates. Monetary policy throughout the region is to balance the aims of simultaneously maintaining close links to the US dollar while ensuring that liquidity conditions reflect the needs of individual economies. In 2018, the UAE continued to shadow the Federal Reserve and raised rates by 25
basis points four times, in March, June, September and December. Rates in the UAE were then cut by the Central Bank to 2.5 per cent following the reduction of the US Federal Funds rate at the end of July and to 2.25 per cent on September 19th.

The Saudi Arabian Monetary Authority (SAMA) kept its official repo rate fixed at 2.0 per cent throughout 2017 and did not follow the US Federal Reserve until March 2018 after which rates were raised in four hikes to reach 3.0 per cent by December 2018. SAMA retained the official repo rate at this level throughout 2019 before lowering it to 2.75 per cent on July 31st in line with the loosening monetary policy in the United States. The Central Bank of Kuwait, in contrast, where the exchange rate of the Kuwaiti dinar is pegged to a basket of currencies, increased its discount rate only twice in the current round of US Federal Reserve tightening on March 15th, 2017 by 25 basis points to 2.75 per cent and on March 21st 2018 to 3.0 per cent, (Figure 1.14).

Equity Prices

Many emerging markets suffered in 2018 as rising interest rates in the United States led to a flight of portfolio investment flows into dollar denominated assets. This was compounded by increased downside risks from the trade tensions arising from United States policies. The Morgan Stanley Emerging Markets Index fell by 18 per cent in 2018 but has recovered by nearly 6 per cent in 2019 to date as the normalization of monetary policy by the Federal Reserve has halted and reversed. The performance of some emerging market equity indices, in contrast, have reflected country specific circumstances, particularly in the case of Argentina where the domestic stock market fell by 6 per cent in 2018 and by 14 per cent in 2019 to-date. The Turkish market declined by over 22 per cent in 2018 as the macroeconomic environment worsened but recovered and has risen by 12 per cent to-date as it has stabilized, (Figure 1.15).

Exchange rates

The US dollar strengthened throughout 2018 on the back of the continuing normalization of interest rates undertaken by the Federal Reserve and the strength of the US economy. The dollar’s value against the Euro rose from
The AE Dirham is pegged to the US dollar at a rate of US$0.27; The US currency against other international trading currencies and regional currencies affect the Emirate’s terms of trade with its partners impacting on the relative cost of Dubai’s imports and exports.
At the beginning of 2018, the US dollar began depreciating against the British pound, starting at £0.74 and continuing to slide to £0.71 by March in the expectation of a smooth departure of the United Kingdom from European Union by the end of March 2019. The rise in the dollar against the value of sterling continued to the end of 2018. The dollar was trading at £0.79, and after a period of volatility resumed to reach £0.80 by September 13th, a further rise of just over 3 per cent.

€0.83 at the start of January 2018 to €0.87 by the end of the year, an appreciation of nearly 5 per cent, thus raising the purchasing power of the AE Dirham throughout the year, but decreasing the international competitiveness of its exports. The dollar’s relative strength continued into 2019 and stood at €0.90 as of September 13th, a further rise of over 3 per cent.

China and Japan collectively contribute over a quarter of Dubai’s imports by value and the value of these exchange rates against the dollar has a major impact on the Emirate’s terms of trade. The value of the Japanese Yen started and ended the year at a similar value in 2018 against the US dollar and the UAE dirham, starting with one dollar to ¥113.06 on January 5th, and ending on ¥110.28 by December 29th. From the start of 2019 the Japanese currency has been volatile, but has generally strengthened against the dollar throughout most of the year 2019 as the Japanese economy’s growth has been greater than expectations and reached ¥108.08 by September 13th.

In contrast, the value of the dollar and the UAE dirham has appreciated strongly against the Chinese currency making imports relatively cheaper for the Emirate in the last three quarters of 2018. Initially, the Chinese currency rose from Yuan 6.48 at the start of 2018 to reach Yuan 6.33 by April 27th, but the start of the trade dispute with the first tariffs imposed by the United States against Chinese imports weakened the Yuan which fell to reach Yuan 6.88 against the dollar by the end of 2018. The Chinese currency continued to depreciate against the dollar throughout 2019 and had reached a level of one dollar to Yuan 7.08 by September 13th, indicating that Dubai’s imports from China were over 9 per cent cheaper since the start of 2018.

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**BOX 1.2**

**The economic consequences of Brexit on Dubai**

**Background**

In June 2016 the UK voted to leave the European Union based on a referendum by 17.41 million votes to 16.14 million. In support of the result the UK invoked Article 50 of the EU treaty in March 2017, which implied an exit on March 29, 2019.

The failure of the UK government to enact a Withdrawal Agreement prior to the discussion of future trading relations that had been negotiated with the EU produced a deadlock in Parliament and the European Union agreed to an extension of the UK’s departure until October 31, 2019. The most objectionable part of the Withdrawal Agreement was the ‘so-called’ backstop which would keep the UK in a customs union with the EU indefinitely in order to avoid a hard border between the Republic of Ireland and Northern Ireland, part of the UK, while a longer-term solution was formulated. A new Prime Minister, Boris Johnson, took power in the summer of 2019 determined to renegotiate a new Withdrawal Agreement without the backstop or take the United Kingdom out of the EU by the October 31 deadline without a deal — a ‘disorderly Brexit’.

There are three possibilities all of which have different implications for the future path of the economies of the UK, the European Union and the world. Scenario One is that the October 31 deadline will be extended again which will have a dampening effect on trade and investment by prolonging a period of uncertainty, or Scenario 2, an agreed deal that will underpin a new relationship between the UK and the EU which could range from maintaining membership to the European Economic Area (EEA) to complying with WTO rules. A deal would involve a trade-off between the UK’s access to EU markets and the degree to which it could unilaterally set regulatory conditions, but most commenters assume a deal would have only a short-term disruptive effect on global trade and growth. The most damaging possibility Scenario 3 is that the UK exits from the European Union without a deal — a so-called ‘disorderly Brexit’ leading to damaging disruptions to trade flows and growth in the UK, the EU and the world.

The impact on of Scenarios One and Two depend mainly on currency effects, while a ‘disorderly Brexit’ in
CHAPTER 1 | Dubai and the Global Economy (in 2018-2019)

Figure 1: Bank of England Updated Scenario for Disorderly Brexit

Source: Bank of England

- No deal, no transition (November 2018): -4.5% to -7.5%
- Updated disorderly: -6%

Figure 2: AED to Sterling and British Pound Effective Exchange Rate (January 2005=100)

Source: Bank of England
contrast, would be more serious given the openness of the Emirate to international trade flows, portfolio investment and FDI patterns. Given the current level of uncertainty it is difficult at present, especially as developments are still unfolding, to predict the choice the UK will opt for and therefore its consequences, let alone assess the precise long-term implications on Dubai.

### Economic Impact

The political divisions in the UK and the fear of a ‘disorderly Brexit’ have kept the value of the British pound at a low level and depressed investment and GDP growth. The Bank of England has modelled in September 2019 that no-deal would lead to fall in the UK’s GDP of just under 6 cent, a rise in unemployment to 7 per cent and as a result of supply problems and a fall in the value of the pound would increase the rate of inflation to 5.5 per cent well above the Bank’s 2 per cent target. This represents an improvement on an earlier scenario modeled in November 2018 showing a maximum fall in GDP of 7.5 per cent because of transition arrangements made to reduce disruption, (Figure 1).

A disorderly Brexit will have negative consequences beyond the UK given its size and trading links. According to the World Bank in 2018 the UK was the world’s fifth largest economy measured by GDP at current exchange rates and In July 2019, the IMF listed a ‘no-deal’ Brexit as one of the main factors that could throw a world economy already vulnerable as result of US-China trade tensions, ‘off-course.’

The most direct effect would be a drop off in import demand in the UK as it resorts to WTO rules which would impact on the EU member countries with which the UK runs a trade deficit particularly Germany and France, but there would also be indirect effects through the disruption of global supply chains. In its April World Economic Outlook the IMF predicted that in a worst case scenario a no-deal Brexit would reduce the UK’s GDP in absolute terms by in the first year after departure by 1.4 per cent and by 0.8 per cent in the second year. A study by the Halle Institute in Germany estimated using World Input-Output Tables that a 25 per cent reduction in UK import demand that the impact through value chains would threaten the jobs of 612,000 people across 43 countries directly with another 433,000 at risk in second-round effects on the companies supplying intermediate inputs.

There are two main channels through which a Brexit shock could be transmitted to Dubai: 1) A direct channel through a weaker British pound and 2) An indirect one through lower global growth prospects which is difficult to estimate.

The value of sterling depreciated against the US dollar and the AED dirham, which is pegged to the American currency, by 17 per cent from May to October 2016 as a result of the referendum and its aftermath. The rate has moved up and down in response to the state of negotiations with the EU and political turmoil in the UK, but sterling has persistently weakened against the AED dirham with some fluctuations from January 2018 onwards, (Figure 2). A disorderly Brexit is likely to have a negative impact on the AED sterling exchange rate, but a deal could lead to some appreciation of sterling.

Bilateral merchandise trade linkages between Dubai and the UK are limited so it is expected that a significant change in the terms of trade between the two countries would have an impact on the services sector. In 2017, Dubai received over 1.2 million visitors from the UK, 8 per cent of the total and the third largest group. One study provided evidence that a decline in the income of an advanced economy (including the UK) by 1 per cent would lead the number of tourists coming to Dubai to decline by 0.8 per cent. Another sector that could suffer is real estate if Dubai property becomes relatively more expensive for British buyers. Data from the Dubai Land Department shows that in 2017 UK nationals were the fourth largest investors in real estate acquiring AED 6 billion of property. However, this impact is likely to be muted by a more neutral effect from British investors who work and reside in the UAE to the extent that they avoid sourcing their income in sterling.

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1.21 In 2018, the emerging market currencies of some countries such as Turkey, India and Iran, which account for a significant portion of Dubai’s exports and re-exports, experienced significant depreciation against the dollar and the AED dirham. Macroeconomic instability in Turkey produced a sharp fall in the value of the Turkish Lira against the dollar and other currencies throughout 2018. The relative value of the AED dirham rose from TL 1.02 at the start of January to TL 1.78 by the end of August before pulling back to TL 1.44 by the end of the year. In 2019, the AED dirham’s value to the Turkish Lira fluctuated in a narrower band, but at TL 1.55 by September 13th Dubai’s exports to Turkey were still 53 per cent more expensive since the start of 2018. The depreciation of the Iranian Riyal against the US dollar and the AED dirham continued into 2018. The relative value of the AED dirham on foreign exchange markets rose from 9,779.7 Iranian Riyal at the start of the year to a peak of 13,277.54 by August 10th, following the decision by the United States to re-impose economic sanctions on Iran several months earlier, an appreciation of almost 36 per cent. The current economic conditions in Iran resulting from sanctions is having a differential impact on official and actual market exchange rates of the Iranian currency. For example, the official rate of the Iranian currency against the dollar stood at the 42,105 Rials (AED 11,463.3) on September 13th 2019, but the online rate offered by the central bank for Iranian traders to convert dollars into domestic currency is around 110,000.

The relative cost of Dubai’s exports to Indian purchasers became more expensive in 2018 as the AED strengthened throughout the year. One AED dirham bought 17.24 rupees at the start of 2017, appreciating to 19.03 rupees by the end of the year, a rise in the value of Dubai’s currency of over 10 per cent. The value of the AED dirham against the Indian currency has fluctuated throughout 2019 and stood at 19.33 rupees by September 13th. In contrast, the value of the AED dirham against the Iraqi Dinar has remained relatively stable throughout 2018 and into 2019. One dirham bought 324.44 Iraqi Dinar at the start of 2018, 322.64 Iraqi Dinar at the end of the year and 323.98 Iraqi Dinar as of September 13th 2019, (Figure 1.17).

1.22 Global GDP and world trade has slowed down in 2019 as a result of the economic impact from tariffs imposed by the United States on China in 2018, which were raised and extended in 2019 and upon the European Union. The IMF predicts that global growth could recover in 2020. Economic expansion in the United States should continue to bolster global output into next year aided by a loosening of monetary policy and a fiscal expansion ahead of the presidential election in 2020. The European Central Bank has also indicated that it will restart its asset purchase program to push down yields across the eurozone. This impetus will partly compensate for economic slowdown in Germany, which could potentially be worsened by a hard
Brexit. However, central bank loosening across the developed world and in China could prove to be counter-productive in effecting competitive devaluations of currencies aimed at combatting any dollar strength.

A recovery in global trade and growth in 2020 could be hit by the downside risk of an intensification of trade tensions in the developed world on top of the negative impact of the lack of a negotiated solution to the trade dispute between the United States and China. The United States has been threatening to impose further tariffs on the European Union, covering a wide range of goods including agricultural products and processed foods for much of 2019. However a decision by the World Trade Organization in September, in favour of the United States on the issue of state subsidies to the airframe manufacturer Airbus, allows the US to collect up to an estimated US$8 billion in damages through punitive tariffs on European imports. The inauguration of a new European Commission could lead to an escalation in the trade dispute and the imposition of retaliatory measures. The extent of any turmoil in trade flows for 2020 is also conditional on the state of future relations between the EU and the United Kingdom and the type of trade deal finally agreed upon.

From a regional prospective, as an open economy Dubai will benefit from a reduction in trade tensions, but would suffer collateral damage if the current disputes are not resolved. A predicted rise in GDP in the oil producing countries that trade with the Emirate — Saudi Arabia and Iraq — is expected in 2019 continuing into 2020. This rise will bolster the demand for Dubai’s output and any steady rise in oil prices will assist in this process. In contrast, too rapid a rise in the price of crude oil would have the opposite effect, depressing the growth rate in India and a recovering Turkey, two important trading partners. The rise would feed through to a further currency depreciation impacting on the terms of trade with Dubai. The rise in oil prices of around 15 per cent in September 2019 is contributing short-term positive effects on demand in many GCC countries after the attack on Saudi Arabia’s Aramco plants. But more seriously, the crisis highlights the serious risks of geopolitical conflict in the region whose economic effects have already been felt in Iran with a sharp downturn in growth and currency depreciation.