

ISLAMIC FINANCIAL MARKETS SET TO ADVANCE WITH GCC AND MALAYSIA LINKAGES

The six-member Gulf Cooperation Council (GCC) and Malaysia are well-positioned to take the initiative to advance Islamic finance. By cooperating on various regulatory aspects, the two leading global Islamic finance hubs are creating new business opportunities that build upon strong existing ties.

As a result, a surge of Shariah-compliant trade and investments is now in progress.

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The GCC and Malaysia’s economic and financial linkages on the rise; Islamic finance sets to benefit

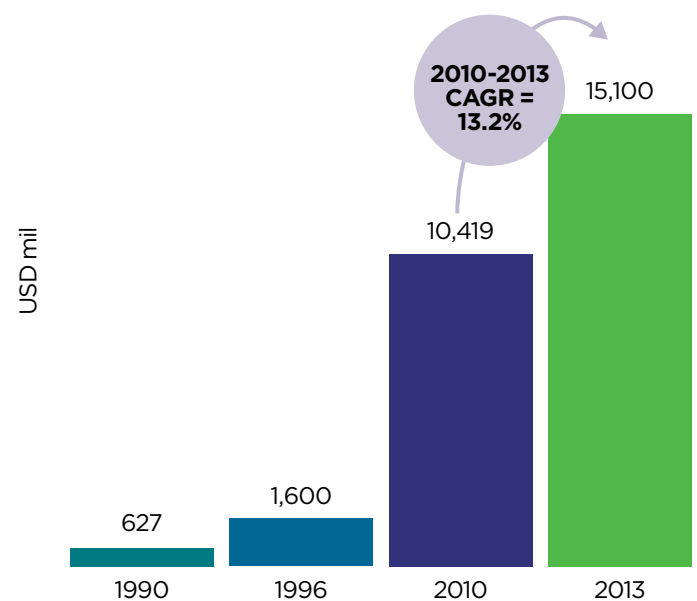
The strengthened economic and financial ties between Malaysia and the Gulf Cooperation Council (GCC) represent a promising opportunity for the global Islamic finance industry to gain traction. Increased trade and investment flows will bring greater forces to contribute towards enhanced Islamic finance integration. Malaysia and the GCC’s annual trade volumes have grown significantly from just USD627million in the 1990 to over USD15bln in 2013¹. This year, landmark cooperation was formed between the Malaysian and Saudi Arabia’s exchanges, expected to pave ways for greater linkages between the two Islamic finance leading markets.

The economic and financial linkages between the two global Islamic finance hubs of Malaysia and the six-member Gulf Cooperation Council² (GCC) have expanded tremendously, with annual trade volumes growing significantly to reach USD15.1bln in 2013³. The growth in the bilateral trade relationship reflects the increasing commercial and diplomatic ties between the GCC and Malaysia over the years. In the last decade, a number of monumental

trade and financial agreements have been signed between the GCC and Malaysia, including bilateral agreements by individual member countries, with a view to enhance the linkages between the jurisdictions. In January 2011, Malaysia and the GCC signed the Framework Agreement on Economic, Commercial, Investment and Technical Cooperation (FAECITC), an agreement allowing both parties to explore and leverage on areas of huge potential available in bilateral trade and investments.

Annual Trade Volume between Malaysia and the GCC (1990-2013)

Source: UN COMTRADE 2014, KFH Research Limited



¹ United Nations Commodity Trade Statistics (UN COMTRADE) 2014

² Saudi Arabia, United Arab Emirates, Qatar, Bahrain, Kuwait and Oman

³ UN COMTRADE 2014

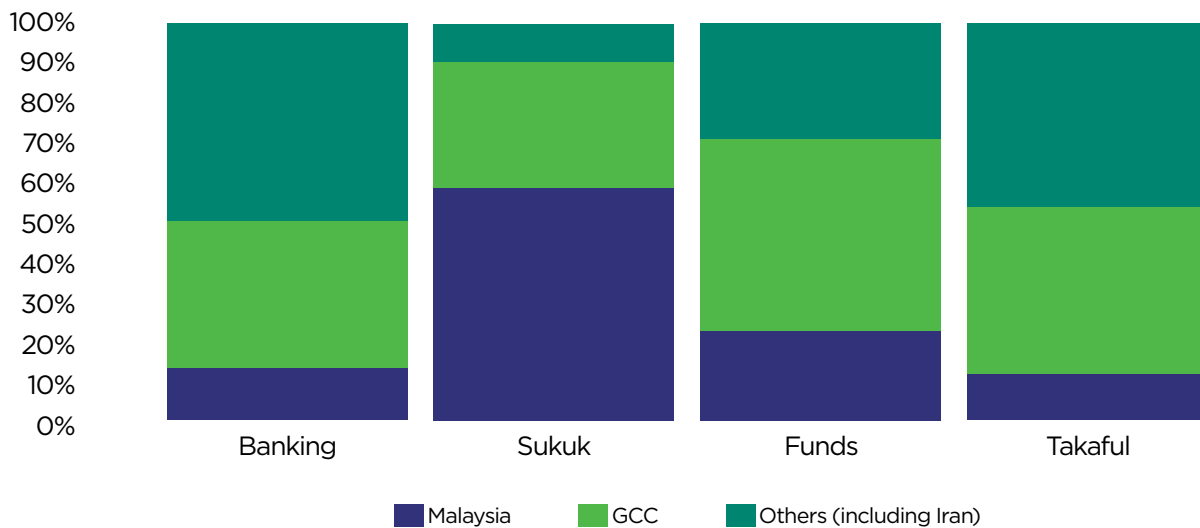
Sustained Leadership

The strong connection and enhanced economic linkages between the GCC and Malaysia are highly beneficial to propel further growth and development of the global Islamic finance industry. The members of the GCC (excluding Oman which only recently ventured into the Islamic finance industry) and Malaysia have consistently featured among the top 10 Islamic finance jurisdictions by assets and are the key drivers of the global Islamic finance industry. As of 2013, these markets (including Oman) accounted for approximately USD1.02tn⁴ or 57% of the global Islamic finance assets.

Given the rapid expansion of Islamic finance in each of these traditional Islamic finance hub markets and including Oman which is recently making great strides in developing its Islamic finance sector, there are tremendous business opportunities for Islamic finance industry players in Malaysia and the GCC, particularly in terms of Islamic banking and capital market sectors as the economic and financial linkages deepens between the two markets.

Islamic Finance Assets Breakdown in the GCC and Malaysia (2013E)

Source: KFH Research Limited



Cross-Border Islamic Finance Business

The Islamic finance cross-border business and financial relationships between the GCC and Malaysia have grown in tandem with the blossoming trade and economic linkages in these two markets. In the Islamic banking sector, a number of GCC banks (including the world’s two largest Islamic banks: Al-Rajhi Bank of Saudi Arabia and Kuwait Finance House of Kuwait) have set up operations in Malaysia,

enhancing the cross transfer of expertise in the Islamic banking business between these markets. In the sukuk sector, a number of GCC firms have tapped into the Malaysian sukuk market by issuing Malaysian ringgit sukuk. Most recently in 2014, the First Gulf Bank of the United Arab Emirates has also announced the proposed issuance of RM3.5bn sukuk and this will contribute towards increasing the

⁴ KFH Research Limited

cross-border Shariah-compliant liquidity flows between these two jurisdictions. Furthermore, the revised screening methodology adopted by the Securities Commission (SC), which is in effect since October 2013, for the Islamic equity markets in Malaysia is likely to attract substantial amounts of investments from the GCC as the new screening methodologies are more aligned with those adopted and preferred by the GCC Shariah scholars.

In addition to the above industry driven linkages, at regulatory level, Bank Negara Malaysia has signed MoUs with four organisations within the GCC member countries namely with the Bahrain Monetary Agency (BMA), Qatar Financial Centre Regulatory Authority (QFCRA), the Central Bank of the

United Arab Emirates (CBUAE) and Dubai Financial Services Authority (DFSA). The Securities Commission Malaysia (SC) and the Dubai Financial Services Authority (DFSA) have also signed a mutual recognition agreement between for the cross-border marketing and distribution of Islamic funds between the two Islamic financial markets.

Most recently, the above is followed by another landmark Memorandum of Understanding (MoU) between Bursa Malaysia and Tadawul, the Saudi Stock Exchange, signed in February 2014. The MoU between the two largest Islamic capital markets (by market capitalisation) intends to formalise a collaboration to develop cross border activities between both exchanges in capital market development.

Bursa Malaysia and Tadawul: Two Islamic capital market leaders join together to boost cross-border Islamic financial markets development

Bursa Malaysia and Tadawul, the stock exchanges of Malaysia and Saudi Arabia have recently entered into a Memorandum of Understanding (MoU) in February 2014 to formalise a collaboration which will set off a series of discussions aimed towards enhancing financial and economic linkages between Malaysia and Saudi Arabia in the domain of Islamic capital markets. The MoU enables both exchanges to share knowledge and expertise while opening doors for skills development and future cross-border opportunities. The collaboration is expected to facilitate cross border development in the Islamic financial markets and to further strengthen the global presence of these two Islamic capital market leaders which will create and provide an environment that will enable global industry players to take advantage of the innovation and expertise that emanate from Malaysia's Islamic finance marketplace. Among others, the MoU aims to pursue various areas of cooperation including product development; cross listing, market data exchange, index creation, corporate governance and other market-led activities. The MoU follows the implementation of the revised Shariah screening methodology by the Securities Commission Malaysia in October 2013 which brings the screening practices in Bursa Malaysia to be in line with the preferences of the GCC Shariah scholars. These two developments are expected to surge cross border investments into the Malaysian Islamic capital markets from the GCC. As at end 2013, Bursa Malaysia's total market capitalisation stands in excess of USD450bln while that of the Saudi Tadawul similarly stands at approximately USD467.4bln.

The MoU between Bursa Malaysia and Tadawul is a landmark step towards enhancing cross-border consolidation between the various Islamic finance jurisdictions. Malaysia and Saudi Arabia are the leading centres of Islamic finance, and as both capital markets come together on a single platform, the global Islamic capital markets are expected to experience increased growth trajectories stemming from the cooperation enhancing Shariah-compliant cross-border liquidity and investment flows.

Opportunities in the Halal Food Business

Another sector which has a natural fit between Malaysia and the GCC region is the multi-billion dollar global halal food business, of which Malaysia is an established market. Statistics released during the World Halal Forum 2013 indicate that the global halal food business is worth approximately USD685bln per year and out of which at least USD83bln is attributable to the GCC countries. The halal food industry is the new growth sector in Malaysia's manufacturing sector and as per latest statistics available, Malaysia's exports of halal products totalled RM35bln, representing nearly 5.1%⁵ of the country's total exports. Islamic finance is heavily involved in the halal food business sector given the need for Shariah-compliant financing and trade financing solutions as mandated by a holistic Shariah system for Islamic commercial business.

“This is a major step towards consolidation in the Islamic finance world. Malaysia and the Middle East are the leading centers of Islamic finance, and as both Exchanges come together on a single platform, this collaboration will add to the strength of this industry thus providing a new dimension to the Islamic market.”

Dato' Tajuddin Atan,

Chief Executive Officer of Bursa Malaysia Berhad

Islamic Trade Financing as a Key Growth Area

The growing trade links between Malaysia and the GCC represents strong opportunities for Islamic finance in general and Islamic trade financing in particular to expand given the

strong proliferation of the Islamic financial sectors in these countries. According to statistics from the World Trade Organisation's Annual Report in 2012, approximately 90% of the global trade is supported by trade financing. Malaysia's trade with the GCC has expanded at a compounded annual growth rate of 13.24% in the last four years. A free-trade agreement is also in negotiation between the two markets. The volume of trade currently stands in excess of USD15bln. Given that the GCC and Malaysia are among the top 10 Islamic finance markets globally, the Islamic finance players have tremendous opportunities to support the ever-expanding trade between these markets with Shariah-compliant financial solutions.

Opportunities for Islamic Portfolio and Real Investments

Increased investment flows between Malaysia and the GCC is beneficial for the expansion of Islamic capital market instruments and syndicated financing in these jurisdictions. For instance, Saudi Arabian investors channelled almost USD733mln⁶ in investments into Malaysia in 2012, making the country as one of the top foreign investors in Malaysia. Recently in March 2013, the Abu Dhabi Government of the UAE has agreed to set up a USD6.76bln⁷ storage facility for crude oil in Johor, the southern state of Malaysia. Similarly, portfolio investments agreements have also taken place in the past, for example in 2010 between the Qatar Investment Authority (QIA) and 1Malaysia Development Berhad, a government-owned strategic development company, with the QIA seeking up to USD5bln in investments⁸. Given that Islamic finance is fast gaining tractions in these markets, the industry players have opportunities to tap the growing financial linkages between these two markets with Shariah-compliant solutions.

⁵ MIDA (2012)

⁶ Gulf Investment Corporation (2013)

⁷ Reuters

⁸ 1MDB

Conclusion

The GCC and Malaysia are the leading Islamic finance markets in the world. The fast expanding bilateral ties between the two jurisdictions represents a promising opportunity for the global Islamic finance industry to gain traction. Increased cross-border activities, enhanced collaborations and fostering mutual linkages encourage transfer of knowledge and innovation between the various Islamic finance jurisdictions. It is often regarded that Islamic financial hubs lack consolidation amongst them leading to differing legislations and rules when it comes to Islamic finance. However, differing views are no longer issues that will limit the process of financial integration between these two key Islamic finance markets. Various efforts have been undertaken to encourage mutual understanding on market practices and cross border activities and ventures have further

facilitated this process. More importantly, enhancement to legislation and regulatory frameworks by regulatory bodies and with the roles played by the Islamic Financial Services Board (IFSB) and other institutions at global level have been able to minimise issues of lack of standardisation and harmonisation. The MoU between Bursa Malaysia and Saudi Tadawul is also one of the promising steps intending to increase cooperation and consolidation between the two Islamic capital market leaders. The progress that the GCC member countries and Malaysian bilateral trade and financial relationships have made represents tremendous opportunities for the Islamic finance industry players to benefit from across all sectors including banking, capital markets, takaful and the halal food business.

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