

# GLOBAL PRIMARY SUKUK MARKET OUTPERFORMS IN 1H2014

Global Primary Sukuk issuances have soared in 1H2014, with some notable events adding new opportunities to the sukuk marketplace. The world's first takaful sukuk and one of the very few real estate and investment trust (REIT) sukuk have demonstrated that innovation is thriving. The corporate sukuk sector recorded a tremendous revival with 66% quarter-on-quarter increase in volume; but perhaps the most notable highlight during 2Q14 was the debut of the United Kingdom in the sovereign sukuk market. In total sukuk were issued in 13 currencies during the first half of 2014, which shows great promise of things to come.

**24 July 2014**

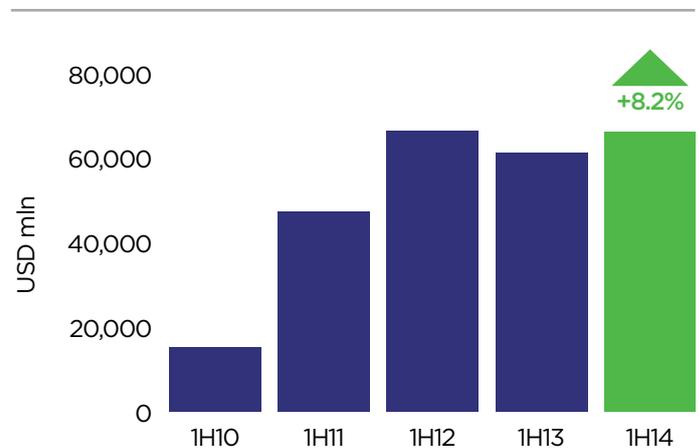
## Global Primary Sukuk Market Outperforms in 1H2014

A surge in new issuances worth USD35.1bln during 2Q14 (1Q14: USD31.1bln) has enabled the primary market volume to reach USD66.2bln in six months ended 30th June 2014. This volume for 1H2014 is 8.2% higher than the USD61.2bln volume in 1H2013. The market has been spearheaded by increased volume of issuances in the traditional sukuk markets of Malaysia, Saudi Arabia, the United Arab Emirates and Turkey. Overall, the global sukuk outstanding has expanded by 6.3% in the first half of 2014, amounting to USD286.4bln (end-2013: USD269.4bln).

The global primary sukuk market experienced a late rally in new issuances during the 2Q14 as issuers overwhelmingly tapped the market ahead of the Islamic month of Ramadan which officially began on the 29th of June. 2Q14 has produced a total new sukuk issuances volume of approximately USD35.1bln (1Q14: USD31.1bln; 2Q13: USD26.7bln), which enables it to become the third most performing quarter over the last two years since 2Q12. Overall, 1H2014's volume of USD66.2bln has outperformed the same period last year by 8.2% (1H2013: USD61.2bln) while nearly equalling 2012's record first half annual issuances volume of USD66.4bln. The volumes in both 1Q and 2Q in 2014, in turn, have exceeded the quarterly average new sukuk issuances volume of USD30.7bln since 2Q12 (See charts on the right).

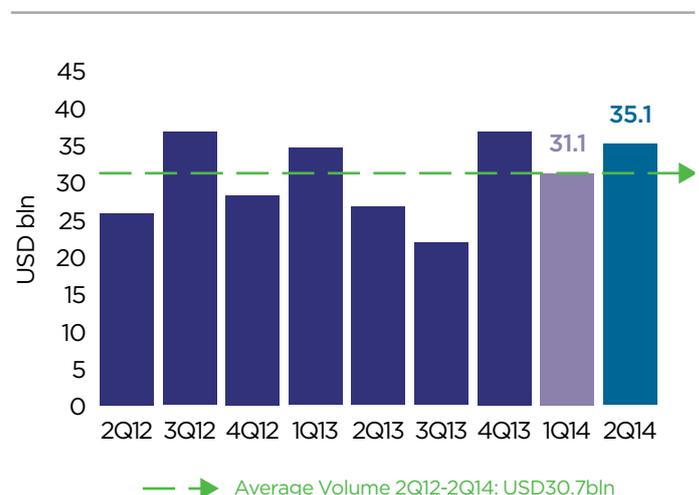
### Global Half-Yearly Sukuk Issuance Trend (1H2010-1H2014)

Source: KFH Research Limited



### Global Quarterly Sukuk Issuance Trend (2Q12-2Q14)

Source: KFH Research Limited



The volume in 2Q14 has been spearheaded by a surge in sukuk issuances in the traditional Islamic finance hubs of the Gulf Cooperation Council (GCC) and Malaysia. The Malaysian primary market issuances increased to USD41.7bln in 1H2014 (1H2013: USD41.5bln), adding USD22.1bln in the 2Q14 (1Q14: USD19.6bln). By market share, Malaysia continues to be the leading jurisdiction accounting for 63% of the total global new sukuk issuances in 1H2014.

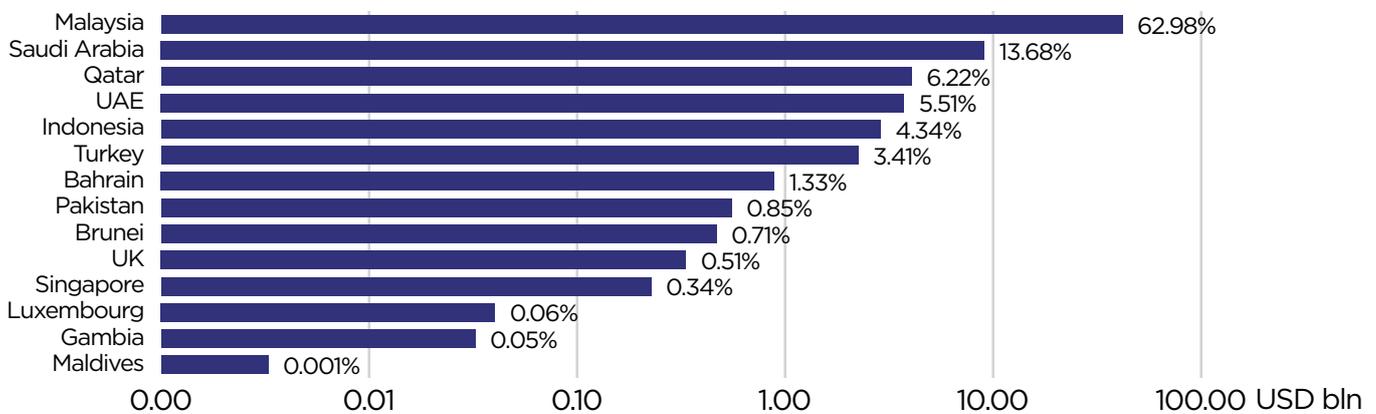
A total of 244 sukuk tranches were issued in 1H2014 by a wide range of corporate and non-corporate issuers in the Malaysian market. During the 2Q14, the world's first takaful sukuk was issued as Malaysia's largest takaful operator (in terms of contributions) tapped the primary market with an issuance worth MYR300mln. In addition, Malaysia's AAA-rated entity KLCC REIT, issued one of the very few real estate and investment trust (REIT) sukuk raising MYR1.55bln through four tranches of different sizes, tenures and maturities.

The GCC market also witnessed a substantial increase with nearly USD10bln of new issuances in the 2Q14 (1Q14: USD7.8bln) as per KFH Research's Global Sukuk Report 1H2014. The report states that following a surge in 2Q14's issuances, the GCC sukuk market now accounts for 26.7% or USD17.7bln of the total global new sukuk issuances in 1H2014 (1H2013: 23% or USD14.1bln). Nearly all the momentum in the region originated from the Saudi Arabia and the United Arab Emirates markets. Saudi sukuk issuers raised more than USD5bln in proceeds during the 2Q14, shoring up Saudi 1H2014 issuances volume to over USD9.05bln (1H2013: USD7.48bln)<sup>1</sup>. Similarly, the United Arab Emirates issuances contributed USD3.35bln in the 2Q14, taking the 1H2014's total value to USD3.65bln (1H2013: USD5.17bln)<sup>2</sup>.

In Turkey, sukuk issuances by three out of the four Turkish participation banks added almost USD1.6bln in Turkish issuances during 2Q14 (1Q: USD658mln). Notably, one of these sukuk were issued in Malaysian Ringgits. On

**Global New Sukuk Issuances by Domicile and Share\* (1H2014, USD bln)**

Source: KFH Research Limited



\*Numbers in percentage indicate share of total issuances for each domicile (based on obligors' domicile)

<sup>1</sup> KFH Research Limited: Global Sukuk Report 1H2014

<sup>2</sup> ibid

30th June, a Turkish participation bank raised MYR800mln through a 5-year sukuk structured on a murabahah contract. Overall, as of 1H2014, Turkish originated sukuk accounted for 3.41% or USD2.26bln of the global new issuances this year (1H2013: 2.95% or USD1.81bln)<sup>3</sup>.

Finally, a notable limelight during the 2Q14 was the debut of the United Kingdom in the sovereign sukuk market. United Kingdom has become the world's first non-Organisation of Islamic Cooperation (OIC) country to issue sovereign sukuk, ahead of the likes of Luxembourg, South Africa and Hong Kong. The British Treasury issued the GBP200mln (USD339.5mln) instrument on the 25th of June and the programme received a very strong demand with order books totalling upto GBP2.3bln. This translates into an oversubscription by almost 12 times. The issue

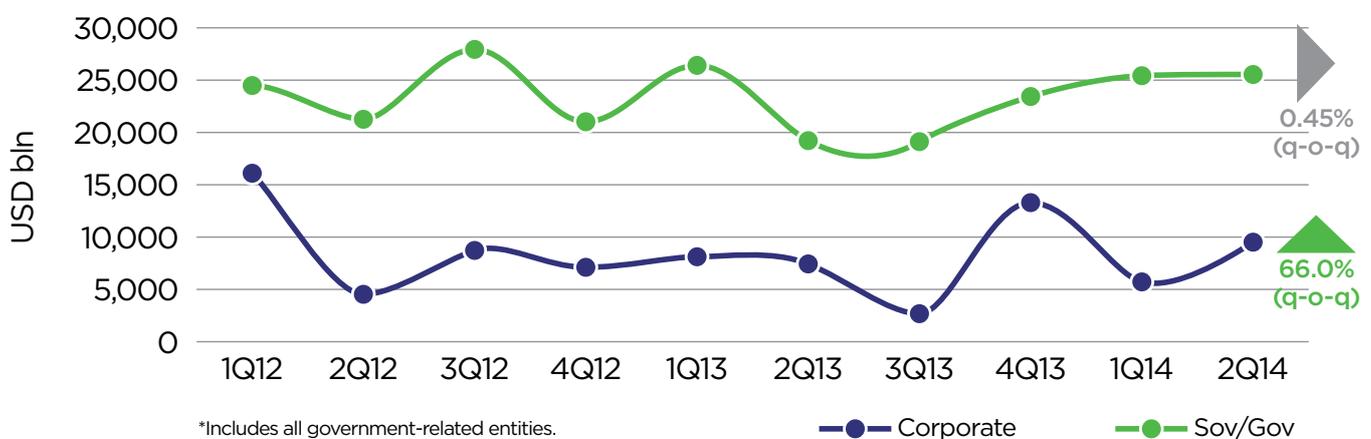
attracted diverse investors' interest including sovereign wealth funds, central banks and domestic and international financial institutions. The geographic allocations of the programme were as follows: United Kingdom (39%); Middle East (37%); and Asia (24%).

### Corporate sukuk sector revives in 2Q14

In terms of the type of issuers in the primary market, the corporate sukuk sector recorded a tremendous 66% quarter-on-quarter (q-o-q) increase in volume with USD9.5bln worth of issuances in the 2Q14 which compares with the subdued USD5.7bln volume in the 1Q14. On the other hand, the sovereign sector remained almost unchanged in the 2Q14 with a USD25.4bln volume, which is a minor 0.45% increase compared to the 1Q14's USD24.4bln volume (see following chart).

Sukuk Issuances by Issuer Type (1Q12 to 2Q14)

Source: KFH Research Limited



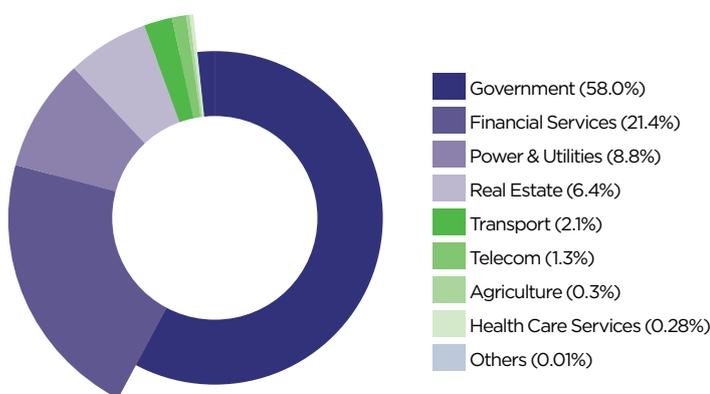
The growth in the corporate sukuk sector during 2Q14 was substantially contributed by issuers originating from Saudi Arabia, the United Arab Emirates and Turkey. Particularly in the month of June, these three markets alone issued USD4.4bln worth of corporate sukuk. The timing of these corporate issuances are in line with the beginning of the Islamic month of Ramadan which formally begun on 29th June during which sukuk market activity has traditionally been observed to remain subdued. During the 2Q14, the share of corporate sukuk in total issuances increased to 27.1% vs 18.4% in 1Q14 . Overall, in 1H2014, the share of corporate sukuk equalled USD15.2bln or 23% of the market (1H2013: USD15.6bln or 25.4%) while the sovereign and government-related entity sukuk amounted to USD50.97bln or 77% share of the market (1H2013: USD45.6bln or 74.6%) .

In terms of sukuk issuances by sector, 2Q14 remained largely consistent with historical trends where the government sector (2Q14: 56.7% market share; 1Q14: 59.5%) and the

financial services sector (2Q14: 19.5% market share; 1Q14: 23.5%) accounted for bulk of the sukuk issued. A notable inclusion among the 2Q14 issuances was a retail industry sukuk worth SAR500mln (USD133.3mln) which was issued by a large fashion retailer in Saudi Arabia. Overall in 1H2014, government issuers accounted for USD38.4bln or 58% of the total new sukuk issuances (2013: 62%) while the financial services sector accounted for USD14.2bln or 21.4% of the market (2013: 10%). The share of the financial services sector has dramatically increased in 1H2014 which is underpinned by the growing trend where Islamic financial institutions have begun to tap the sukuk market. Islamic banks need to raise capitalisation funds in order to comply with the Basel III standards of best practices that are being gradually implemented in most jurisdictions globally. Another notable sector in 1H2014 was the power and utility industry which accounted for USD5.8bln or 8.8% market share (2013: 9.4%).

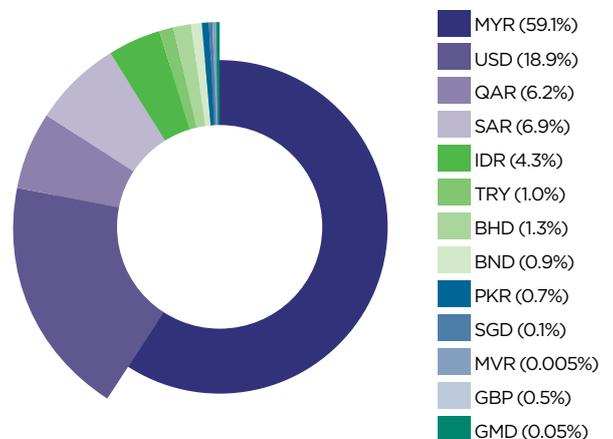
**Sukuk Issuance by Sector (1H2014)**

Source: KFH Research Limited



**Sukuk Issuance by Currency (1H2014)**

Source: KFH Research Limited



<sup>4</sup> KFH Research Limited: Global Sukuk Report 1H2014

<sup>5</sup> ibid

Analysing the currencies of sukuk, a total of 13 currencies have been utilised in 1H2014 with the only addition of GBP in 2Q14 on account of the United Kingdom sovereign sukuk. GBP becomes the 13th currency in 2Q14 vs 12 currencies in 1Q14. During 2Q14, issuances have largely been local currency based with a notable exception in the United Arab Emirates and Turkey where sukuk have been denominated in US Dollars and, in the case of one Turkish sukuk issued in Malaysia, in Malaysian Ringgit. Overall, the Malaysian Ringgit accounted for bulk of the issuances, representing 59.1% of the total market in 1H2014 (2013: 67.1%)<sup>6</sup>. The US Dollars was the second most widely utilised currency accounting for a 18.9% share of the market in 1H2014 [2013: 15.02%]<sup>7</sup>. The increased share for the US dollar sukuk draws upon the increased preferences by issuers in the GCC and now in Turkey for such currency instruments. Moreover, US dollar sukuk issuances by multilaterals such as the Islamic Development Bank and the International Islamic Liquidity Management Corporation have also helped in shoring up the US dollar sukuk share.

Among the other notable currencies include QAR with a 6.2% share (2013: 1.0%), spearheaded by large chunks of Qatar Central Bank's local currency sukuk. SAR had a 6.9% share (2013: 9.1%) on the back of local currency

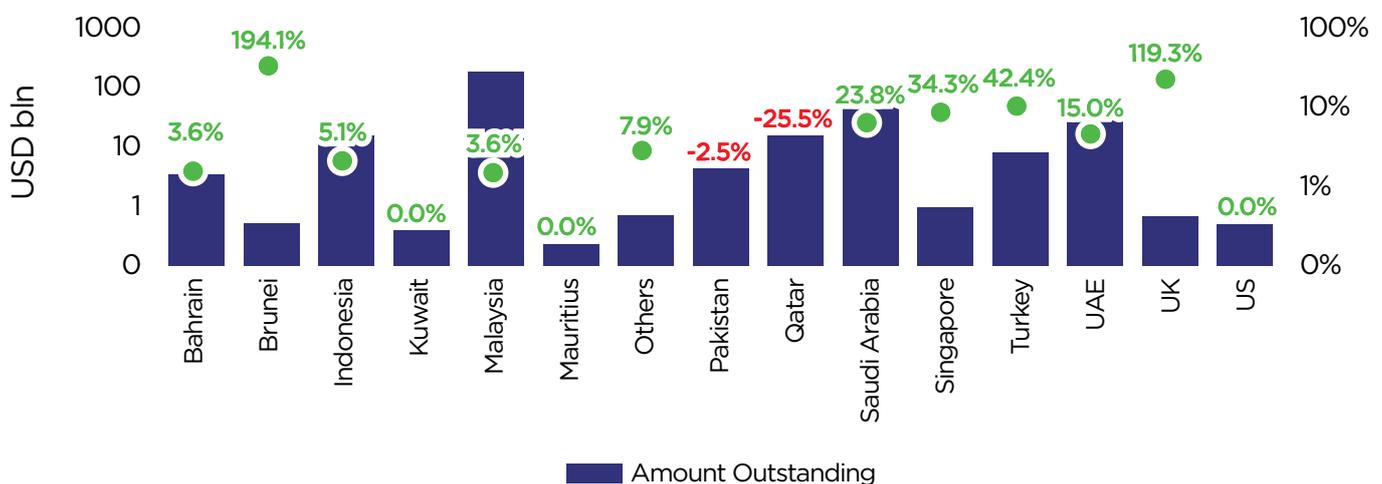
issuances by Saudi corporates and government-related entities; IDR 4.3% (2013: 3.4%) stemming from the Indonesian Ministry of Finance Ijarah sukuk instruments; TRY at 1.0% share [2013: 1.6%] spurred mainly by a TRY1.33bln Turkish Sovereign Sukuk in February; and also BHD 1.3% [2013: 1.4%] driven by the Central Bank of Bahrain's regular supply of short-term liquidity management Sukuk al-Salam. The rest of the currencies including PKR, SGD, BND, MVR, GBP and GMD had lower than 1% shares.

**Malaysia continues leading the Global Sukuk Outstanding**

Overall, the global sukuk outstanding market reached USD286.41bln as at 1H2014, a 6.3% expansion YTD from the USD269.4bln as at end-2013 and a 16.8% growth y-o-y since 1H2013. The outstanding volume has accelerated in the 2Q14, following a modest 1.3% growth in 1Q14. Malaysia continues to stand out as the only sukuk market with global outstanding above USD100bln. As at 1H2014, Malaysian outstanding sukuk amounted to almost USD164bln, a 4% increase compared to the USD158.3bln outstanding as at end-2013. In contrast, the outstanding volume in the second largest sukuk market of the GCC totalled USD92.9bln in 1H2014, a 9% increase in value compared to the USD85.3bln outstanding as at end-2013.

**Sukuk Outstanding (as at 1H2014) and y-o-y Growth by Domicile**

Source: KFH Research Limited



<sup>6</sup> KFH Research Limited: Global Sukuk Report 1H2014

<sup>7</sup> ibid

In terms of returns on sukuk instruments, yields in most markets had generally become volatile towards the end of 2Q14 on account of expectations that developed market interest rates could increase sooner than previously anticipated. Particularly, yields on USD sukuk instruments had sharply experienced increases in the first two weeks of June, ahead of the US Federal Reserve's Federal Open Market Committee (FOMC) meeting held on the 17th and 18th of the month. For example, USD sukuk yields across the main markets in the GCC, Malaysia and Turkey had increased by a sample range of 3.9bps to as high as 10.5bps on selected sovereign instruments between the 1st of June and 18th June. However, yields have since then begun to ease as in the post FOMC-meeting conference, US Federal Reserve's Chairwoman Janet Yellen assured the market and suggested that a rise in interest rates will happen a 'considerable' time after US tapering concludes by the end of this year.

Overall, yields on sukuk instruments have generally eased in 2014 YTD providing capital gains to investors holding such instruments. For example, yields on the 5-year Dubai Department of Finance Sukuk maturing May 2017 eased by 131.6bps in 1H2014<sup>8</sup>. In the largest sukuk market of Malaysia, yield trends have varied between sovereign and corporate sukuk. In 1H2014, yields on the Malaysia 5-Year Sovereign Benchmark Sukuk have eased by 7.2bps while in contrast, the yields on the benchmark AAA-rated 5 year corporate sukuk have climbed by 22bps<sup>9</sup>. In Turkey, where sukuk yields had sharply climbed earlier on account of emerging markets funds outflow crisis, yield on the Turkish Lira Sovereign Sukuk Hazine 10/14 decreased by 63bps in 1H2014, after having increased by a significant 393bps y-o-y to close at 9.48% as at 31st March 2014<sup>10</sup>. In summary, markets have generally reflected upon the macroeconomic fundamentals and characteristics of the issuing economies when pricing sukuk instruments.

### Future Outlook

Despite economic uncertainties and other challenges afflicting the global financial system at the start of this year, issuers have overwhelmingly tapped the sukuk sector to raise liquidity, enabling the global primary market to outperform itself in 1H2014 as compared to the first half of last year. The issuances have not been restricted in OIC countries alone and obligors' based in the likes of Singapore, Luxembourg and most recently the British Government have also tapped the market in 1H2014. The international multilateral bodies including the World Bank, the Asian Development Bank and the African Development Bank have also renewed their commitments to Islamic finance this year and have ventured into exploring sukuk as options to narrow global funding gaps. A number of efforts are being directed towards enabling sukuk to serve as viable tools for meeting global liquidity needs - for example, to support Africa's infrastructural development needs. The number of sectors utilising sukuk has also grown and during 1H2014, the world's first takaful sukuk was issued in May.

Moving forward, the overall tremendous performance of the global sukuk market in 1H2014 has reinforced expectations that the annual new issuances volume this year is likely to surpass last year's USD119.7bln volume. Supporting these expectations are the rapid expansions in the global sukuk market horizons. To date, at least 29 jurisdictions have tapped the sukuk market (excluding offshore domiciles) and more are expected to follow suit following United Kingdom's highly successful sovereign sukuk programme. In the near future, sovereign issuances are imminent from more non-OIC countries including Luxembourg and Hong Kong.

In conclusion, in spite of various macroeconomic challenges and uncertain financial conditions at the start of this year, global primary sukuk market in 1H2014 has outperformed the previous year.

<sup>8</sup> Bloomberg, KFH Research Limited

<sup>9</sup> ibid

<sup>10</sup> Bloomberg, KFH Research Limited

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