

STANDPOINT COMMENTARY

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Global Sukuk Outlook 2015

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2015 - USD100 billion-USD120 billion of global sukuk issuances

RAM Ratings anticipates new global sukuk issuance to remain fairly resilient in 2015, at around USD100 billion–USD120 billion (2014: USD116.23 billion; source: Zawya), despite the challenging environment for Malaysia and the GCC amid the steep fall in global oil prices since last year. GCC sukuk issuers that typically tap the international markets could well delay their plans to the second half of 2015, until the full impact of soft oil prices and the possible effects on their credit standing can be digested by potential investors. Geopolitical risks in the GCC, Europe's quantitative-easing programme and the much-touted rate increase by the US Federal Reserve this year have compounded the uncertainties for GCC sukuk issuers and their potential investors.

Although ringgit-denominated sukuk issuance was rather slow off the block this year, issues from the infrastructure sector and financial institutions as well some supply of Islamic securities from Bank Negara Malaysia are expected to keep Malaysia in the lead, with about 60-70% of the global sukuk market's issuances. The stability of the sukuk market is also underpinned by sturdy demand from Islamic and conventional ringgit-mandated domestic institutional funds as well as Malaysian-domiciled Islamic banks that are less likely to be perturbed by external shocks.

Momentum strong, but still long road ahead for sukuk

Sukuk has gained tremendous global traction in the last several years, with Malaysia spearheading the way. At the same time, the GCC has also been gaining ground while sukuk from non-OIC countries such as the United Kingdom, Luxembourg, South Africa and Hong Kong have added to the momentum. Putting things in perspective, however, the global sukuk market is valued at USD312.3 billion,¹ or approximately only 0.35% of the USD90 trillion² global bond market.

1 Source: Thomson Reuters: Page 6, Sukuk Perceptions and Forecast 2015 Report

2 Source: June 2014 figure extracted from the :BIS Quarterly Review: December 2014

[Table 18: All maturities, amounts outstanding, by sector and residence of issuer Total debt securities - all issuers]

[http://www.bis.org/statistics/r_qa1412_hanx18.pdf]

Issues involving *Sharia* interpretation, the standardisation of documentation, tax treatment and the still-developing legal and regulatory frameworks to support sukuk in different jurisdictions form part of the slew of hurdles that global issuers and investors alike have to contend with, when deciding between sukuk and conventional bonds. These factors tend to segmentalise the global sukuk market and limit the pace of cross-border issuance.

The formula for the acceleration of the global sukuk market has already been proven in the Malaysian sukuk and bond market, which accounts for some 60-70% of the world's sukuk. The Malaysian sukuk market has also played host to many well-known GCC-based issuers, which have been raising ringgit-denominated sukuk since 2008. This underlines how regulatory drive as well as a supportive legal and tax environment in a particular market can foster cross-border sukuk growth.

2014 - year of non-OIC sovereign sukuk issues

In 2014, global sukuk issuance³ eased to USD116.23 billion (2013: USD118.31 billion). We note that global sukuk issuance has indeed been declining since 2012. However, issuance in Malaysia normalised in 2013 and 2014, after a bumper year in 2012 - mainly fuelled by highway concessionaire Projek Lebuhraya Usahasama Berhad's sukuk.

Compared to new sukuk issuance from Malaysia and the GCC, both of which decelerated in 2014, those from other regions charted an uptrend last year. This is attributable to the debut of non-OIC sovereign sukuk issues. Sovereign and quasi-sovereign issuers represented a combined 78% of the issued sukuk in 2014. Among last year's sovereign issuers, Bank Negara Malaysia – through its Notes-i⁴ - accounted for a typically large component with about USD40 billion.⁵

In terms of sectors (excluding government institutions), financial services, power & utilities and transportation constituted the bulk of last year's global issues. These sectors were also the main sukuk issuers in Malaysia. At the same time, the issuance of sukuk from the financial-services sector was boosted by BASEL III sukuk in both Malaysia and within the GCC.

More important to focus on long-term development

Building a sizeable and sustainable global sukuk market that appeals to a broader base of investors and issuers beyond the OIC nations is imperative. Analysing what has worked in Malaysia and rapidly adapting it elsewhere could be a first step in the right direction.

More importantly, creating further demand for sukuk by reallocating a significant portion of the GCC's and other OIC nations' sovereign wealth funds into sukuk from Asia, Europe, the US and other non-OIC nations could be a tipping point. Issuers from non-OIC nations that typically do not opt for sukuk could then be more convinced to explore this route to gain funding diversity, once these sovereign wealth funds reallocate.

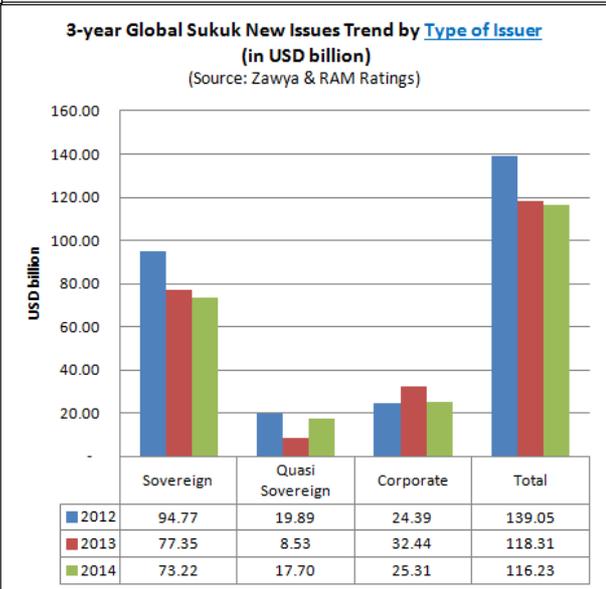
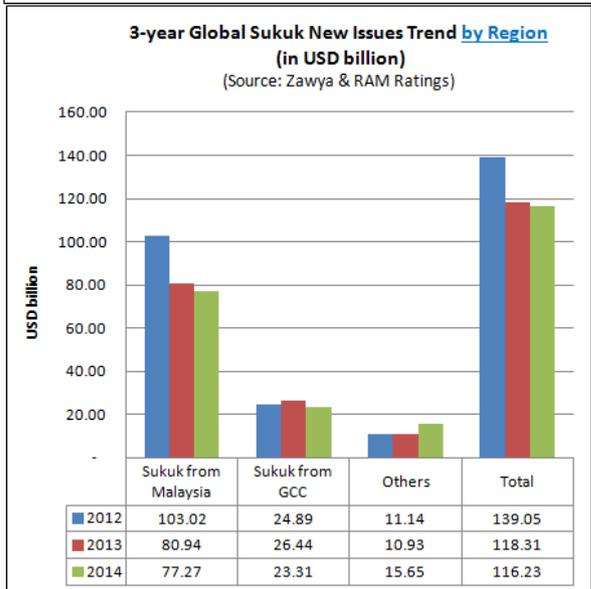
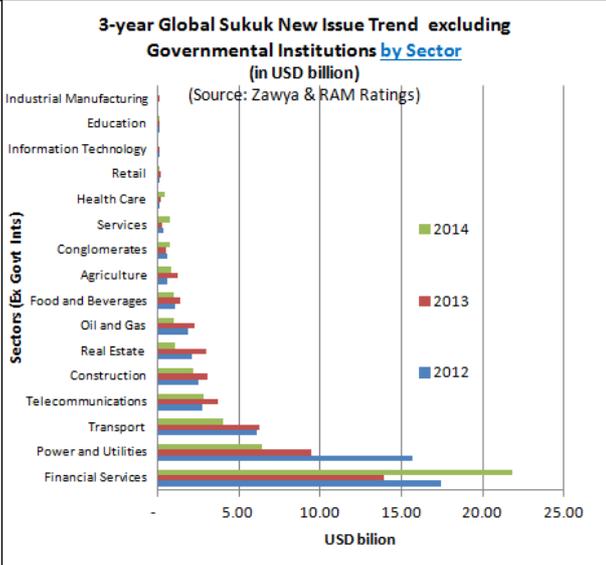
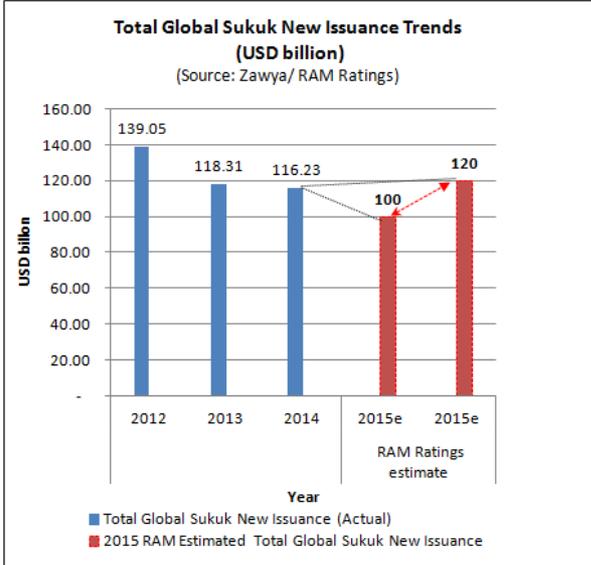
All said, the transaction requirements, funding and other related costs for sukuk must be comparable to those of conventional bonds. This commercial equilibrium between sukuk and conventional bonds, if achieved, will give sukuk the staying power to eventually evolve into a mainstream global financial instrument.

³ Source: Zawya

⁴ Islamic securities issued by Bank Negara Malaysia for purposes of managing liquidity in the Islamic financial market

⁵ Source: BPAM (approximated value converted from Ringgit)

APPENDIX :GLOBAL SUKUK DASHBOARD



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