



GLOBAL SUKUK REPORT 1Q 2015

Since reaching new heights over the past few years, global sukuk issuances for the 1Q15 declined to USD18.7bln from USD24.2bln in 4Q14. As the global sukuk market is closely tied to sentiment in the global economic and financial sector and, as most sukuk issuing countries are among the world's leading oil producers, the decline in oil prices has been a notable factor effecting the sukuk market. Concerns on exchange rate volatility in emerging markets has been another key market driver in 1Q2015. However, this decline in sukuk issuances is likely to be temporary as growth drivers for the sukuk market remain intact, continuing to attract cross-border issuances, issuances from supra-national organisations, sovereign entities and corporate issuers tapping the market for capital expansion and working capital needs. Sukuk are expected to maintain its status as a viable and competitive source of funding.

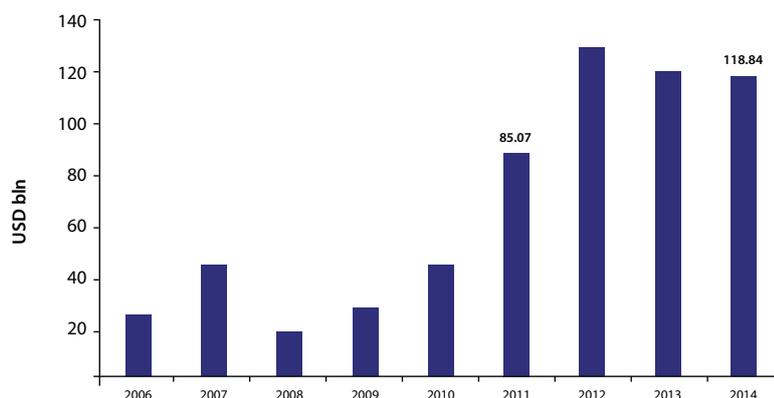
MALAYSIA
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MARKETPLACE

Global economic uncertainties weighed on the sukuk market in 1Q2015

In the past few years, the global sukuk market had witnessed solid growth, as annual issuances almost tripled from USD45bln in 2011 to USD118.8bln in 2014¹. Of significance, growth was driven by both the key markets of Malaysia, Saudi Arabia and the United Arab Emirates (UAE), as well as emerging

frontiers such as Turkey and Indonesia. More recently in 2014, landmark issuances were recorded from the UK, Hong Kong, Senegal, South Africa and Luxembourg – cementing the sukuk market’s status as a viable and competitive source of funding.

Annual Sukuk Issuances



Source: ISRA, IFIS, Zawya, Bloomberg

In addition, a few positive trends emerged in the past year, signalling more cross-border activity in the sukuk market. The market had witnessed increased issuances in foreign currency sukuk, especially in USD; while Malaysia attracted issuances from other domiciles such as Singapore and Turkey. Apart from issuances, sukuk listings also pointed to more cross-border activity as issuers increased listings on key stock exchanges particularly in Europe – namely the London Stock Exchange, Irish

Stock Exchange and Luxembourg Stock Exchange². Another notable trend in 2013 to 2014 were the issuances of sukuk which to support Islamic financial institutions’ compliance with Basel III liquidity and capital requirements³.

Overall, the sukuk market had reached new heights over the past few years, accompanied by a wider issuer base, more cross-border activity and more innovative issuances.

¹ ISRA estimates

² IFIS

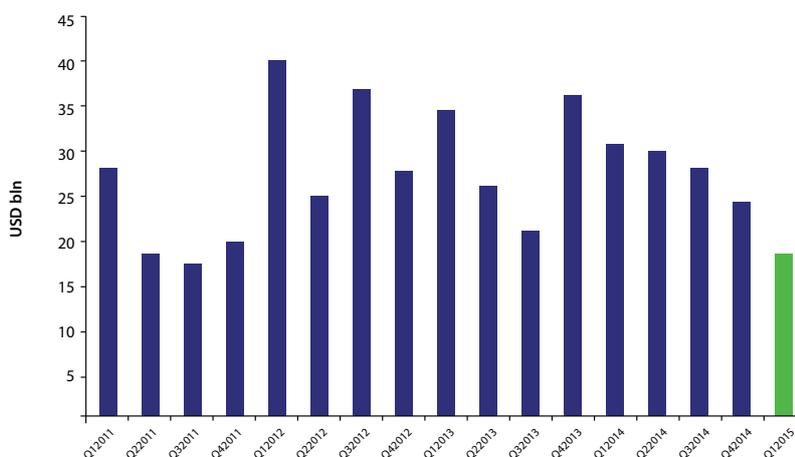
³ ISRA

2015: An environment of heightened uncertainty in the global economy has affected the sukuk market

As seen in the past, activity in the global sukuk market is closely tied to sentiment on global economic and financial sector. A notable factor for the sukuk market is the decline in oil prices, from around USD115 per barrel in June 2014 to an average of USD80 per barrel in 4Q2014 and USD58 per barrel in 1Q2015⁴. Overall, lower oil prices are positive for the global economy, especially for advanced economies⁵ which are predominantly oil importers. These economies will benefit from lower inflation and better consumer sentiment.

Nevertheless, economic prospects for oil producing countries remain subdued in the near future, as these economies adjust to lower oil prices and lower export earnings, amongst others. As such, sukuk issuances, which are dominated mainly by oil exporting countries, have been affected in the 1Q2015⁶. Other key market drivers in the 1Q2015 include concerns on exchange rate volatility in emerging markets, which continued to be affected by expectations on growth and monetary policy⁷. Global sukuk issuances for the quarter declined to USD18.7bln from USD24.2bln in 4Q14. Comparatively, the average quarterly issuances recorded over the last two years was USD29.8bln.

Quarterly Sukuk Issuances



Source: ISRA database, IFIS, Zawya, Bloomberg

The sukuk issuer profile in 1Q2015 remained broadly similar to historical trends⁸, with Malaysia, the UAE and Indonesia leading issuances for the quarter. Issuances from Malaysia accounted for a sizeable 42.3% of total issuances, while the UAE and Indonesia accounted for 18.2% and 14.1% share, respectively. Meanwhile, Bahrain recorded a notable rise in sukuk issuances at USD2.6bln for the quarter (full-year 2014: USD2.4bln), supported by several

large, long-term sukuk issued by the Central Bank of Bahrain (CBB). These sukuk were supported by robust demand and were oversubscribed⁹. A newcomer to the sukuk market is Central Bank of Bangladesh, which began issuing short-term sukuk for liquidity management – a positive step for this Islamic finance domain with a population of 156.6mln people¹⁰.

⁴ Bloomberg

⁵ IMF World Economic Outlook (April 2015)

⁶ Issuances from the top three sukuk issuers (Malaysia, Saudi Arabia and the UAE) declined in 1Q2015. Source: Data from IFIS, Bloomberg and Zawya.

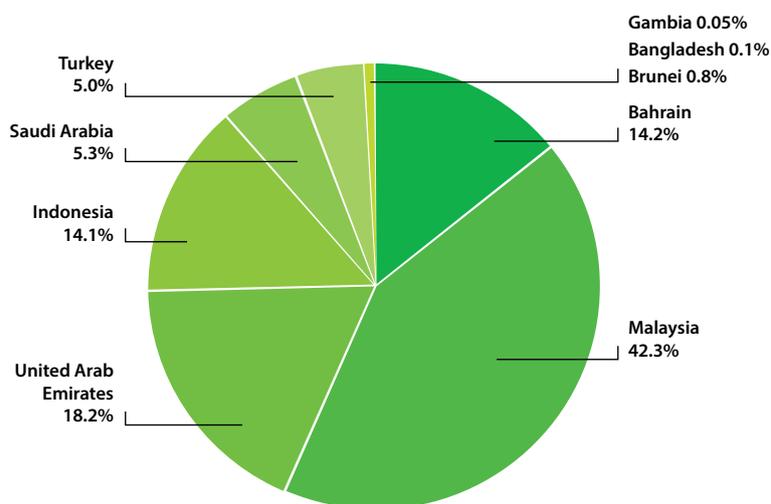
⁷ IMF World Economic Outlook (April 2015)

⁸ ISRA

⁹ Zawya

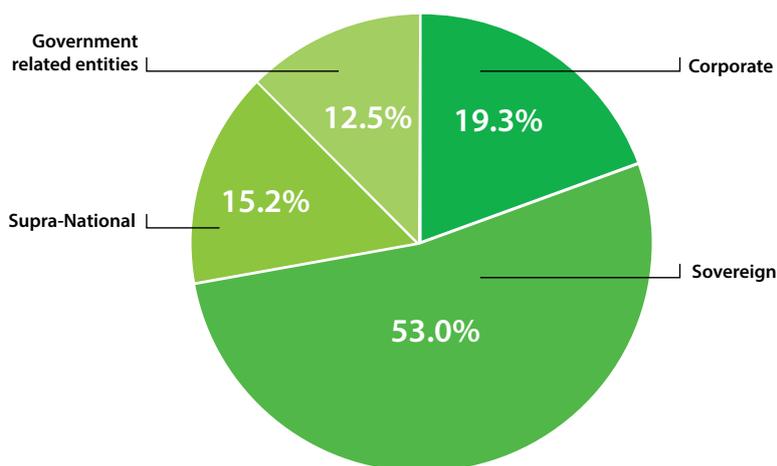
¹⁰ World Bank, US Census Bureau (2013 estimate)

Sukuk Issuances by Country (1Q2015)



Source: ISRA, IFIS, Zawya, Bloomberg

Sukuk Issuances by Issuer Type (1Q2015)



Source: ISRA database, IFIS, Zawya, Bloomberg

Overall, sovereign issuers dominated the market¹¹, accounting for more than half of total issuances, while supra-national bodies such as the Islamic Development Bank (IDB) and the Islamic Liquidity Management Corporation (ILM) also led the market with a few large issuances (15.2% share). Corporate

issuers were mainly from the financial sectors of Turkey and Malaysia. Two financial institutions from Turkey issued MYR-denominated sukuk in Malaysia, and announced plans for more similar cross-border issuances in the future.

¹¹ ISRA

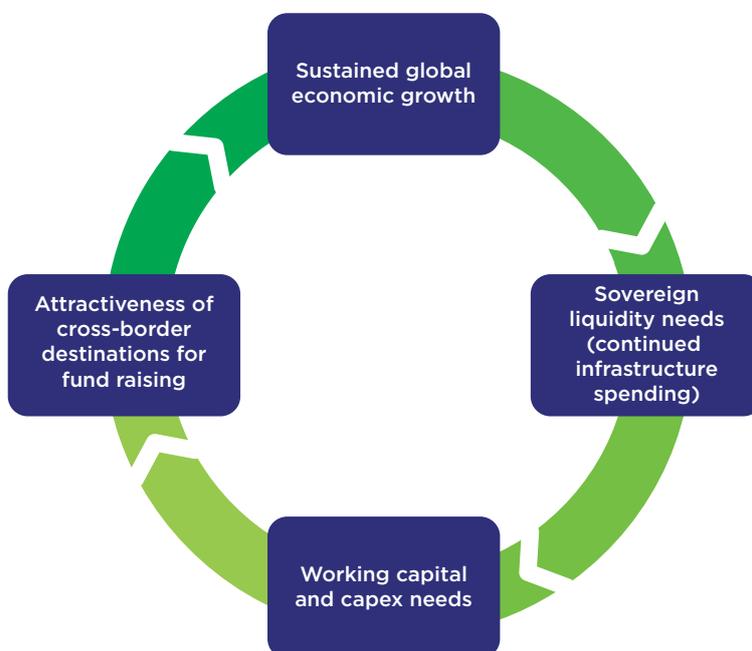
Growth drivers for the sukuk market remain intact

The decline in sukuk issuances¹² in 1Q2015 is likely to be temporary and linked to the adjustment of oil-exporting countries to the fall in oil prices, as well as volatilities in emerging market economies. Importantly, despite these headwinds, the sukuk market continued to attract cross-border issuances, as well as issuances from supra-national associations and sovereign entities. The world's first sukuk backed by UK Export Finance (UKEF) was issued by Emirates Airlines. The USD913mln sukuk is also the biggest offering in the capital markets from the aviation sector with an Export Credit Agency guarantee. Proceeds from this issuance will be used to fund the acquisition of four Airbus A380-800 aircraft. The sukuk attracted a diverse investor base, with approximately 39% of investments from

the Middle East and Asia, 32% from Europe and 29% from the United States. Of significance, the sukuk marks the UK's growing role in Shariah-compliant finance, after the UK government issued its debut sukuk in 2014.

On the corporate side, one of the deals in 1Q2015 was the USD1.25bln sukuk issued by national oil and gas producer PETRONAS to raise working capital¹³. In addition, new issuers entered the market, including a leading retailer of children's apparel and goods from Malaysia. In the transport sector, a perpetual Musharakah sukuk was issued by a Malaysian entity for the purposes of working capital financing, offering a solid profit rate of 7.5%; with more issuances planned in the future¹⁴.

Key Drivers of Sukuk Issuances



Source: ISRA

¹² Zawya
¹³ "PETRONAS begins USD17bln bond and sukuk drive", The Star (March 2015)
¹⁴ Zawya

Overall, growth drivers for the sukuk market remain intact. Global growth is projected to increase slightly from 3.4% in 2014 to 3.5% in 2015, supported by lower inflation, accommodative monetary conditions and sustained growth in global trade¹⁵. As witnessed in 1Q2015, corporate issuers continued to tap the market for capital expansion and working capital needs. Cross-border issuances are likely to continue, given the attractiveness of selected key jurisdictions in terms of sukuk issuance infrastructure, incentives and a ready pool of investors. In addition, there has been keen interest in “green sukuk” or “Socially Responsible Initiatives (SRI) sukuk”; Malaysia’s national investment fund, Khazanah Nasional Berhad, recently announced plans to issue the country’s first social-impact sukuk¹⁶. The RM1bln Sukuk Ihsan programme follows the introduction of the “Sustainable and Responsible Investment Sukuk framework” by the Securities Commission in August 2014. Under these guidelines, the SRI sukuk may be used to finance projects relating to

the protection of natural resources, promotion of renewable energy and community and economic development¹⁷.

Meanwhile, issuances by sovereign entities will be driven by liquidity needs due to declining oil reserves, amid continued expansion plans¹⁸. Recently, the GCC announced railway, road and maritime transportation plans amounting to USD422bln over the next five years¹⁹. On another note, building on the momentum of debut issuers in 2014, several Islamic finance jurisdictions in Africa, Central Asia and the Middle East have expressed interest in issuing their debut sukuk in 2015²⁰. A few notable sukuk deals were recorded in 2Q2015; the Malaysian government (which was oversubscribed by 6 times)²¹, major Islamic banks from the UAE and another perpetual sukuk from the transport sector²². As these longer-term drivers remain intact, the momentum in the sukuk market is likely to pick-up after the slower performance in 1Q2015.

¹⁵ IMF World Economic Outlook (April 2015)

¹⁶ “Khazanah to launch Malaysia’s first social impact bond”, Reuters (April 2015)

¹⁷ “Guidelines on Sukuk”, Securities Commission (August 2014)

¹⁸ “Strong start for sukuk in 1Q15 in tough market conditions”, Fitch (April 2015)

¹⁹ “GCC rail, road & maritime projects worth USD422bln”, Saudi Gazette (May 2015)

²⁰ “Sukuk Pipeline – Issue Plans Around the World”, Zawya (May 2015)

²¹ “Malaysia’s successful sukuk an endorsement of country’s strong fundamentals, say analysts”, The Star (April 2015)

²² Zawya database

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