Insights

GLOBAL SUKUK MARKET
SUSTAINED MOMENTUM IN 2014

Sovereign and quasi-sovereign issuers are expected to drive growth in the global sukuk market throughout the year. New entrants such as Maldives made their debut in the market this year, with more expected to follow by the end of the year. Having recorded a new sukuk issuances volume of USD31.14bln in 1Q14, the global sukuk market continues to exceed the average quarterly volume, since 1Q12, of USD31bln. Malaysia continues to lead the way with more than 60% of the share of new sukuk issuances worldwide every quarter since 1Q12, followed by the GCC countries.

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Global sukuk market begins 2014 with a sustained momentum as sovereign and quasi-sovereign issuers spearheaded the new sukuk issuances in 1Q2014

The volume of new sukuk issuances in the global sukuk market amounted to USD31.1bln in 1Q14, which exceeded the average quarterly volume of USD31bln (1Q12-1Q14), leading to expectations that the primary sukuk market will once again surpass the USD100bln mark in new issuances volume this year. The expectations are further supported by a number of high profile issuances which remain in the pipeline for 2014 including debut sovereign issuances from the United Kingdom, Luxembourg, South Africa and Hong Kong, among others.

The global sukuk market recorded a new sukuk issuances volume of USD31.14bln in 1Q14 which represented a sustained performance for the market [4Q13: USD36.73bln; 1Q13: USD34.53bln]. Although the volume is 15.2% short of the volume produced in 4Q13, 1Q14's performance exceeded the average quarterly new sukuk issuances volume of USD31bln since 1Q12 (see chart below). The sustained performance in the sukuk market follows despite the commencement of the tapering exercise by the US Federal Reserve since January 2014 which has led to an increase in funding costs for issuers, particularly in emerging markets. The volume in 1Q14 has been spearheaded by a number of noteworthy sukuk issuances including the USD1.5bln benchmark 5-year sukuk issuance by the Islamic Development Bank (IDB), which is the largest transaction to date by the global multilateral entity. The International Islamic Liqudity Management Corporation (IILM), is another noteworthy issuer which continues to expand its short-term sukuk programme with a current outstanding portfolio of USD1.35bln. Maldives was a debut issuer in 1Q14 when it tapped the sukuk market for the first time with a 10-year corporate real estate sukuk raising USD3.9mln in proceeds for the issuer. The pipeline of issuances for the remainder of the year remains healthy with a number of high-profile debut issuances expected from sovereign issuers including the United Kingdom, Luxembourg, Hong Kong, Tunisia, South Africa, Senegal and Egypt, among others. Furthermore, the multilateral entity, Asian Development Bank (ADB) is also considering feasibility to float a maiden sukuk in 2014.

> "The global sukuk market recorded a new sukuk issuances volume of USD31.14bln in 1Q14 which represented a sustained performance for the market"

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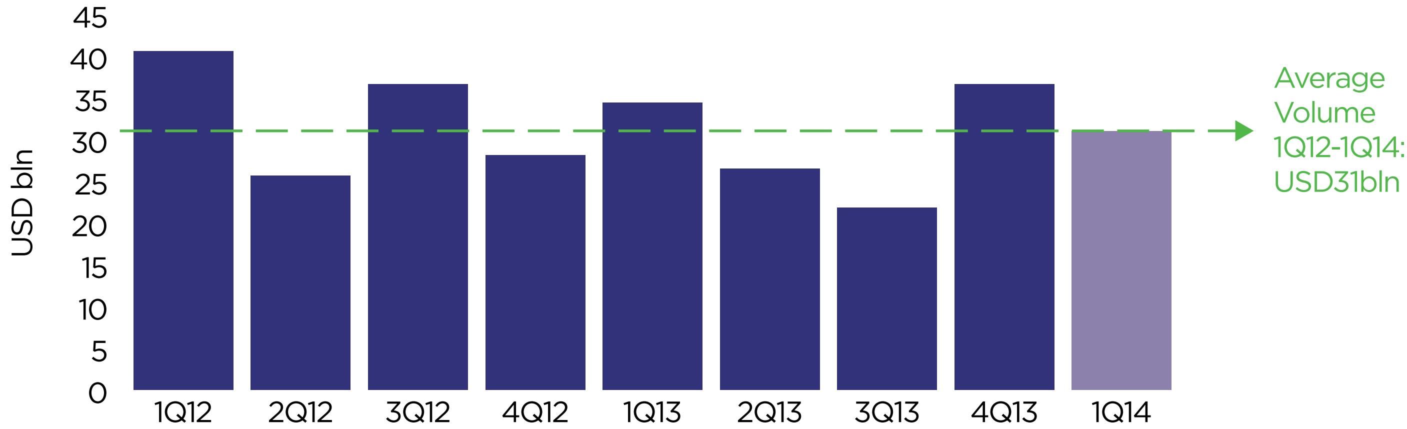
Global Sukuk Issuance Trend (1Q12-1Q14)

Source: KFH Research Limited



Malaysia continues to be the leading jurisdiction driving the global new sukuk issuances with a 63.05% or USD19.63bln share of total issuances in 1Q14. Malaysia's share of new sukuk issuances have consistently exceeded more than 60% since 1Q12. The market has been tapped by a number of international issuers over the years including obligors based in the GCC countries, Singapore, Hong Kong, Kazakhstan, among others. Most recently, Singapore has once again tapped the Malaysian sukuk market in 1Q14 when Bumitama Agri, a Singapore-listed company, raised USD152mln in proceeds by issuing a Malaysian-Ringgit sukuk. A number of announced sukuk from international issuers remain in the Malaysian sukuk industry pipeline this year including potential issuances from the UAE-based First Gulf Bank, Bahrain-based Gulf International Bank and France-based Societe Generale.

In the Gulf Cooperation Council (GCC) region, which is the second largest sukuk market after Malaysia, the volume of sukuk issuances in the GCC fell by 12.5% in 1Q14 as compared to the volume in 1Q13. Within the GCC region, the biggest drop in volume was recorded in the United Arab Emirates (UAE) which saw issuances drop by 92.1% to USD300mln in 1Q14 as compared to the USD3.82bln volume in 1Q13. Saudi Arabia experienced a 17% decline in volume to USD2.5bln (excluding IDB's USD1.5bln issuance) as compared to the USD3.01bln issuance in 1Q13. Particularly in the month of March, the only GCC-based issuances were short-term liquidity management sukuk by the Central Bank of Bahrain (excluding the multilateral Islamic Development Bank's (IDB) USD1.5bln sukuk).

Overall, among the various issuing jurisdictions, the most substantial y-o-y growth in volumes in 1Q14 as compared to 1Q13 were witnessed in Qatar (998.6% increase on the back of a huge USD3.02bln sukuk issuance by the Central Bank of Qatar), Gambia (193.4%), Brunei (190.4%) and Bahrain (88%). The volumes in each of these jurisdictions were spearheaded by an increased supply of Shariah-compliant papers by their respective central banks.

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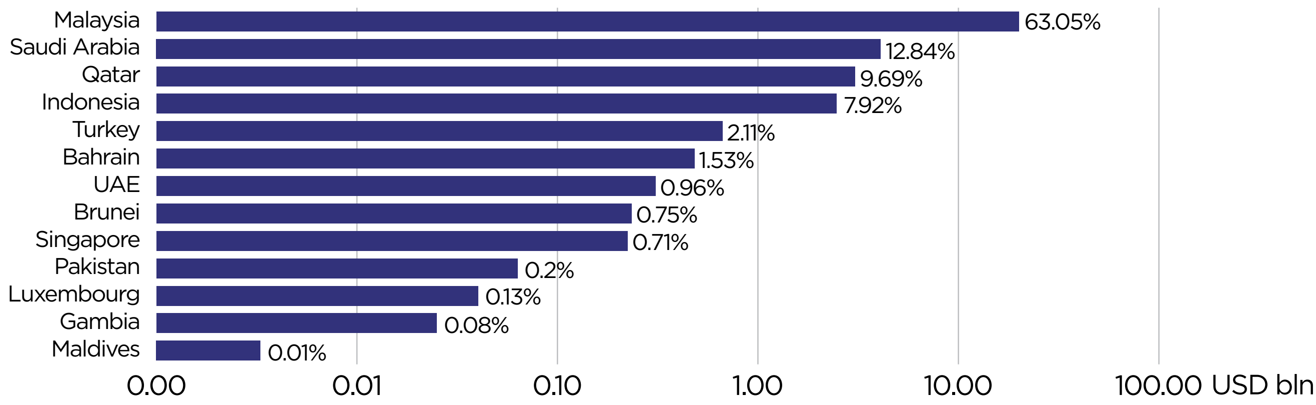
Global Sukuk New Issuances by Domicile and Share* (1Q14, USD bln)

Source: Bloomberg, IFIS, Zawya, KFH Research Limited

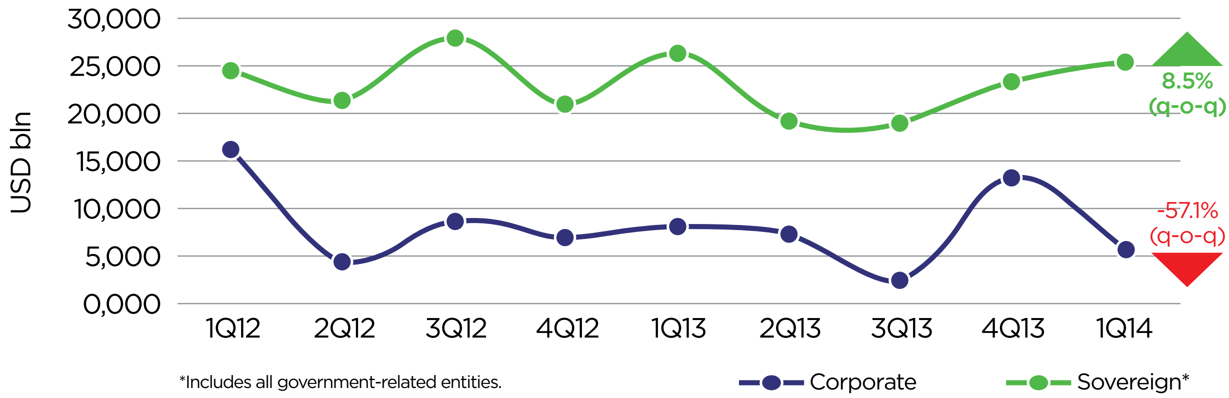


*Numbers in percentage indicate share of total issuances for each domicile (based on obligors' domicile)

Sovereign and quasi-sovereign sukuk issuers continue to be the key drivers of the global sukuk market with issuances worth USD25.43bln or more than 81% share of the total issuances in 1Q14. Notably, sovereign issuers produced a volume of USD21.37bln in 1Q14 which, in terms of absolute amount of issuances, represents the highest volume since 3Q12 when sovereign issuers had generated USD25.66bln in volume. Malaysian Government-related entities have played an active role in spearheading the quasi-sovereign sector with large volume issuances by Syarikat Prasarana Negara Berhad (USD734.1mln), Khazanah Nasional Berhad (USD699.3mln) and also Perbadanan Tabung Pendidikan Tinggi Nasional (PTPTN) (USD760.3mln), among others. In contrast, the corporate sukuk issuances performance subdued in 1Q14 as the sector's share dropped to USD5.72bln in 1Q14, a staggering 57.1% decrease as compared to the record corporate sukuk volume produced in 4Q13 worth USD13.29bln. The decline in the corporate sukuk volume in 1Q14 stems mainly from the US Fed's tapering impact on sukuk funding costs as well as the slowdown in GCC sukuk issuances during the quarter.

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

Source: Bloomberg, IFIS, Zawya, KFH Research Limited



*Includes all government-related entities.

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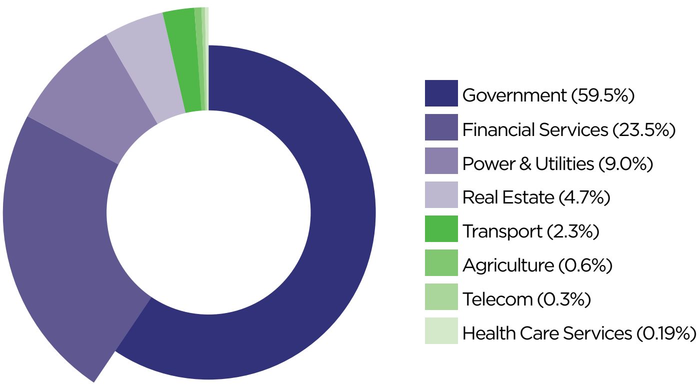
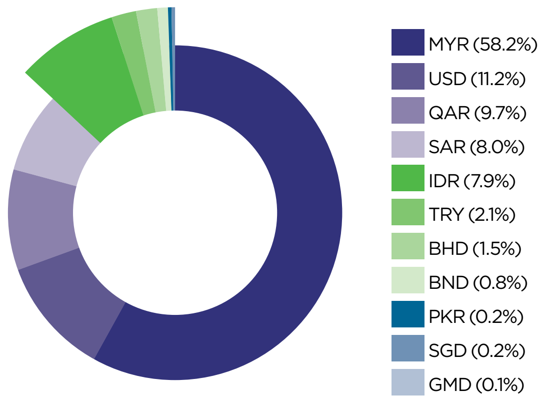
Sukuk Issuance by Sector (1Q14)

Source: Bloomberg, IFIS, Zawya, KFH Research Limited



Sukuk Issuance by Currency (1Q14)

Source: Bloomberg, IFIS, Zawya, KFH Research Limited



In terms of sukuk issuances by sector, during 1Q14, strong sukuk issuances emerged from the financial services sector which accounted for 23.5% share of total issuances [2013: 10%; 2012: 11.4%]. This sector has been spearheaded by a growing trend where Islamic financial instituitions have begun to tap the sukuk market to raise capitalisation funds in order to comply with the Basel III standards of best practices that are being implemented in most jurisdictions gradually. Meanwhile, the government issuers continued to account for the major share of the new sukuk issuances in 1Q14 with an almost 60% share of all issuances [2013: 62%]. The other notable sector was the power and utility industry which accounted for a 9% share of the total issuances [2013: 9.4%].

In terms of currency, issuances during the 1Q14 have largely been driven by local currency dominated sukuk, with the Malaysian Ringgit representing the largest share of 58.2% of the issuance value [2013: 67.1%]. The US Dollars was the second most widely utilised currency accounting for a 11.2% share of the market [2013: 15.02%]. The GCC currencies have witnessed a sustained momentum in 1Q14 on the back of a surge in local currency denominated sukuk, mainly in Qatar, Saudi Arabia and Bahrain. The QAR-denominated sukuk represented a 9.7% share in 1Q14 [2013: 1.0%]; SAR 8.03% [2013: 9.1%]; and also BHD 1.5% [2013: 1.4%]. Other notable currencies utilised by issuers in 1Q14 include IDR with a 7.9% share [2013: 3.4%] driven by sovereign issuances; TRY at 2.1% share [2013: 1.6%] spurred by a TRY1.33bln Turkish Sovereign Sukuk in February; and the rest of the currencies including PKR, SGD, BND and GMD had lower than 1% shares.

Overall, global outstanding sukuk reached USD272.96bln as at 1Q14, a 15.96% y-o-y growth since 1Q13. Malaysia stands out as the only sukuk market with global outstanding above USD100bln while Saudi Arabia, the UAE, Qatar and Indonesia follow significantly behind. As at 1Q14, there was USD160.6bln worth of sukuk yet to mature in Malaysia, while sukuk outstanding in the GCC totalled almost USD85.0bln. In particular, the total GCC sukuk outstanding portfolio declined by 0.4% quarter-on-quarter (q-o-q) to a value just under USD85bln in 1Q14, as compared to the USD85.3bln outstanding as at end-2013. This decline in the GCC sukuk outstanding portfolio is partly on account of a huge USD9.07bln sukuk redemption by the Central Bank of Qatar in January 2014.

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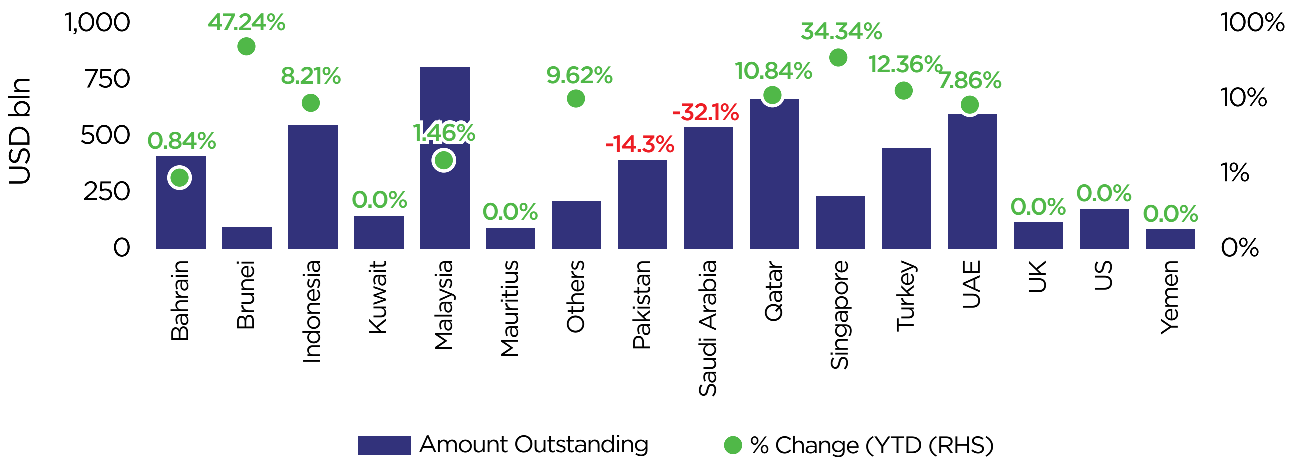
Sukuk Outstanding (as at 1Q14) and y-o-y Growth by Domicile

Source: Bloomberg, IFIS, Zawya, KFHR



In terms of sukuk performances for 1Q14, markets have generally reflected upon the macroeconomic fundamentals and characteristics of the issuing economies when pricing sukuk instruments. The yields on sukuk in the two largest sukuk markets of Malaysia and the GCC have generally eased in 2014 yield-to-date (YTD) on account of robust economic performances in the backdrop of the US Fed's tapering exercise. For example, in the Malaysian marketplace, the yields on the 5 year and 10 year benchmark sovereign sukuk have decreased 9.2bps and 13.2bps respectively 2014 YTD. The yields on the GCC sukuk instruments have generally eased by 50bps to 70bps 2014 YTD. On the other hand, yields on other emerging markets including Turkey and Indonesia have been severely affected. For instance, the yields on Turkish Lira Sovereign Sukuk Hazine 10/14 have increased by 72bps 2014 YTD. As a result, there has been a considerable heterogeneity in yields between various jurisdictions in 1Q14.

Future Outlook

Moving forward in the remainder of 2014, the global sukuk industry is expected to continue being one of the fastest growing segments of the Islamic finance industry and once again surpass the USD100bln mark in new sukuk issuances. Over the years, the global pool of Shariah-compliant funds have become an attractive source for various sovereigns, government-related entities and corporates to tap into in order to meet their financing needs. A number of high profile issuances remain in the pipeline for 2014 including among others, debut sovereign issuances from United Kingdom, Luxembourg, South Africa, Senegal, Hong Kong, Tunisia and Mauritania. Malaysia will continue to be the global leader for sukuk issuances in 2014 as a number of infrastructural development projects stream in under the Malaysian government's economic transformation programme. The GCC region is another critical driver for sukuk issuances on the back of vast infrastructure and capital expenditure plans in the region over the next ten years. Based on the announced pipelines, 2014 will also witness the return of France into the corporate sukuk sector after its inaugural and only issuance in 2012. Meanwhile, the more established markets of Indonesia, Pakistan, Turkey and Singapore also have sukuk announced in the pipeline for issuances in 2014. Overall, 2014 is likely to witness another exciting year for sukuk issuances as the industry continues to attract newer jurisdictions, including non-Muslim economies, into the fastest growing segment of the Islamic finance industry.