

Islamic finance maintains growth despite global crisis



By Shuchita Kapur on Monday, June 29, 2009

Despite the economic slowdown last year, Islamic finance resumed its rapid growth, exceeding 10 per cent annual growth in the last decade, said a top official in an Islamic bank in the UAE.

And that is not all. The outlook for the industry is promising in 2009 with interest from various quarters.

"The long-term pipeline for asset-backed sukuk issuance is healthy, and the market is attracting interest from around the world," Hussain Al Qemzi, Group CEO, Noor Islamic Bank told Emirates Business.

Analysts at Standard & Poor's also have the same view. "We believe that the outlook for asset-backed sukuk is positive despite the doubts raised by the disruption in global financial markets and in structured finance," said Paul Coughlin, Executive Managing Director, Corporate & Government Ratings at Standard & Poor's.

According to S&P figures, conservative estimates of the pipeline of sukuk that have been talked about or announced are in excess of \$45 billion (Dh165bn). Several factors support the sustainable growth of this market, including increasing popularity of Shariah-compliant products and government openness to Islamic finance, massive investment and financing needs in the Gulf, and issuers' desire to tap investors from the Middle East and Muslim Asia.

Issuers from more than 20 countries have expressed interest in issuing, or announced their intention to issue sukuk, and several new sovereigns will enter the market, said the rating agency.

Despite the positive outlook of the industry and its better performance than conventional financial industry, there will be impact of short-term slowdown on the long-term sustainability of Islamic banks.

"The credit crisis has created an unsteady environment for the industry with the last six months bringing to light new developments. The continuing fallout has led to more worries about the outlook for the regional and the world economies. The knock-on effect of the financial crisis has put pressure on all financial institutions and created new obstacles for development such as scarce liquidity, stock market declines, and falling real estate prices," said Qemzi.

Low level of liquidity is also a worrying issue for Islamic banks just as it is for the conventional banks.

According to S&P, "like their conventional peers, Islamic financial institutions were ill prepared, in our view, to enter an environment where liquidity became scarce and cost of funds increased".

Islamic banks realise this, said Qemzi. "For long term growth, banks should enhance their liquidity risk management practices, focus on sharp balance sheet management building and work with regulators to comply with new requirements and policies, transparent and good corporate governance."

"The financial and market turmoil over the last year has placed increased focus on the interaction of credit, market, and liquidity risks during stressful periods. While the Basel II framework addresses market risk, credit risk, and operational risk in great detail – liquidity risk, which was a contributing factor of the recent problems, does not receive the same attention," he said while talking of key drivers to sustainability in the industry.

Despite the slowdown witnessed within Islamic banks, there is an increasing acceptability of its ways of doing business across the world, even in non-Islamic world markets.

"Islamic banks have already gained foothold in Europe and Asia, but there is tremendous room for growth. In the wake of the financial crisis, there is a perceptible gap of confidence in the conventional form of banking. As a result, conventional banks are meeting growing

of banking. At a time when conventional banks were posting massive losses, Islamic banks have proven resilient with solid growth," said Qemzi.

"However, Islamic banking is still in its nascent stages and has not reached the economies of scale that conventional banking has. I don't think that it is a question of succeeding over conventional banking, rather it is about co-operation and partnership between conventional and Islamic banks so as to provide solutions and services that are in demand by a growing customer base," he added. Going forward, Qemzi sees regions with a good Muslim population providing attractive opportunities for development.

"Regions with sizeable Muslim populations continue to offer the best opportunities for Islamic banks. These regions include Asian countries such as Indonesia, Malaysia, Pakistan and India; in Europe we can consider the UK, France, Germany; and of course the new frontiers of Africa."

"All of these regions are under-banked in terms of Islamic banking, but have the potential for growth as the consumers are much more aware of the benefits that Islamic banks can offer and government and corporates alike are structuring many of their transactions using Shariah solutions," he said.

As far as products are concerned, Qemzi sees mainstream consumer products such as savings, term deposits, auto finance, personal finance, mortgage finance, with high growth potential.

He added these have now almost become standardised and commoditised. On the wholesale and capital market side, sukuks have seen increasing demand and appetite and will continue to be an effective mechanism of capital raising and asset and liability management. Similarly, there is a gap and subsequent need for offering insurance and investment products at the retail level in addition to the basic savings and time deposit products, he said.

Qemzi, however, believes that Islamic banks need to reach out to the masses to reach its full potential.

"Islamic banking is an ethical alternative to conventional banking. However, it has not reached the mass distribution of conventional banks. As is evident by the rising introduction of Islamic windows in conventional banks, there are customers that will choose to hold accounts in both conventional and Islamic banks, whereas others will choose to use only Islamic banks."

"Ultimately, Islamic banks are commercial institutions run according to Shariah rules. This is something that needs to be communicated effectively to potential customers who are wary of non-secular entities," said Qemzi.

LIQUIDITY CRUNCH

A look at sukuk market performance in 2008 shows the dent that the liquidity crunch has made in issuance. Total sukuk issuance worldwide reportedly declined to \$14.9bn (Dh54bn) in 2008, compared with more than \$34.3bn a year earlier.

Still, S&P continues to foresee positive prospects for the sukuk market in the long term. S&P expects Sukuk issuance to recover, at the earliest, during the second half of 2009 or, most probably, in 2010.

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