The Resilience and Relevance of Global Sukuk

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INTRODUCTION

The global sukuk market has proven itself as an effective measure of some of the fastest-growing economies in the world, while also providing steady cash flow. Unlike traditional fixed income investments, sukuk offer a stake in the underlying assets and pay investors a percentage of profit at predefined regular intervals. Sukuk could be attractive to both Muslim and non-Muslim investors as an alternative to conventional bonds for those looking for diversification options.

As evidenced during the start of the global pandemic in early 2020, the sukuk market witnessed a more muted downturn relative to traditional bond markets and experienced a quick recovery afterward. This resilience during volatile times is often tied to the high-quality nature of issuers and strong credit fundamentals of the underlying sukuk structure.

Despite a small decrease in market size for 2020, the U.S. dollar-denominated sukuk market has experienced a compound annualized growth rate of nearly 20% since 2013, as measured by the Dow Jones Sukuk Total Return Index (ex-Reinvestment) and the S&P Global High Yield Sukuk Index. As capital needs evolve and investor awareness broadens, the global sukuk market is well positioned to build on its current momentum.

A REVIEW OF 2021

Global sukuk relative performance remained strong in 2021 driven by the continued economic recovery, increased liquidity in debt markets, and strong investor demand. Through December 2021, the Dow Jones Sukuk Total Return Index (ex-Reinvestment) outperformed the S&P Global Aggregate Developed Bond Index by over 500 bps (see Exhibit 1).

This article was first published in Islamic Finance news Annual Guide 2022: Islamic Indices.

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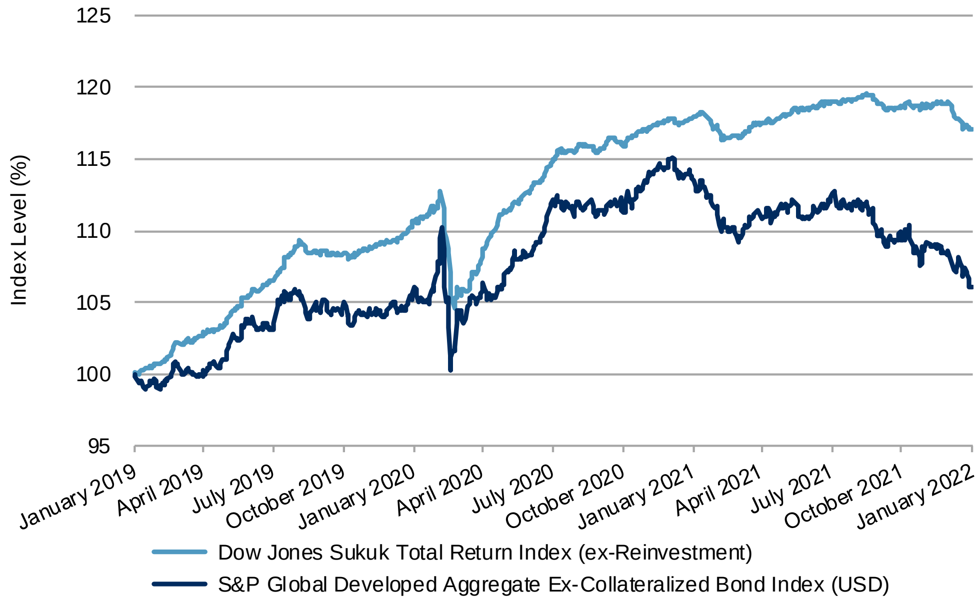
Exhibit 1: Global Sukuk Performance Comparison



Source: S&P Dow Jones Indices LLC. Data as of Oct. 21, 2021. Past performance is no guarantee of future results. Chart is provided for illustrative purposes.

Corporate sukuk issuances in Malaysia and Indonesia led the way in terms of total volume and number of new entrants.

Total sukuk issuance was down year-over-year as of Dec. 31, 2021, largely due to narrowing fiscal deficits for many sovereign issuers. As expected, funding needs in the Gulf Cooperation Council (GCC) countries slowed, as oil prices increased throughout the year. Single-name corporate issuance set new records with Saudi Aramco's USD 6 billion sukuk. Additionally, corporate sukuk issuances in Malaysia and Indonesia led the way in terms of total volume and number of new entrants.

Global sukuk issuers continued to build on the confluence of ESG aspects within a sukuk framework.

Global sukuk issuers continued to build on the confluence of environmental, social, and governance (ESG) aspects within a sukuk framework. In March 2021, the Islamic Development Bank issued a USD 2.5 billion sustainability sukuk to fund climate change and green projects across its 57 member countries. The following month, Malaysia issued the world's first USD sovereign sustainability sukuk. The proceeds under the framework will finance green, social, or sustainability projects falling under six categories: green buildings, energy efficiency and renewable energy, affordable housing, pollution prevention and control, sustainable water and wastewater management, and socioeconomic advancement and empowerment. Investor demand was so strong that it resulted in the lowest yield and spread ever for a Malaysian sukuk issuance.

A PREVIEW OF 2022

In the year ahead, global sukuk momentum is expected to be supported by refunding needs and relatively low borrowing costs. Within the GCC states, oil prices will likely drive sukuk issuance trends in 2022; however, most oil-rich countries have committed to diversifying their economies away from fossil fuels in response to growing demand for action on climate change.

New sukuk entrants will likely emerge in the coming year, with West African countries offering the most potential for sovereign issuances.

New sukuk entrants will likely emerge in the coming year, with West African countries offering the most potential for sovereign issuances. Nearly one-quarter of the world's Muslim population is located in Africa, but Africa's Shariah-compliant banking assets make up less than 2% of global Islamic banking assets.

Egypt, Morocco, Sudan, and Nigeria stand out as best positioned for growth in Islamic finance. They have large Muslim populations, are making the necessary regulatory changes required for Shariah-compliant finance, and most have a history of sukuk issuance. Egypt's Ministry of Finance has indicated that it will likely issue its debut sukuk sometime in early 2022.[1]

The convergence of ESG principles and Shariah-compliant investment standards offer significant potential for increased investor awareness.

Additionally, the convergence of ESG principles and Shariah-compliant investment standards offer significant potential for increased investor awareness, potentially opening a wider pool of international investors and diversifying sources of capital for issuers. The trend could have major implications for GCC states seeking to invest heavily in the renewable energy sector. Saudi Arabia aims to power half the country with renewable sources by 2030 under a green initiative.[2]

Similarly, Abu Dhabi is planning ways to reduce the emirate's oil dependency and achieve a 65% contribution to GDP from non-oil sectors. Further, Dubai's 2050 integrated clean energy strategy plans to increase clean energy to become 75% of its total generation mix by 2050.[3]

CONCLUSION

For the past 20 years, the global sukuk market has been dominated by issuers and investors from the GCC region, as well as Malaysia, Indonesia, and Turkey. Looking ahead, the investment landscape is poised for significant evolution driven by product innovation, sustainability targets, and new market entrants.

Sukuk indices, like those offered by S&P DJI, will play an integral role in the investment decision-making process.

It could be expected that sukuk will continue to attract the attention of some of the world's largest and most significant institutional investors in the U.S., Europe, and Asia, as many may view sukuk as an effective way to invest in some of the fastest-growing regions of the world.

As the global sukuk market evolves, sukuk indices, like those offered by S&P DJI, will play an integral role in the investment decision-making process, providing tools to better measure, benchmark, and replicate various sectors of the market.

[1] Ministry of Finance Arab Republic of Egypt, www.mof.gov.eg.

[2] Saudi Green Initiative, https://www.saudigreeninitiative.org/about-saudi-green-initiative/.

[3] Emirates Green Building Council, https://emiratesgbc.org/uae-sustainability-initiatives/.

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