Bloomberg

By David Yong and Haris Anwar
Published: Oct 12,2010 2:31PM

Shariah Money Markets Expand With First Global Bill Sales: Islamic Finance

The first global Shariah-compliant money-market securities may be sold early next year, providing Islamic banks with more opportunities to invest reserves and boost profits.
The bills to be issued by Kuala Lumpur-based International Islamic Liquidity Management Corp. will help improve investment across borders, according to an Oct. 7 statement from the Islamic Financial Services Board, a standard-setting body. The new organization will start selling the notes on a regular basis from "early next year," Zeti Akhtar Aziz, Malaysia's central bank governor, said in an interview in Washington on Oct. 10.
IFSB is stepping up its efforts to bolster money markets after Lehman Brothers Holdings Inc. went bankrupt in September 2008, causing a global credit crunch. Dubai World roiled markets last November seeking to delay payments on $24.9 billion of debt. The Shariah-compliant products will fill a hole in the $1 trillion industry, Shehzad Janab, head of asset management at Daman Investments PSC, said in an interview yesterday.
"It's one big missing piece of the pie," said Janab at Dubai-based Daman, which has over 5 billion dirhams ($1.4 billion) of securities under management. "If we can start getting instruments which are short dated in maturity, then definitely it will fulfill a big need."

'A Breakthrough'

The new securities will enable lenders and investors to match the maturity of assets and liabilities and deploy idle funds, according to Riyadh-based Saudi Investment Bank and Albaraka Banking Group based in Manama, Bahrain.

A dearth of money-market instruments has forced Islamic lenders in Indonesia to keep as much as 20 percent of their excess cash with the central bank, compared with 2.1 percent at non-Islamic banks, according to a 2006 study by IFSB. In Pakistan, the figure was 3.8 percent against 0.3 percent. In Bangladesh, the ratio was 57.3 percent versus 24 percent. Such deposits earn little or no interest.

Siham Ismail, a spokeswoman for the IFSB in Kuala Lumpur, declined to comment on the agency's launch when contacted by telephone yesterday and said no new data was available for the money parked with the monetary authorities. The new entity will be formally established on Oct. 25 in Kuala Lumpur, according to the statement from the IFSB, which comprises regulatory and supervisory agencies in about 40 countries.

"It's a breakthrough," said Zeti at Bank Negara Malaysia, who is an IFSB council member. "They are short term, and they will be, we expect, highly rated instruments and therefore, there would be strong demand for them. This would enhance the competitiveness of Islamic finance," she said.

Libor Benchmark

Regular sales of bills that are acceptable across all Islamic jurisdictions will create a vibrant secondary market and become benchmarks for banks and investors, according to Seera Investment Bank based in Manama.

"Islamic institutions have no choice but to rely on Libor as a reference to price non-conventional instruments," Sohail Tohami, head of treasury at Seera, said in an interview yesterday. A transparent, highly-rated debt issuer under the IFSB plan "may be able to overcome that handicap in future," he said.

The British Bankers' Association, a trade organization for more than 200 members in 60 countries, publishes daily fixings for London interbank offered rates, or rates banks charge each other for loans.

Global issuance of sukuk, which pay asset returns to comply with the religion's ban on interest, fell 16 percent to $11.8 billion so far this year from the same period in 2009, data compiled by Bloomberg show.

Industry Growth

Sukuk returned 12.7 percent this year, according to the HSBC/NASDAQ Dubai US Dollar Index, while bonds in developing markets gained 15.7 percent, JPMorgan Chase & Co.'s EMBI Global Diversified Index shows.

The difference between the average yield for global sukuk and three-month Libor narrowed nine basis points yesterday to 344, according to the HSBC/Nasdaq Dubai US Dollar Sukuk Index. The spread shrank 123 basis points this year.

The yield on Malaysia's 3.928 percent dollar-denominated note maturing in June 2015 was little changed today at 2.42 percent. The spread with the Dubai Department of Finance's 6.396 percent sukuk due November 2014 has narrowed 22 basis points to 350 this month, Bloomberg data show.

'Lack of Creation'

The Islamic finance industry has been growing 20 percent annually since 2000, bringing it into direct competition with non-Shariah-compliant global banking without offering a comparable level of liquidity and returns, according to an IFSB report issued in April. It estimated assets will reach $1.6 trillion by 2012 compared with $660 billion in 2007. Revenues may rise to $120 billion from $53 billion, it predicted.

"There's a lack of creation in Islamic money-market instruments and the market needs a lot of them," said Khalid Abu Khadra, assistant treasury manager at Saudi Investment Bank. "There's also a problem with the mismatch of maturity, so if this could work in harmony across all jurisdictions, then we have one less barrier to growth."

Malaysia, the world's biggest market for Islamic bonds, Bahrain and Indonesia sell bills to help soak up cash in the financial system and set benchmarks for short-term bond sales.

Pakistan plans to sell sukuk maturing in a year or less in the domestic market as it seeks to double Shariah banking and attract investors from the Persian Gulf, spokesman Syed Wasimuddin said in an e-mail in July. The United Arab Emirates is looking at issuing short-term bills that comply with religious principles once regulations are passed, central bank GovernorSultan bin Nasser al-Suwaidi said in March.

‘Liability Mismatch’

The U.A.E.’s eight Islamic banks held $49.8 billion of deposits at the end of 2009, or about 19 percent of the total, according to the central bank. Malaysia has 21.8 billion ringgit ($7.03 billion) of Shariah-compliant bills outstanding, according to the central bank’s website.

“If you are going to fund your long-term investment with short-term liabilities like customer deposits, you run an asset- liability mismatch,” Malek Temsah, a treasury and investment manager at Albaraka Banking, said in an interview yesterday. “This, as the global credit crisis showed, is dangerous. You could end up in a liquidity freeze.”