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Shariah Banks Get Profit Boost With Money-Market Products: Islamic Finance

Islamic banks will be offered a range of new money-market instruments in coming months, allowing lenders to earn larger returns from excess cash stored at central banks or locked into longer-dated securities.

The International Islamic Liquidity Management Corp., which is being set up in Kuala Lumpur by 11 central banks, will sell its first short-term bills in dollars early next year, Malaysian central bank Governor Zeti Akhtar Aziz said Oct. 28. Prime Rate Capital Management LLP plans to start a \$250 million Islamic cash fund in January, Chief Executive Officer Christopher Oulton said in a Nov. 23 interview. The U.A.E.'s central bank auctioned its first Shariah-compliant certificates of deposits on Nov. 10.

Demand for services complying with Shariah law is increasing about 15 percent annually and assets under management may almost triple to \$2.8 trillion by 2015, according to the Kuala Lumpur-based Islamic Financial Services Board, a standards body for the industry. Money-market products will allow banks to invest idle cash more profitably, Paris-based Anouar Hassoune, an analyst at Moody's Investors Service, said in an e-mailed response to questions on Dec. 1.

"Liquidity is basically managed by accumulating central bank and interbank placements, as well as some government bonds, the latter still being relatively scarce," he said.

"Banks are penalized by crystallizing a significant amount of funds in cash forms."

U.K. Options

Shariah-compliant short-term investment products will fill a hole in the industry, according to London-based Prime Rate Capital, which oversees \$3.8 billion of assets.

“There is a dearth of products and none of them are overnight,” Oulton said. “The alternatives include just leaving it and getting no return at all.” Islamic banks will be able to place their deposits with the fund, which will then buy and sell commodities in so-called Murabahah transactions, he said.

A Murabahah contract is a sale and deferred-payment accord based on an asset, usually a commodity such as oil, sugar or metals, in which the cost and profit margin are pre-agreed.

“Even though there are providers out there, this particular segment needs some institutional deepening,” said Ahmad Alanani, the Dubai-based director of fixed-income sales at investment bank Exotix Ltd.

Certificates of Deposits

Global sales of sukuk, which pay returns based on asset flows to comply with the religion’s ban on interest, fell 31 percent this year to \$13.8 billion, Bloomberg data show. Issuance reached a record \$31 billion in 2007.

Shariah-compliant bonds returned 11.3 percent this year, the HSBC/NASDAQ Dubai US Dollar Sukuk Index shows. Debt in emerging markets gained 13.8 percent, according to JPMorgan Chase & Co.’s EMBI Global Diversified Index shows.

The difference between the average yield for emerging- market sukuk and the London interbank offered rate narrowed two basis points to 347 on Dec. 3 and has narrowed 26 basis points since Sept. 30, the HSBC/NASDAQ Dubai US Dollar Sukuk Index showed. Malaysia’s 3.928 percent Islamic note due in June 2015 rose, driving the yield seven basis points lower to 2.86 percent today, according to prices provided by Royal Bank of Scotland Group Plc. The extra yield investors demand to hold Dubai’s government sukuk rather than Malaysia’s dropped three basis points to 380, according to data compiled by Bloomberg.

Money Markets

The U.A.E. central bank offered Islamic certificates of deposits of one week up to one year, the monetary authority said in an e-mailed statement Nov. 14. Bahrain, the only country in the Persian Gulf to sell Islamic debt due in six months or less, plans to issue additional securities, central bank Governor Rasheed al-Maraj said in an Oct. 27 interview in Marrakesh, Morocco.

The International Islamic Financial Market, founded by the central banks of Bahrain, Indonesia and Malaysia, plans to create Shariah-compliant repurchase agreements to help Islamic banks manage funds and boost trading, Chief Executive Officer Ijlal Ahmed Alvi said in August.

The first global Shariah-compliant money-market securities will be sold by International Islamic Liquidity Management on a regular basis, Malaysia's Zeti said in an interview in Washington on Oct. 10.

"Instead of having a series of different counterparts for the placement of excess liquidity and borrowing short-term from a number of correspondents, the idea is to have a one-stop shop for liquidity placements and short-term borrowing," said Moody's Hassoune.