



By Simon Harvey and Dana El Baltaji

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Sukuk Fifth Monthly Gain Spurs Sales Recovery Forecasts: Islamic Finance

Islamic bonds gained for a fifth month, sending yields to the lowest levels since 2005, as faster growth in the Persian Gulf lured investors who expect new sales to recover after falling 27 percent this year.

The notes returned 0.7 percent in October while average yields dropped 19 basis points to 4.85 percent, above the Oct. 11 low of 4.62 percent, according to HSBC/NASDAQ Dubai US Dollar Sukuk Indexes. Issuance of sukuk, which pay asset returns to comply with the religion's ban on interest, dropped to \$13.5 billion, from \$18.5 billion a year earlier, data compiled by Bloomberg show.

Improving risk appetite in the Gulf after Dubai World's agreement with creditors this year to restructure \$24.9 billion in debt bodes well for sales in 2011, according to HSBC Holdings Plc and Moody's Investors Service. Australia may tap the market for the first time once tax barriers have been removed, Glenn Woolley, managing director of Intrinsic Investment Management overseeing almost A\$200 million (\$196.7 million), said in an interview in Kuala Lumpur Oct. 28.

"We remain positive for the outlook for next year," Mohammed Dawood, the Dubai-based director of debt capital markets at HSBC Holdings, the second-biggest underwriter of sukuk this year, said in an interview Oct. 28. "We should see a combination of first issuers and repeat issuers. I'm optimistic about the opportunities in the first six months of the year."

Next Year's Sales

The Islamic Development Bank, a Jeddah, Saudi Arabia-based multilateral lender, may sell at least \$500 million of the securities next year to meet funding needs of more than \$1 billion annually, Vice President Abdul Aziz Al Hinai said in an interview in Kuala Lumpur on Oct. 26. The newly created International Islamic Liquidity Management Corp. will sell the first of its short-term bills in 2011, Malaysian central bank Governor Zeti Akhtar Aziz said in Kuala Lumpur Oct. 28.

Thailand is considering selling between 40 billion baht and 50 billion baht (\$1.7 billion) of Islamic bonds to fund infrastructure projects, Islamic Bank of Thailand President Dheerasak Suwannayos said in Malaysia's capital on Oct. 25. The state-run bank will delay its inaugural offering of sukuk until early next year as it awaits new guidelines from the securities commission, he said.

Global sukuk returned 12.1 percent this year, according to the HSBC/NASDAQ Dubai US Dollar Sukuk Index. Bonds in developing markets gained 16.4 percent, JPMorgan Chase & Co.'s EMBI Global Diversified Index shows. Islamic bonds in the GCC returned 12.5 percent, the HSBC/NASDAQ Dubai GCC US Dollar Sukuk Index shows.

Yields Narrow

The difference between the average yield for emerging-market sukuk and the London interbank offered rate narrowed 11 basis points, or 0.11 percentage point, this month to 361 on Oct. 29, according to the HSBC/NASDAQ Dubai US Dollar Sukuk Index.

The yield on Malaysia's 3.928 percent Islamic note due in June 2015 rose two basis points to 2.49 percent last week, data compiled by Bloomberg show. The extra yield investors demand to hold Dubai's government sukuk rather than Malaysia's widened seven basis points from last week to 394, according to data compiled by Bloomberg.

Sukuk sales from the six-nation Gulf Cooperation Council, which includes the United Arab Emirates, Saudi Arabia and Qatar, will probably rise in 2011, Khalid Howladar, a Dubai-based senior analyst at Moody's, said in an interview in Dubai Oct. 28.

"We would expect some modest issuance from the GCC reaching perhaps \$5 billion to \$6 billion by year-end," Howladar said. "Liquidity and funding in banks is still an issue,

so I wouldn't be surprised to see Islamic banks continue to tap the sukuk market" next year, he said.

'Credit Issues'

Issuance of Islamic bonds from the Persian Gulf dropped 28 percent so far in 2010 to \$4.5 billion, from \$6.2 billion last year, after a wave of debt restructurings, defaults and tumbling property prices hurt investors' confidence.

There's a lack of new sukuk offerings in dollars, with most of the sales denominated in local currencies, said Yavar Moini, senior adviser of global capital markets at Morgan Stanley, in an interview in Dubai Oct. 28.

"The big issuers were from Dubai and mostly real-estate entities," Moini said. "As long as they're saddled with their credit issues, the issuance is unlikely to pick up. The dollar-based issuance will continue to be affected as long as we have supply limited to government, or government-linked issuers."

Malaysia Sales

Sales of ringgit Islamic bonds in Malaysia, the world's biggest market for the securities, have declined 28 percent this year to 20.7 billion ringgit (\$6.7 billion).

Issuance will increase next year as Malaysia's government pushes forward its economic transformation program to improve the nation's infrastructure, said Alhami Mohd Abdan, the head of international finance and capital markets at OCBC Al-Amin Bank Bhd., in an interview in Kuala Lumpur on Oct. 26.

"In terms of U.S. dollars, we're looking at around \$15 billion to \$20 billion next year, given the recent mega projects announced by the prime minister," he said.

Malaysia unveiled plans in September to develop a nuclear energy industry and build a mass rail network as part of \$444 billion worth of potential private-sector led projects.