Debt capital markets: Weathering the storm

By all accounts, 2013 (as at the 6th December) has been a relatively volatile year from the perspective of factors influencing Sukuk issuances globally. In order to review and analyze global Sukuk issuances in 2013, it would be helpful to reflect briefly on the platform the end of 2012 provided. RIZWAN H KANJI shares his view.

By the year end 2012, there had been approximately US$134 billion-worth of Sukuk issued globally. This reflected a growth of 57.64% in global Sukuk issuances compared to issuances of US$85 billion for the year ended 2011. The major geographic contributor for Sukuk issuances in 2012 was Malaysia with US$104 billion issued, a contribution of 77% of the total global Sukuk issued. This was followed by Saudi Arabia with US$10.5 billion or 7.8% issuance followed by the UAE and Indonesia with just over US$6 billion each.

In 2012, the highest ever aggregate value of Sukuk were issued globally. With a backdrop of a record-breaking year, below is a brief review of global Sukuk issuances in 2013 and the expectations for 2014.

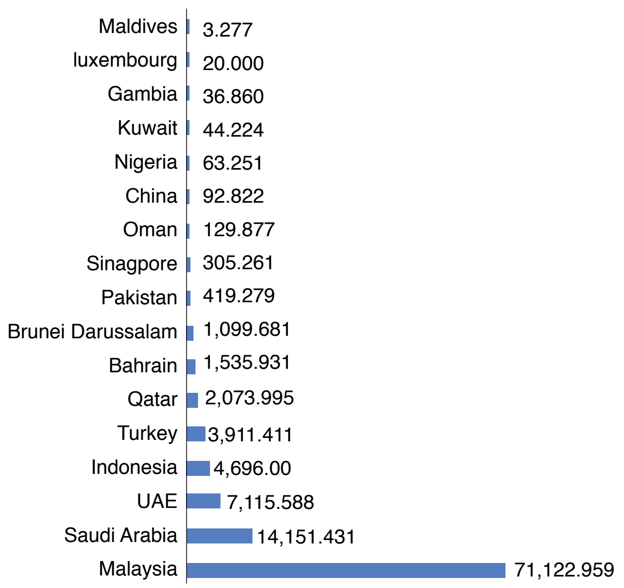
2013: A review

Total global Sukuk issuances in 2013 were lower compared to 2012, decreasing from approximately US$134 billion in 2012 to US$106 billion in 2013, a decrease of 20.9%. Whilst this may be a moderate reduction from the record-breaking year of 2012, 2013 can be carved into three general segments.

> "This increase in the interest rate environment forced certain issuers with no particular urgency for funding to hold off issuing Sukuk"

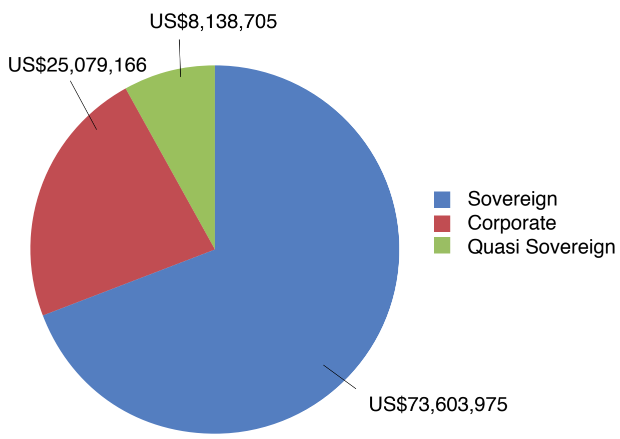
The first segment of the year reflected strong market activity with almost US$11 billion of Sukuk being issued in January 2013. This was followed by a relatively subdued level of international Sukuk issuances during the second segment noting the concerns the market showed as a result of the announcement by the US

Total size of issues (US$ million)



Source: Zawya Sukuk Monitor

Breakdown by issuer type



Source: Zawya Sukuk Monitor

Federal Reserve that it may ease QE3 by tapering its bond buying program of US$85 billion a month. The market reacted to this by pushing up interest rates which increased the cost of returns payable to Sukukholders. This increase in the interest rate environment forced certain issuers with no particular urgency for funding to hold off issuing Sukuk with a view to wait and see for a reduction in the interest rate environment.

The final segment, particularly the last quarter of 2013, reflected a flurry of successful issuances primarily as a result of the announcement in September 2013 by the US Federal Reserve that it was postponing the tapering of its bond-buying program. This in turn resulted in the market responding with lower interest rates and hence driving down the rates payable to Sukukholders. This provided an impetus for transactions on hold to approach the market and for other issuers to tap the market with relatively tighter pricing. Issuances from the GCC surged to US$4.7 billion since the 30th September 2013 indicating that issuers' realized that they may be in a low interest rate environment that may not last for long.

> **"Sovereign issuances will continue to contribute the bulk of Sukuk issuances in 2014 with a number of non-Islamic sovereigns issuing Sukuk"**

Malaysia continued to lead the market with US$71 billion-worth of issuances, a contribution of approximately 67% of total global Sukuk issuances in 2013. This was followed by Saudi Arabia with US$14 billion (13.21%) followed by the UAE with US$7 billion, Indonesia with US$4 billion and US$3.9 billion from Turkey.

The bulk of the global Sukuk issuances were by sovereign states at US$73 billion with corporates contributing US$25 billion of issuances. Whilst corporate issuances still lag behind substantially compared to sovereign issuances, 2013 has been a year of capital-raising type issuances.

In March 2013, Bank Asya, the biggest participation bank in Turkey, debut a US dollar-denominated Tier 2 Sukuk. This was the first Tier 2 Sukuk out of Turkey and Europe which was then followed by Al Baraka Turk, another Turkish participation bank, with a privately-placed Tier 2 Sukuk. Additionally, the market also witnessed the first corporate hybrid Sukuk issuance out of Saudi Arabia by Almarai (a local currency facility) and by GEMS Education, the first international corporate hybrid Sukuk. These issuances have equity-type features which are much closer to the spirit of the definition of Sukuk.

Expectations for 2014

The US Federal Reserve's decision in relation to the slight reduction of its bond-buying program to US$75 billion may in turn result in an increase in interest rates which may impact the cost of borrowing. This high interest rate environment may be a "new reality" that issuers may have to get used to.

Sovereign issuances will continue to contribute the bulk of Sukuk issuances in 2014 with a number of non-Islamic sovereigns issuing Sukuk. Offerings from corporates will continue to increase and we may also see the continued growth of capital-raising issuances and hybrid issuances. The various infrastructure needs, particularly in the GCC, may also prompt an increase in project Sukuk issuance.

Conclusion

The issuance activity in the early part of 2013 and at the end of 2013 have collectively avoided 2013 being a damp squib compared to 2012. The late flurry of stalled and new issuances coming to fruition near the end of the year has resulted in 2013 being a relatively decent year for Sukuk issuances.

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