Islamic Finance: Resilient Growth Despite Missed Opportunities

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S&P Global Ratings

This report does not constitute a rating action

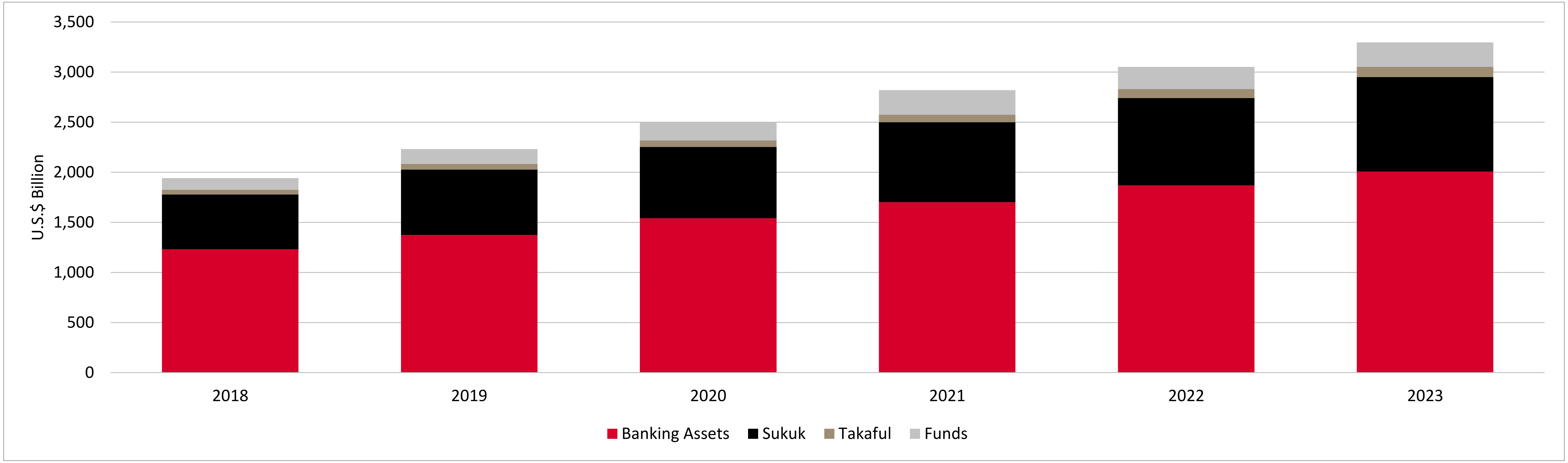
Agenda

1. The Good News
2. The Challenges
3. The Key Takeaways

The Good News: Strong Growth Continues

- Islamic finance assets have more than doubled over the past decade. They reached almost $3.3 trillion at YE2023 (excluding Iran) driven primarily by the growth of the banking assets and sukuk issuances.
- We forecast a growth rate of high single digit in 2024-2025.

A $3.3 Trillion Industry



Source: Central Banks, Eikon, S&P Global Ratings

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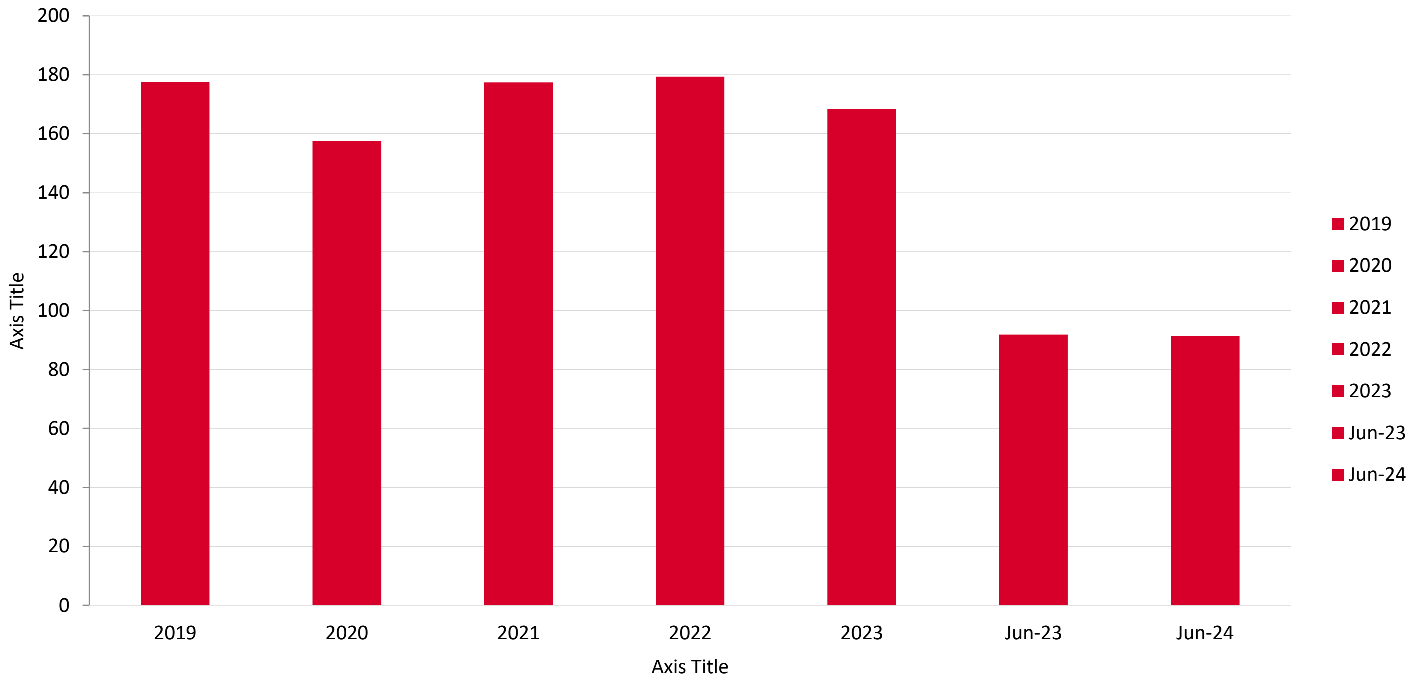
The Good News: The Sukuk Market Is Heading For A Good 2024

Global Sukuk issuance stabilized in the first half of 2024

Total Sukuk issuance



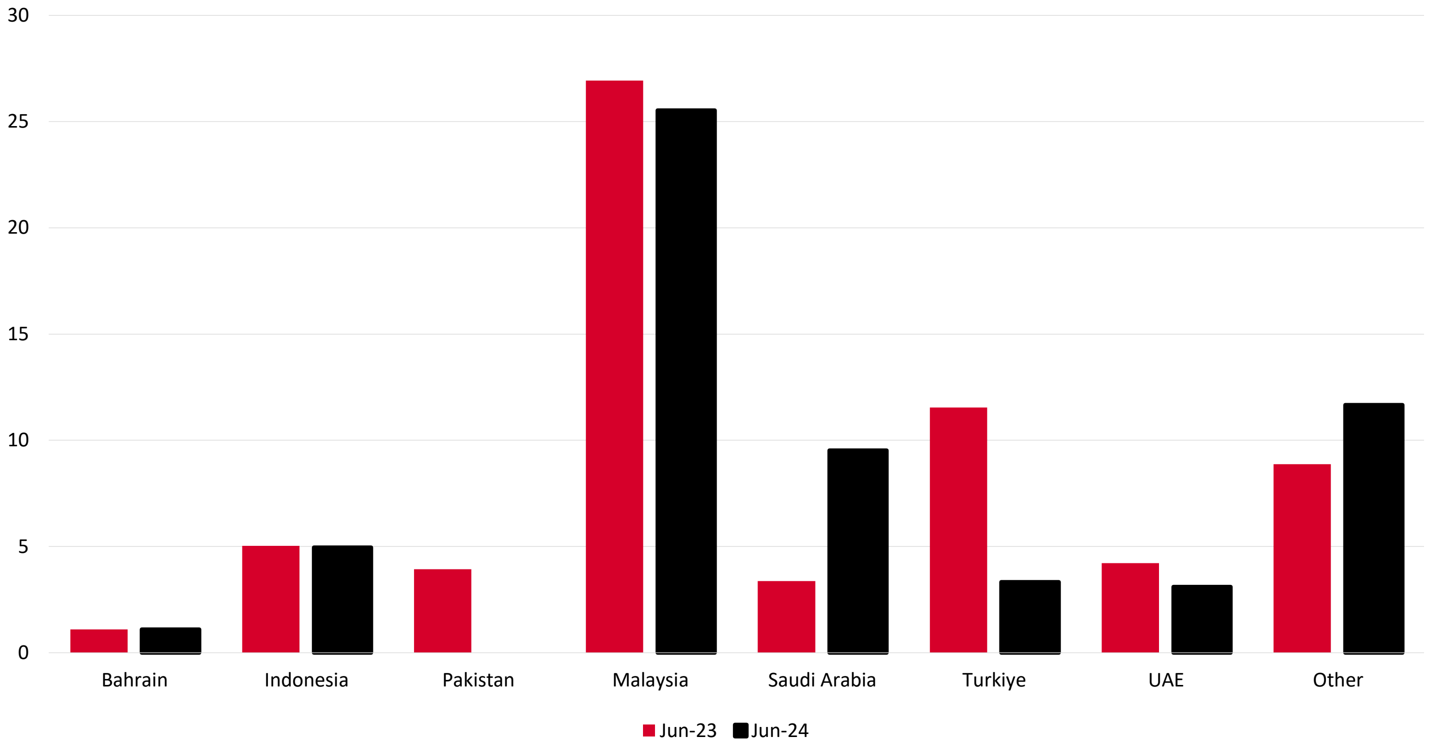
Source: S&P Global Ratings, Eikon

- Total sukuk issuance reached $91.9 billion at midyear 2024, which is a similar performance to last year but with a substantial upward trend in foreign currency-denominated issuances.
- We maintain our 2024 global sukuk issuance forecast of $160 billion-$170 billion, including foreign currency-denominated issuance of $45 billion-$50 billion.
- High financing needs in core Islamic finance countries and improved visibility on the medium-term trajectory of interest rates has benefited foreign currency-denominated sukuk issuance.

The Good News: The Sukuk Market Is Heading For A Good 2024

Local currency issuance dropped

Local currency sukuk issuance



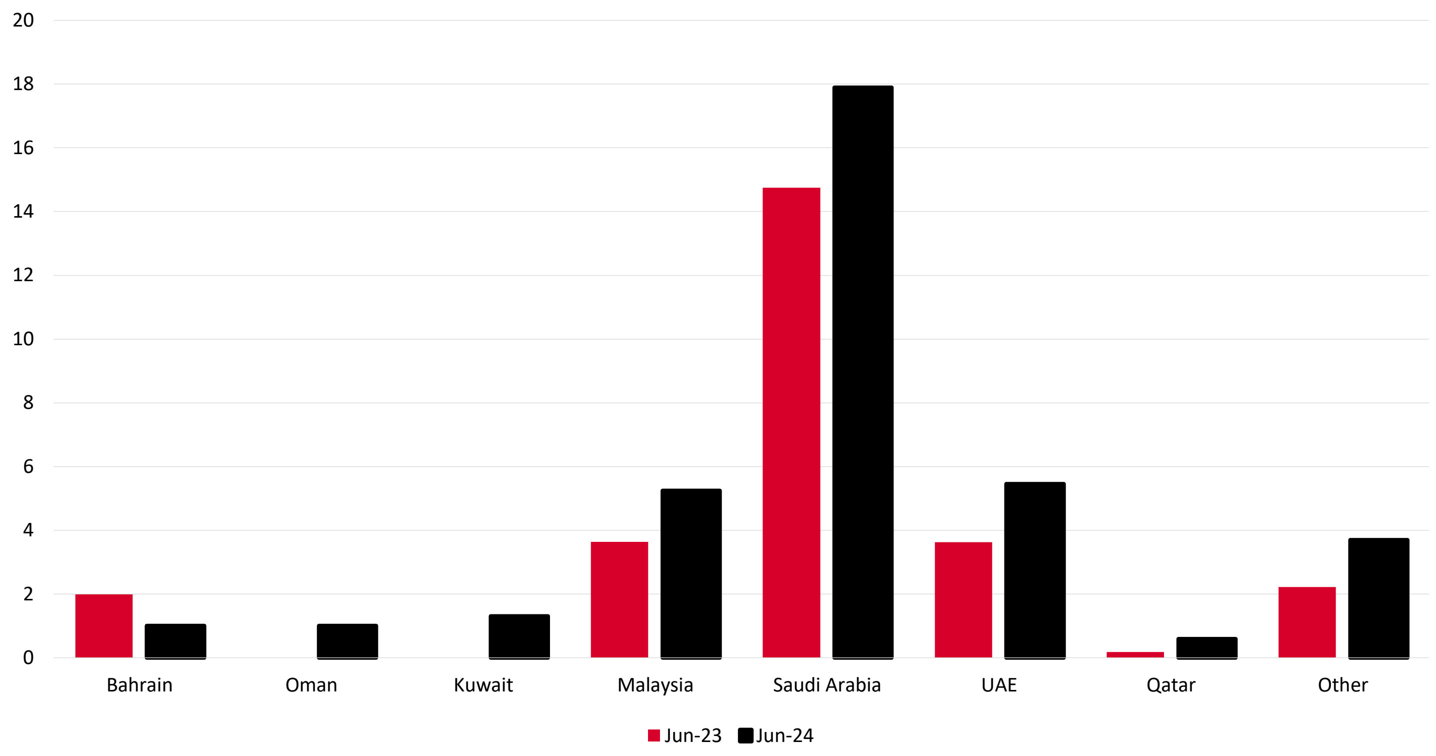
Source: S&P Global Ratings, Eikon

- Local currency-denominated sukuk issuance has dropped by 8.8% vs. 2023.
- The largest drop was in Türkiye, where monetary tightening combined with better fiscal policy coordination continues to help rebalance the economy.
- In the UAE, the decline can be explained by lower local-currency denominated issuance by the Federal Government and other authorities.
- Local currency issuance in Saudi Arabia resumed its growing trend thanks to government's jumbo issuances and retail sukuk.

The Good News: The Sukuk Market Is Heading For A Good 2024

Foreign currency issuance increased

Foreign currency Sukuk issuance



Source: S&P Global Ratings, Eikon

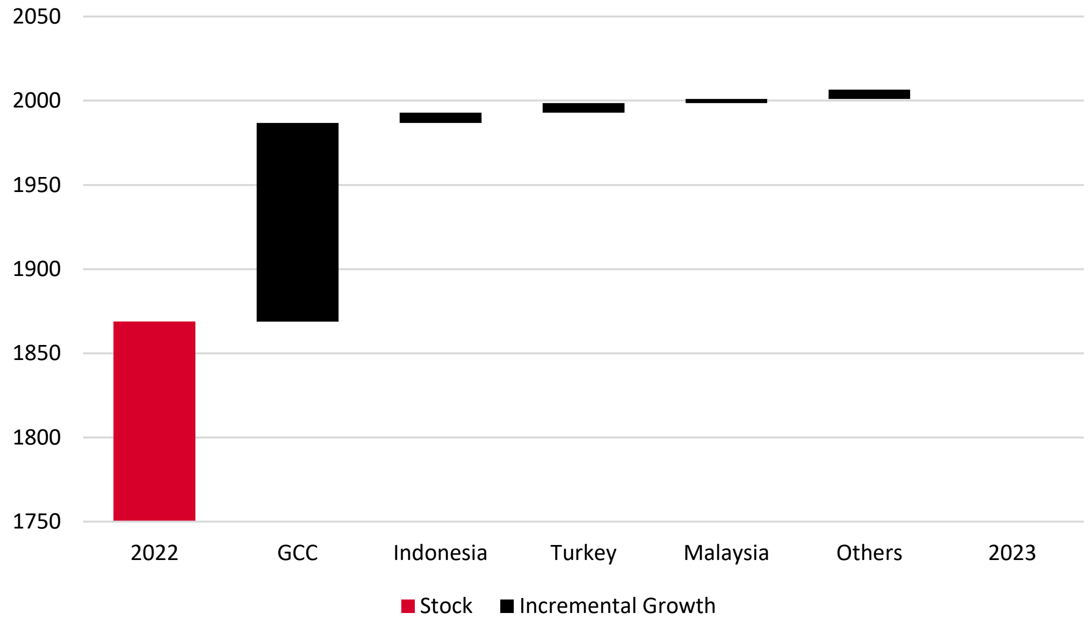
- High financing needs in core Islamic finance countries, stable rates, and improved clarity on the future path of rate cuts explain the continued increase in foreign currency-denominated issuances.
- The main contributors were: Saudi Arabia (government and banks), UAE (real estate developers and banks) and a few other countries.
- Additional issuances of $3.6 billion settled in July 2024.
- We did not see issuers outside core Islamic finance countries coming into the market in the first half of 2024.

The Challenges: Concentrated Growth

No change in the distribution of the Islamic finance banking assets over the past decade.

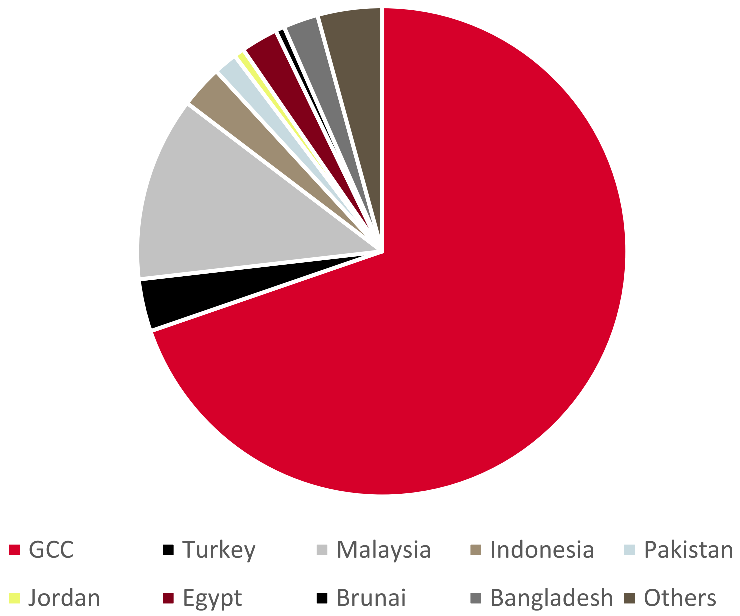
- 70% of the growth of banking assets came from two countries in 2023 (Saudi and UAE). Saudi has also shaped the sukuk market in 2023.
- Economic added value and ease of transaction are key determinant especially for non-Muslim jurisdictions.

A few countries contributed to the growth in 2023



Source: Central Banks, Eikon, S&P Global Ratings

Geographic distribution of Islamic banking assets in 2023



Source: Central Banks, Eikon, S&P Global Ratings

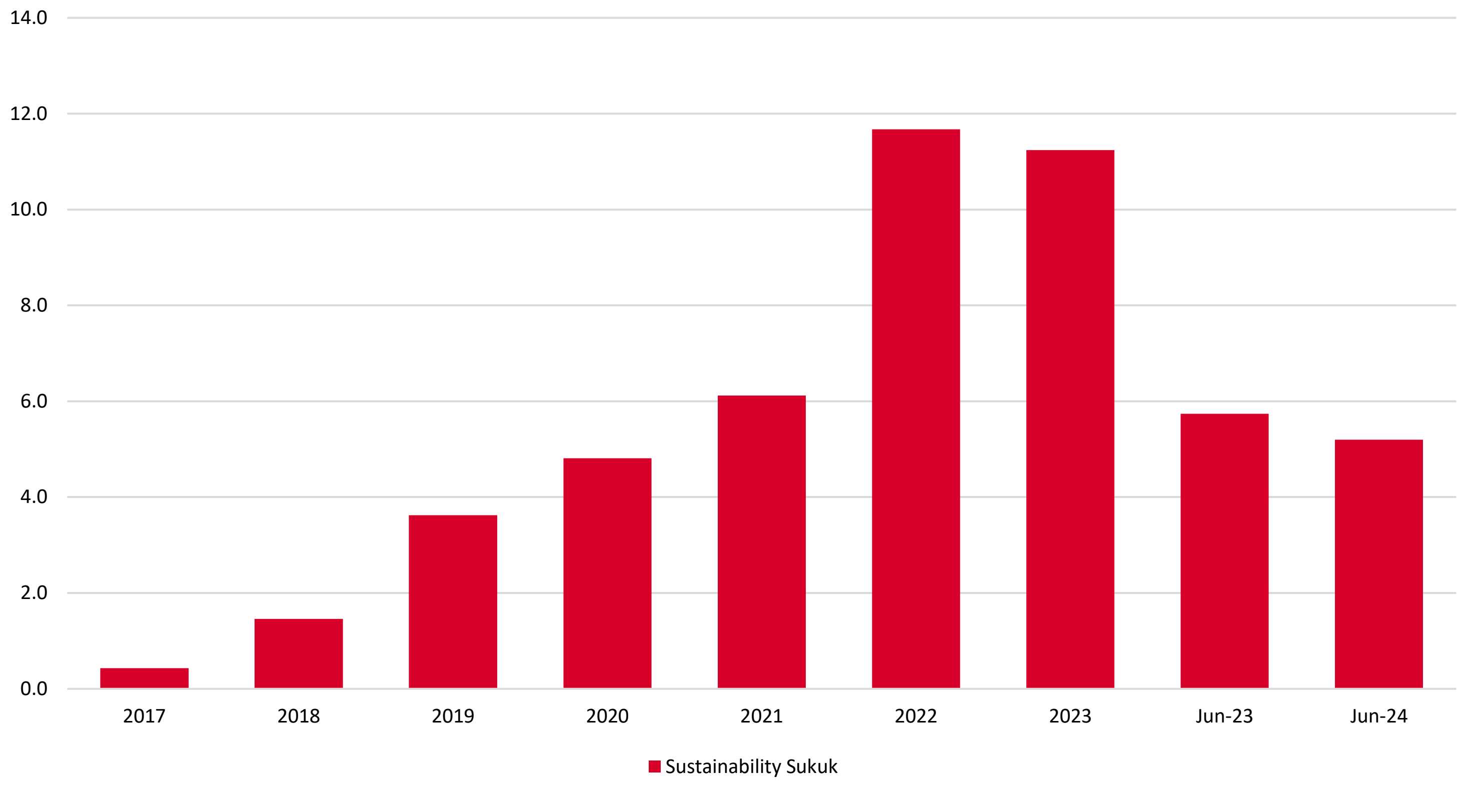
The Challenges: Disruption is on the horizon

Standard 62 adoption could change the nature of the sukuk market and increase fragmentation

- A key requirement of the standard is that the ownership and risks related to the underlying assets are to be transferred to sukuk holders. This could affect the market in several possible ways, among them:
- Sukuk may become more expensive than conventional issuances (cost of registering the assets).
- Investors may be exposed to asset-related risks (some TLE risks can no longer be covered by the sponsor and investors could be exposed to the market value of the assets).
- Potential legal issues (countries where sovereign assets cannot be transferred to foreign investors; governing law of the sukuk.)
- If the standard is adopted as is, the market for AAOIFI adopters could be put on hold until sukuk structurers find ways to restore the fixed income characteristics of the instrument and make it more appealing to fixed income investors.
- This could lead to a situation where the complexity of the instrument increases further or the market becomes more fragmented (AAOIFI adopters vs. non-adopters). This could encourage some adopters to transition away from the standards if they see a significant effect on their ability to tap capital markets. In any case, some fixed income investors may decide to disinvest temporarily, or permanently, which we observed when previous Sharia requirements were changed.

The Challenges: Sustainable And Digital Sukuk Are On The Backburner For Now

The market for sustainability sukuk continues to expand



Source: S&P Global Ratings, Eikon

- We expect the issuance volume of sustainable sukuk to hover at approximately $10 billion-$12 billion in the absence of any major acceleration in the implementation of net zero policies by core Islamic finance countries or regulatory action.
- 80% of sustainability issuance in the first six months of 2024 came from GCC banks as they begin their climate transition journey.
- There are some traction in the digital sukuk space (stablecoin regulation in the UAE, Haqq network plans to issue sukuk and a stablecoin, etc.) but we are still far from significant adoption.

The Key Takeaways

The sukuk market has displayed a good performance in the first half of 2024 and we expect that to continue in the second half of the year.

Disruption is on the horizon with the potential adoption of Standard 62, but this will be a 2025 (or beyond) story.

Sustainable and digital sukuk are on the backburner for now.

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