# Fitch Ratings: Sukuk Issuance Volumes Normalise From 2017 Record High

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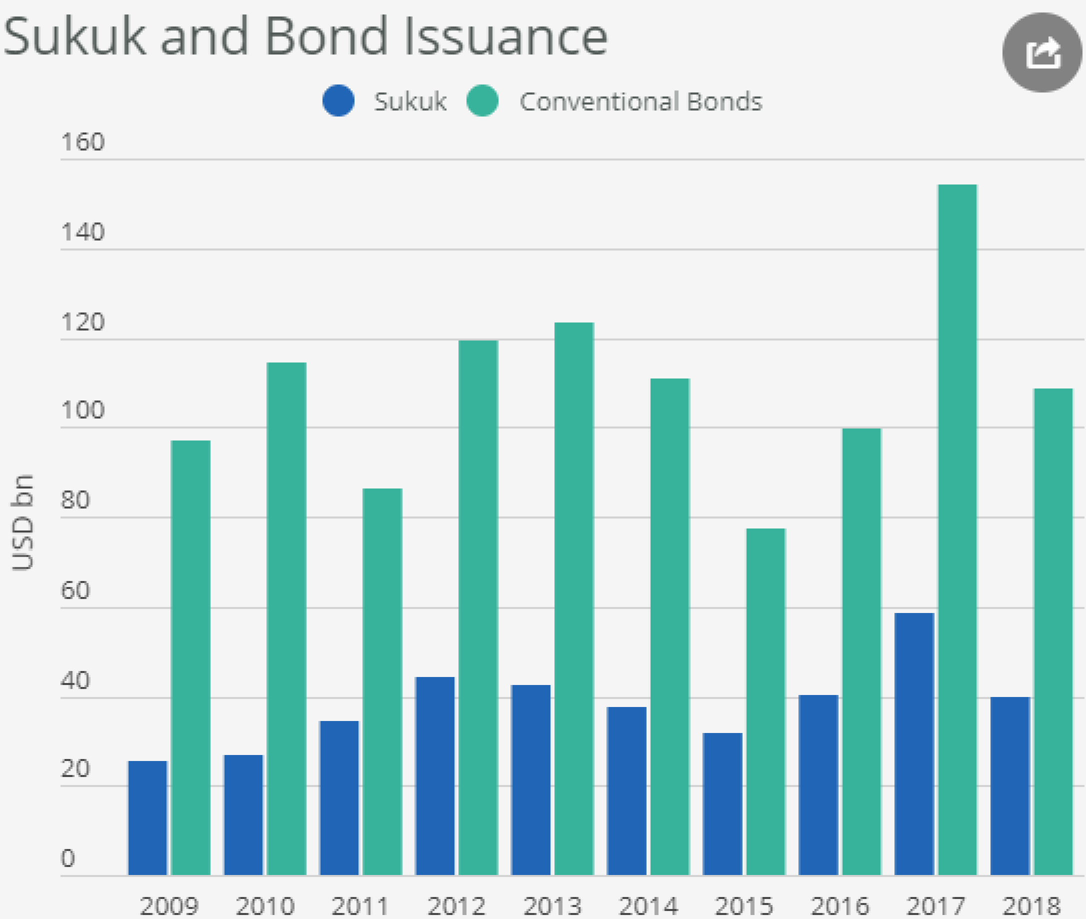
Fitch Ratings-Dubai/London-29 January 2019: Sukuk issuance in the ten largest markets fell last year following record issuance in 2017, Fitch Ratings says. We do not believe this reflects long-term trends, but it shows how issuance volumes can be influenced by the activity of individual borrowers, notably oil-exporting sovereigns.

Sukuk issuance with a maturity of more than 18 months from the Gulf Cooperation Council (GCC) region, Malaysia, Indonesia, Turkey and Pakistan totalled USD39.8 billion in 2018 - a decline of nearly one-third from the previous year, but in line with the 2012-2016 average.

Last year's 30% decline in conventional bond issuance suggests that lower sukuk issuance was principally a function of higher oil prices in 9M18, which reduced immediate borrowing needs among some sovereigns and improved liquidity in their banking systems. US monetary tightening has also raised borrowing costs. Sukuk's share of total issuance was broadly unchanged at 27%.

Debt capital markets in the GCC are relatively immature, and individual sovereign funding decisions can profoundly affect total supply. Most notably, last year, Saudi Arabia raised USD2 billion in new sukuk, having raised USD9 billion in its first international deal in 2017 (the largest ever sukuk). Idiosyncratic factors, such as the embargo of Qatar or Turkey's currency crisis, can affect regional and international investor appetite for some credits, although both were active in their local currency debt markets in 2018.




Data covers GCC, Malaysia, Indonesia, Turkey and Pakistan issuance with a maturity of more than 18 months. Source: Dealogic, Fitch Ratings

We believe that sukuk issuance is more likely to stabilise or slightly recover in 2019 than fall further. We expect debt issuance to constitute a larger share of GCC sovereigns' funding given reduced drawdowns from government reserves. We forecast oil prices to average USD65/bbl (Brent), which may support both conventional and sukuk issuance. Several exporters will need to fund budget deficits, but the price may be sufficient to support investor confidence in these countries' economic performance.

Refinancing volumes should increase in the GCC and elsewhere. The volume of outstanding Fitch-rated sukuk touched USD100 billion for the first time last year, and we estimate that about 30% is due to mature in 2019-2021. We expect the bulk to be refinanced.

Index inclusion should boost investor inflows. Sovereign and quasi-sovereign conventional bonds and sukuk from Saudi Arabia, UAE, Bahrain, Kuwait and Qatar will be eligible for J.P. Morgan's EMBI Global Diversified, EMBI Global and EURO-EMBIG series from 31 January this year.

Efforts to develop markets and products continue. Indonesia has issued the first sovereign green sukuk. The UAE's new debt law allows the federal government to issue sovereign bonds and sukuk. Several sovereigns, such as Saudi Arabia, maintained regular sukuk issuance in their domestic market last year to improve market functioning and liquidity. However, this could take time to translate into large-scale corporate sukuk issuance where banks remain the primary source of debt funding, as in the GCC. In contrast, Malaysian corporates are regular issuers of ringgit sukuk in their domestic market.

Long-standing constraints on the expansion of Islamic finance remain, notably the lack of standardisation of product structure, documentation, financial reporting and sharia codification. Recent initiatives to boost standardisation include the agreement between the Malaysia-based Islamic Financial Services Board and the Accounting and Auditing Organization for Islamic Financial Institutions in Bahrain, to cooperate on prudential, sharia, accounting and governance standards.

But gaps remain, including in relation to legal documentation, and an absence of case law. The sukuk restructuring agreed by Dana Gas creditors left the question of whether sharia compliance has credit implications untested in the UAE courts. However, in response to the case, warranties and waivers' clauses aiming to limit an obligor's ability to challenge sukuk enforceability on the grounds of sharia compliance are increasingly used.

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