



# ***Growth of Islamic Investment*** **International Fund Investment** **Debate**

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## Growth Islamic Investment: Agenda

- MENA Economic Renaissance?
- Macroeconomic & Demographic Factors underlying growth in demand of Shari'a compliant financial services
- Mainstreaming and creating a market for Shari'a compliant financial services
- DIFC/DIFX role in creating a regional market for Shari'a compliant FS



## High Oil Prices leading to:

- Large Increase in Wealth in Oil Producers: Value of oil wealth increased by an estimated \$40 trillion between 1995 and 2005 (IMF 2006)
- Permanent Income increase of some \$850 billion at a Real Rate of 3%
- Real exchange rate appreciation
- Rise in prices of non traded goods & services
- Real Estate boom & asset price appreciation
- Credit Market boom
- Regional stock market boom

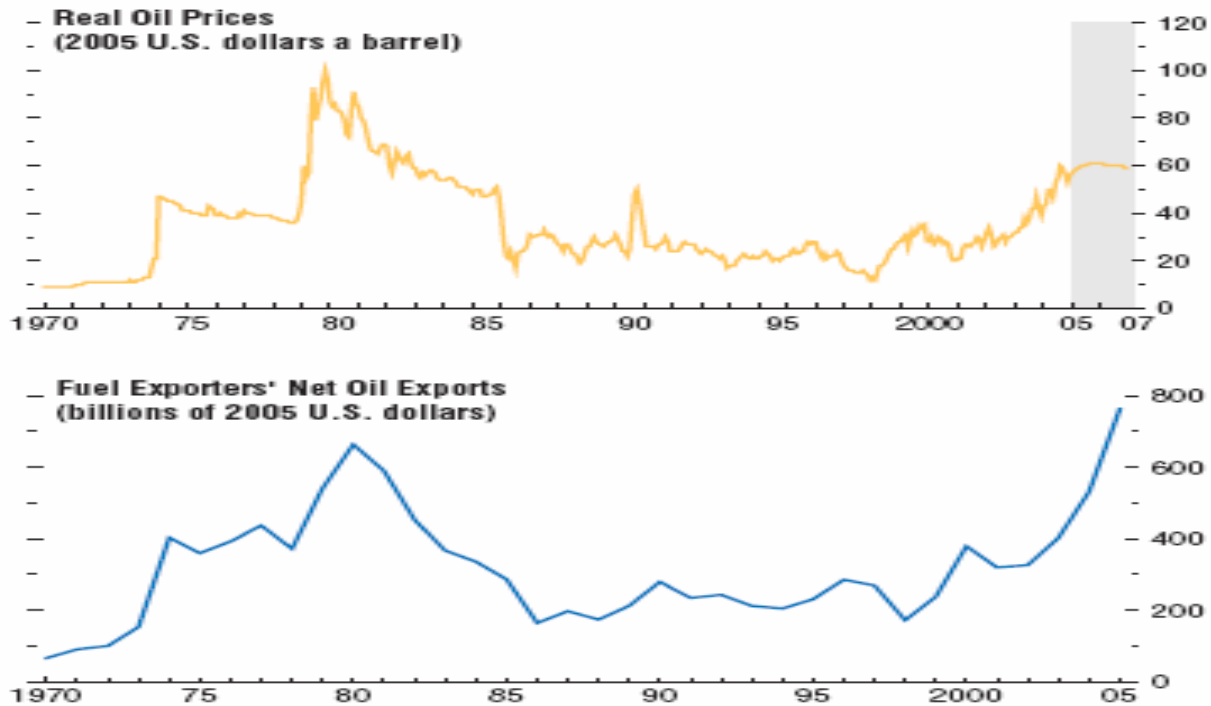


## A MENA Growth Resurgence and Economic Renaissance?

- Average real GDP growth 6.2% over 2003-2005 vs. 4% in 1998-2002
- ↑ Labour flows to oil exporters → ↑ remittances to labour exporting countries (Egypt, Jordan, Lebanon, Morocco)
- Current account surpluses of \$250/\$300 billion or about 25% GDP
- C/A surpluses recycled back into regional economies
- Oil producers have remained fiscally conservative
- Real exchange rate appreciation in oil producers
- Positive demographics sustaining labour & output growth
- Surge in Shari'a compliant banking & finance



## Real Oil Prices and Net Oil Exports



Source: IMF World Economic Outlook Report, April 2006



## Higher Oil Prices Mean Higher Wealth

	Percent of World Reserves	Value of Reserves in Percent of 2005 GDP <sup>1</sup>	Change in Value of Reserves, 1999–2005		Percent of World Crude Oil Production
			Percent of 2005 GDP	Percent of 2005 world GDP	
<b>Sample of selected fuel exporters</b>	<b>88.2</b>	<b>2,156</b>	<b>1,763</b>	<b>98.3</b>	<b>62.4</b>
Kuwait	8.3	8,178	6,708	10.5	3.0
Libya	3.3	5,847	5,034	4.3	2.0
Saudi Arabia	22.1	4,722	3,856	27.6	13.2
Kazakhstan	3.3	4,145	3,663	4.5	1.6
United Arab Emirates	8.2	4,129	3,368	10.3	3.3
Iran, I. R. of	11.1	3,679	3,199	14.8	5.1
Venezuela	6.5	3,329	2,724	8.1	3.7
Azerbaijan	0.6	3,276	2,672	0.7	0.4
Qatar	1.3	2,244	2,143	1.9	1.2
Nigeria	3.0	2,111	1,862	4.0	3.1
Angola	0.7	1,826	1,672	1.0	1.2
Congo, Rep. of	0.2	1,729	1,425	0.2	0.3
Gabon	0.2	1,416	1,123	0.2	0.3
Sudan	0.5	1,290	1,280	0.8	0.4
Equatorial Guinea	0.1	1,133	1,042	0.2	0.4
Oman	0.5	1,033	849	0.6	1.0
Yemen	0.2	1,010	995	0.4	0.5
Brunei Darussalam	0.1	927	761	0.1	0.3
Syrian Arab Republic	0.3	661	572	0.4	0.7
Algeria	1.0	635	522	1.3	2.4
Russia	6.0	529	454	8.0	11.6
Trinidad and Tobago	0.1	399	354	0.1	0.2
Norway	0.8	185	144	1.0	4.0
Turkmenistan	—	175	142	0.1	0.3
Bahrain	—	53	36	—	0.1
Iraq <sup>2</sup>	9.7	—	—	12.1	2.5
<b>OPEC</b>	<b>74.9</b>	<b>3,601</b>	<b>2,997</b>	<b>95.3</b>	<b>41.0</b>
<b>World</b>	<b>100.0</b>	<b>153</b>	<b>128</b>	<b>128.0</b>	<b>100.0</b>

Sources: BP, *Statistical Review of World Energy 2005*; Energy Information Administration; and IMF staff calculations.

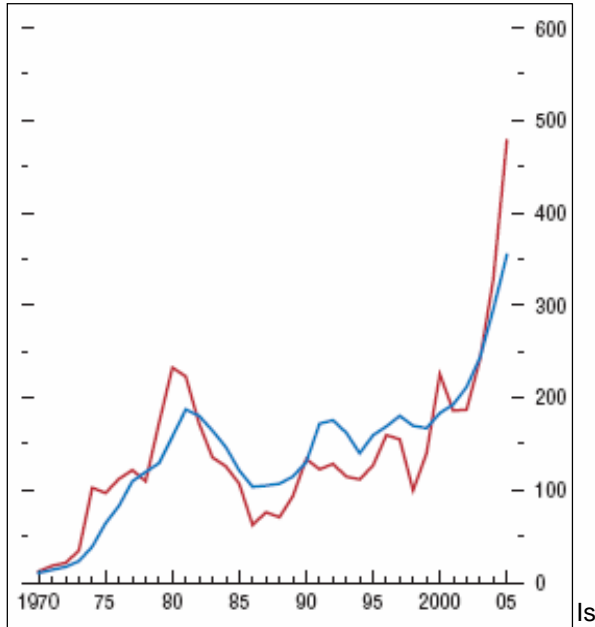
Note: Estimates of reserves refer to end-2004 and of crude oil production to 2004 (except for Bahrain, where production estimates refer to 2003).

<sup>1</sup>Total value of stock of reserves calculated using average petroleum spot price for December 2005.

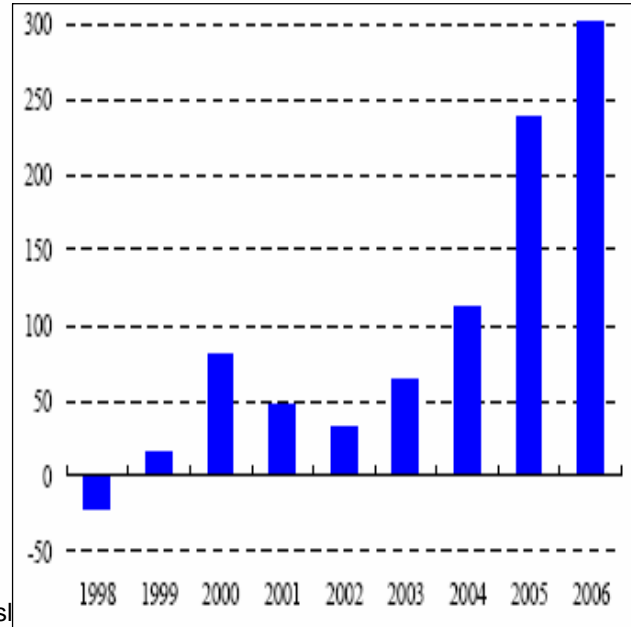


## Higher Oil-Related Inflows Led to Stronger External Positions for Oil Exporters with Current Account Surpluses running at 20-25% of GDP

**OPEC Imports and Oil Exports**  
(Billions of USD)



**Current Account Balance for Oil Exporters**  
(Billions of USD)

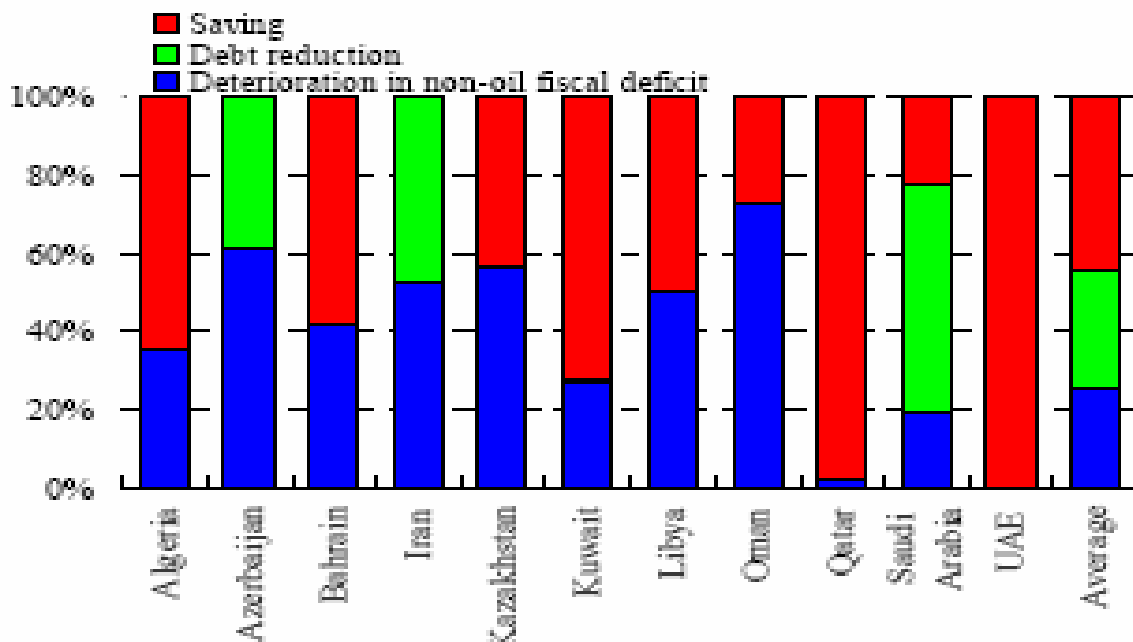


Source: IMF World Economic Outlook Report, April 2006/ IMF Staff Estimates & Projections



## Current Account Surpluses of Oil Exporters Recycled Back Into Regional Economies

Use of Additional Oil Revenue, 2003-2005 (In percent, base year = 2002)





## MENA Sustaining the Boom I

- Oil price shock more likely to be permanent than in earlier episodes 1973-1974 or 1979-1981
- Increased Absorptive Capacity
- Greater Economic & Financial Integration
- Oil exporters have learnt lesson from 1970s: fiscally prudent
- Regional boom: tourism, investment and wealth repatriation as a result of high returns on investment, increased asset risk uncertainty and higher barriers in external markets

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## MENA Sustaining the Boom II

- Economic reforms and state divestment & privatisation.
- Growing private sector participation in infrastructure across MENA countries.
- Infrastructural Developments: estimated value of projects planned or under development in the Gulf exceeds USD 1 trillion.
- Greater regional economic integration: GCC Monetary Union in 2010, lower trade barriers Greater Arab FTA
- With economic diversification and liberalisation attractive prospects exist across many sectors.

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## Islamic Finance: Size of Market

- Sukuk: US\$ 15 billion
- Islamic Assets: US\$ 275 billion
- Islamic Funds: US\$ 350 billion
- Annual Growth Rate: 15% p.a.
- Shari'a compliant institutions now account for about 25% of banking & financial system in UAE, Bahrain



## Shari'a compliant finance: product availability

- Overall size estimated at some US\$650/700 billion made up of (in descending order):
  - Morabaha transactions
  - Shari'a compliant funds
  - Retail Finance products
  - Sukuk



## Growth of Islamic Finance Dependent on

- Challenge is access to Shari'a compliant FS: only 20% of Muslim population in GCC buys Shari'a FS
- Greater Standardisation & regulatory & legal alignment
- Adoption of Shari'a compliant CG
- Improvement & harmonisation of Shari'a regulatory compliance process
- Issuance of tradable Shari'a compliant financial instruments
- Creating liquidity for a secondary market for Shari'a compliant financial instruments
- 'Lender of last resort' function
- Creating "breadth, depth & liquidity"
- Set-up Corporate Governance framework for Shari'a compliant institutions and FS



## Shari'a compliant finance: product availability

- Funds generally mandate or institution focused: limited development of retail collective investment instruments
- Despite popularity, retail real estate funds have limited accessibility
- Sukuk funds have yet to take off: supply remains limited and institution focused
- Alternative investment instruments including derivatives and hedge funds are untested, nascent and require Shari'a compliance assessment and approval



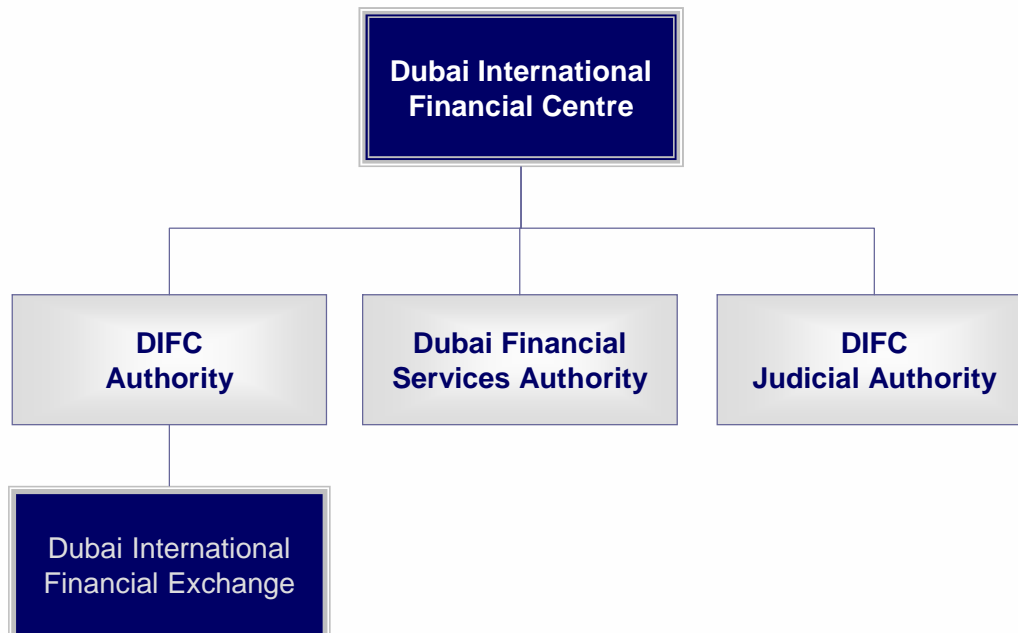
## DIFC/DIFX: Creating a market for Shari'a FS

- DIFC has set clear procedures for authorising Shari'a compliant institutions
- DIFC/DFSA/DIFX have streamlined listing of Shari'a compliant financial instruments
- DIFC has set-up an Islamic Finance Advisory Council (IFAC)
- Aim is to provide the main regional platform for a secondary market in Sukuk and Shari'a compliant funds
- DIFC is home to largest ever Sukuk issue US\$3.4 billion
- Creation of a Government Sukuk market:
  - Financing infrastructure
  - Mainstreaming as public finance instrument
- Creation of Shari'a based mortgage market to support housing finance

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**DIFC Authority**

*DIFC Authority*

Responsible for the entire development of the Centre. Comprises of industry experts from business development, finance, IT, communications, administration and human resources

**DIFX**

*Dubai International Financial Exchange*

Responsible for creating and developing the international financial exchange that will provide an aggregated and liquid securities market to meet the funding/investing needs of the region

**DFSA**

*Dubai Financial Services Authority*

An independent regulatory and supervisory body of the highest quality, responsible for ensuring that the DIFC is among the best-regulated global financial markets

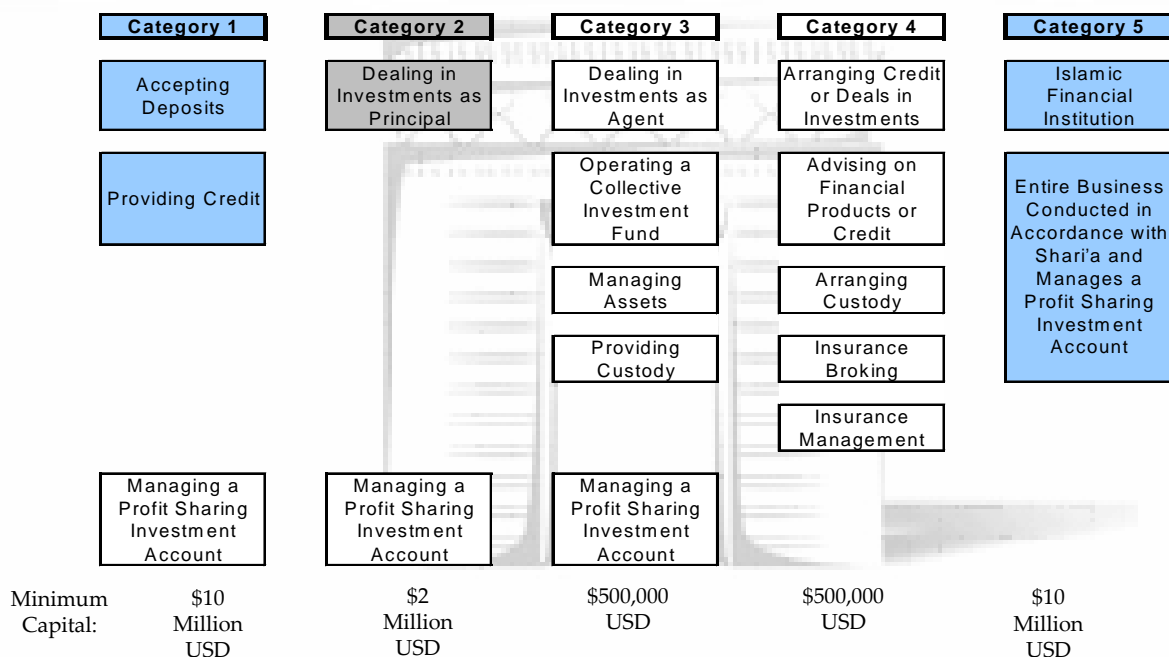
**DJA**

*DIFC Judicial Authority*

An independent court with unlimited civil and commercial jurisdiction, comprised of a Chief Justice and other judges who will hear and determine civil matters, refer them to arbitration, or establish specialist tribunals as required



## Financial Services Authorisation Categories





## Some Implications

- Asset management industry has to build Shari'a compliance capacity: knowledge, people, funds
- Asset management industry has to establish a geographical presence in MENA-Central Asia region
- Asset management industry has to develop compliance capacity: Shari'a, legal and regulatory aspects
- DIFC intends to become the major hub and capital market for Shari'a compliant financial services and instruments