

Challenges & Opportunities of the Global & Regional Economic Landscape

Islamic Securitization World 2009

Dubai - February 9 2009

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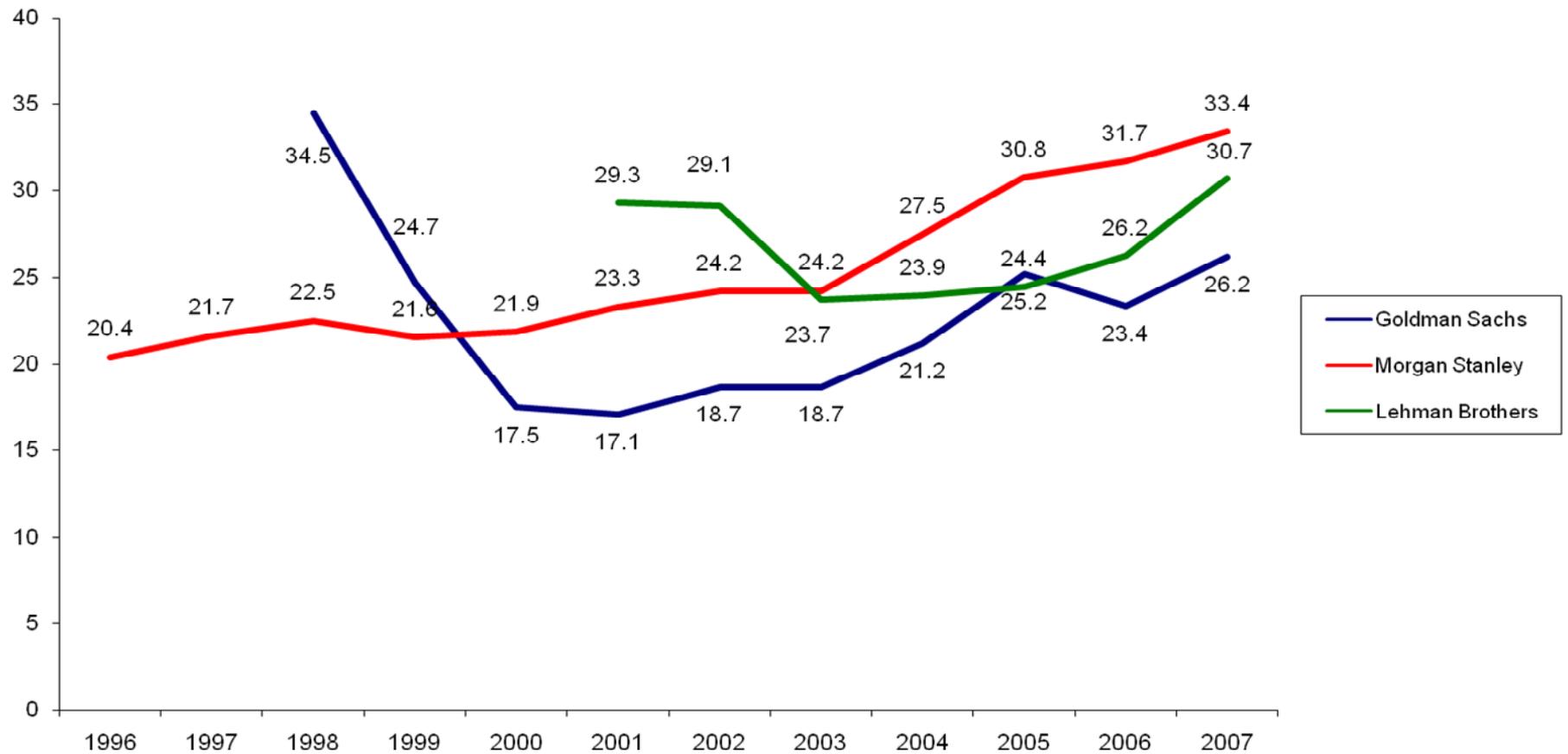
- **The Wall Street meltdown: what have the effects been on the regional markets?**
- **Which markets are more prone to an asset “bubble”?**
- **GCC economic prospects**
- **Islamic securitisation opportunities**

A crisis triggered by deleveraging



- Deleveraging process was proceeding more or less in an orderly way through a mix of asset sales and capital injections until the Lehman collapse in September 2008
- After that the financial institutions suffered a severe crisis of confidence with credit markets all but frozen
- Banks and funds were forced to dispose precipitously of their assets to restore capital adequacy ratios. Loss of confidence & increased risk aversion propagated like an earthquake wave through all markets even those with limited exposure to toxic assets and other excesses
- Emerging markets were able to cope while the deleveraging process remained under control, but after September 2008 the shockwaves were simply too powerful to be withstood

Leverage in major US investment banks



Average Leverage in US Financial Institutions

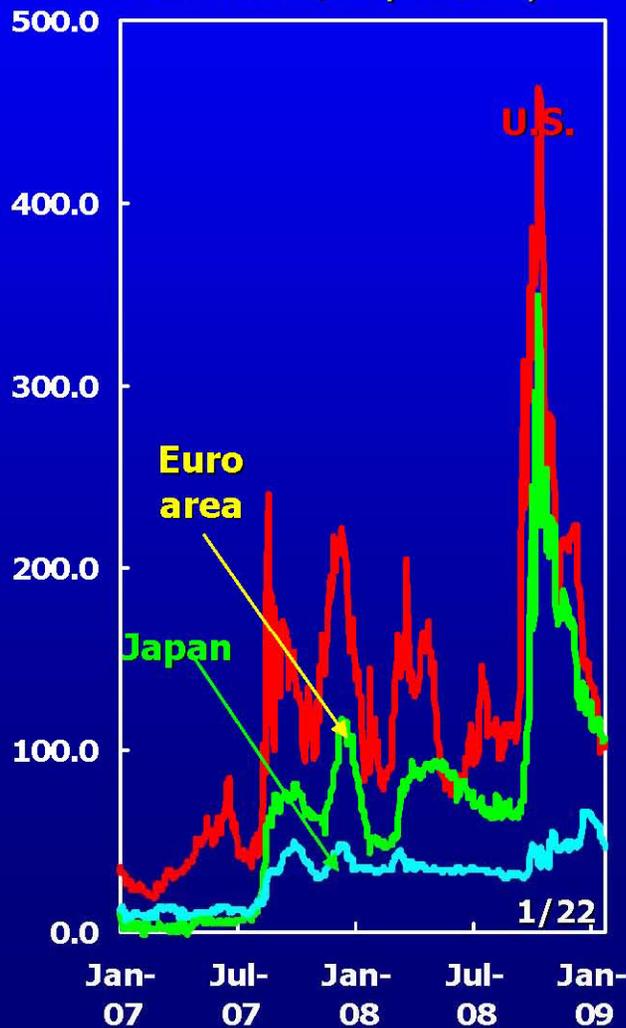
- Commercial banks 9.8
- Investment banks and
• hedge funds 27.1
- Fannie & Freddie 23.5



Global financial system slowly coming back from the brink

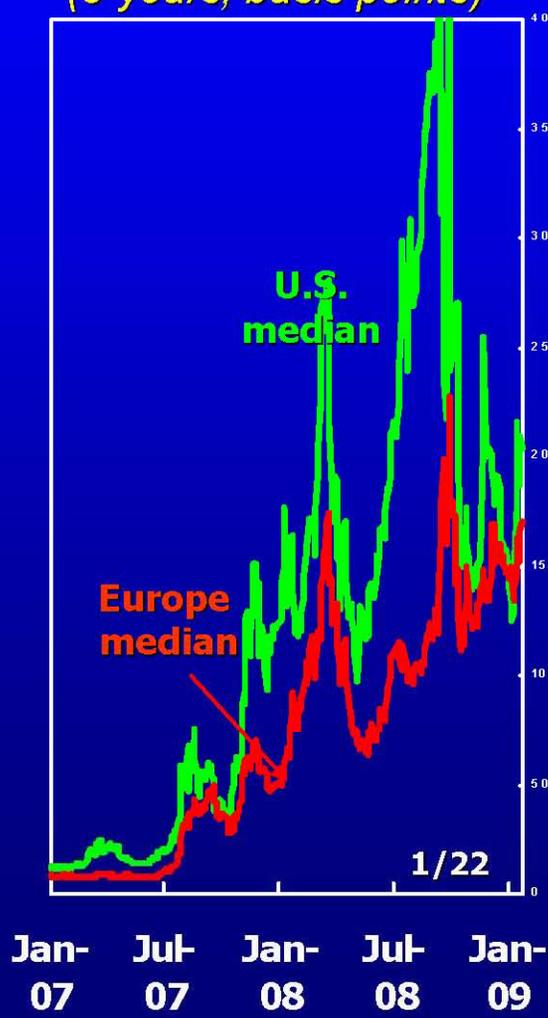
Interbank Markets

(3-month LIBOR minus T-bill rate; in percent)



Bank CDS Spreads

(5-years; basis points)



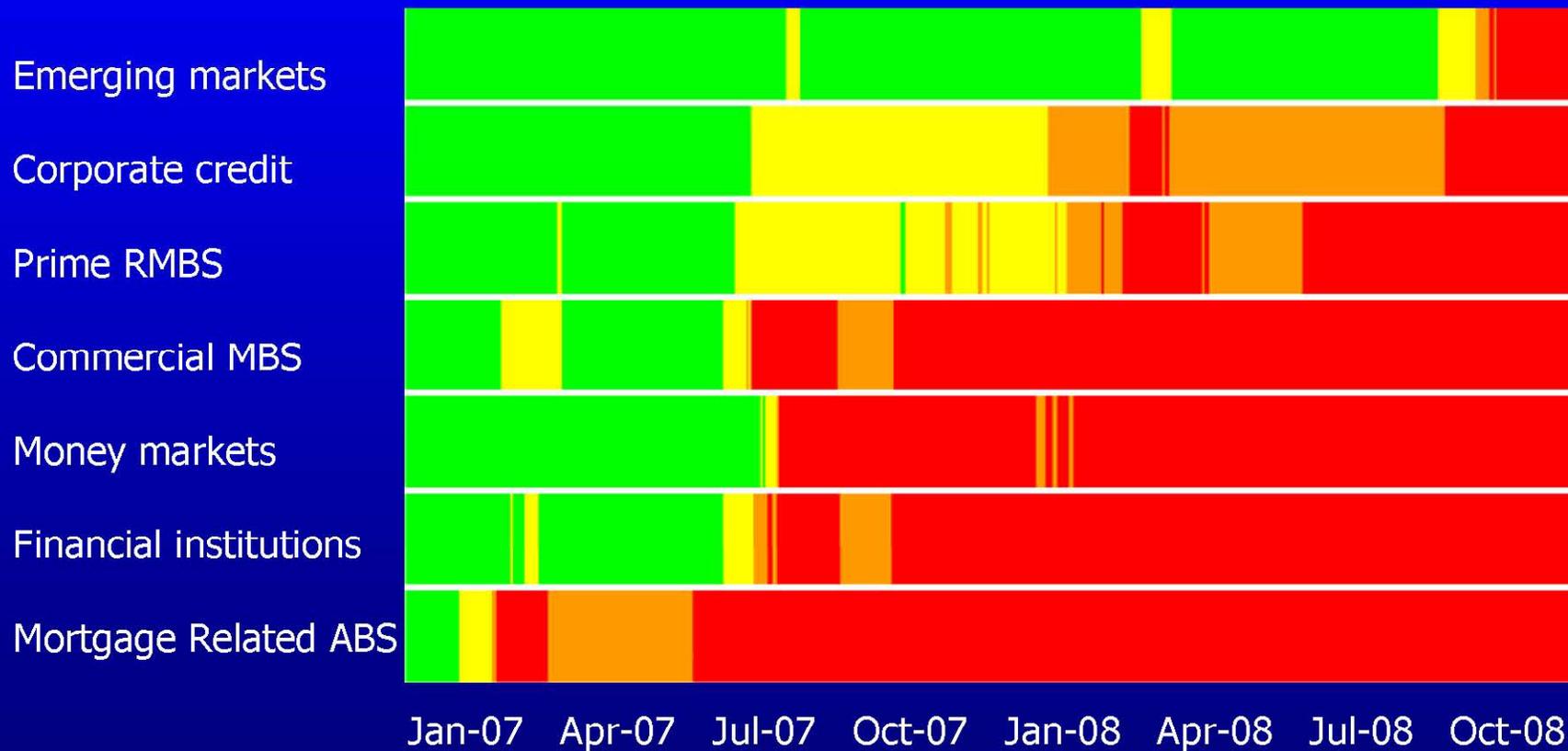
High-Grade Spreads

(basis points)



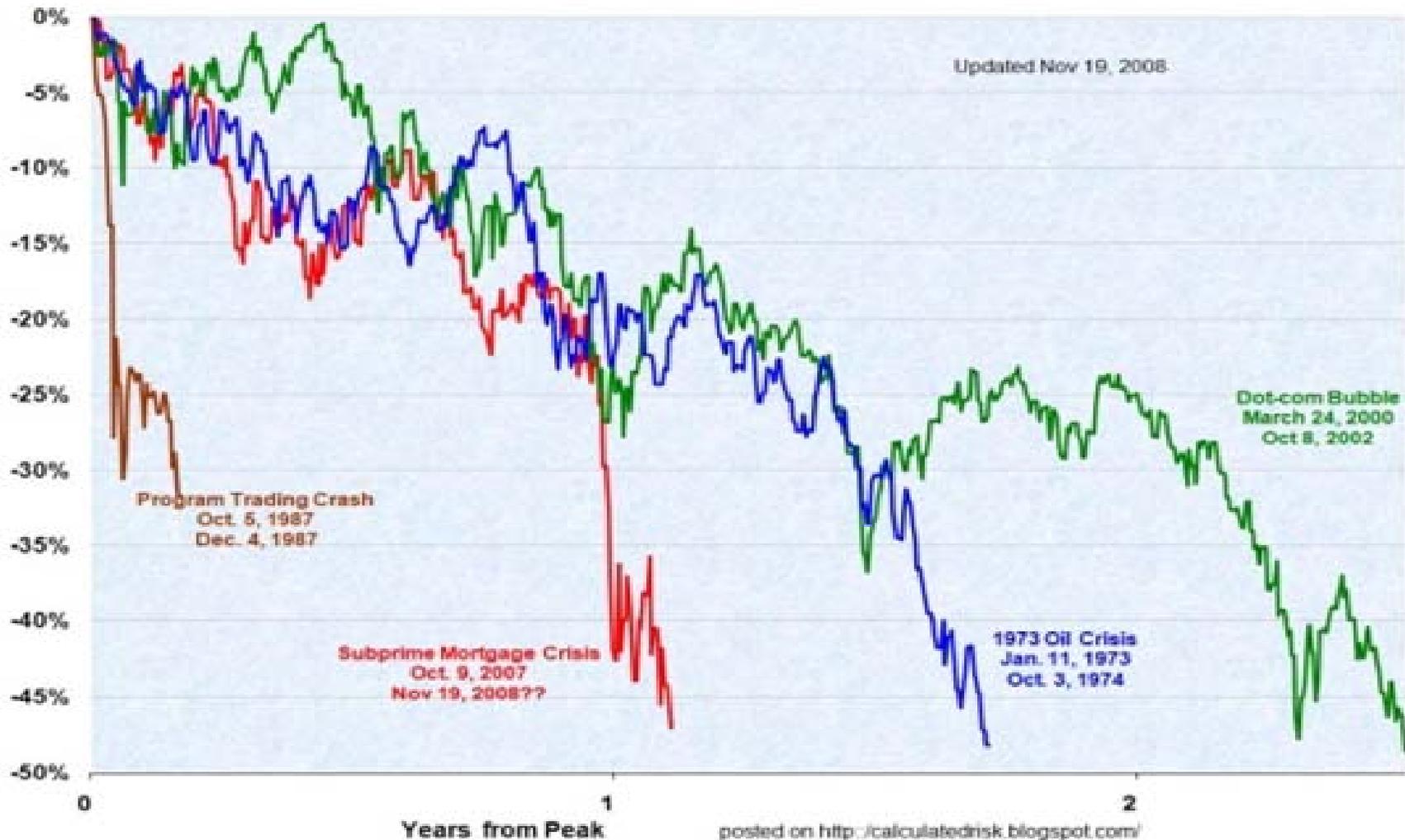
And the spread of the crisis to emerging markets will continue

Heat Map of Systemic Asset Classes



Comparison with other US crashes

S&P 500 Crashes



Stylised Facts on the Aftermath of Severe Financial Crises

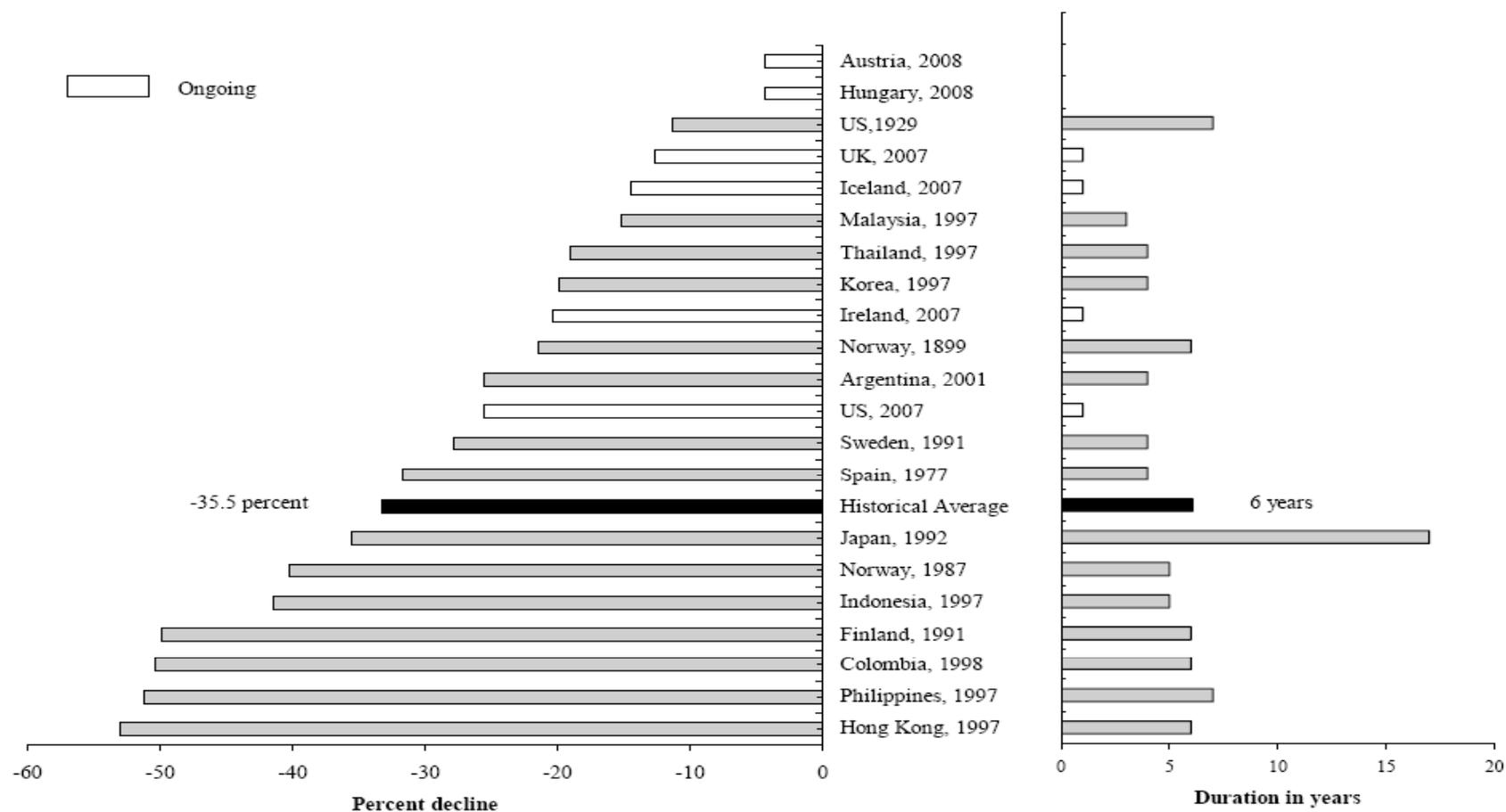
C. Reinhart & K. Rogoff (2008)



- 1. *Asset market*** collapses are deep and prolonged. Real housing price declines average 35 percent stretched out over six years. Equity price collapses average 55 percent over a downturn of about three and a half years.
- 2. *Aftermath of banking crises is*** associated with profound declines in output and employment. Unemployment rate rises an average of 7 percentage points over the down phase of the cycle, which lasts on average over four years. Output falls (from peak to trough) an average of over 9 percent, although the duration of the downturn, averaging roughly two years, is shorter than for unemployment.
- 3. *Real value of government debt tends to*** explode, rising an average of 86 percent in the major post–World War II episodes. Main cause of debt explosions is not the costs of bailing; the big drivers of debt increases are the collapse in tax revenues as a result of recession.

Past and Ongoing Real House Price Cycles and Banking Crises:

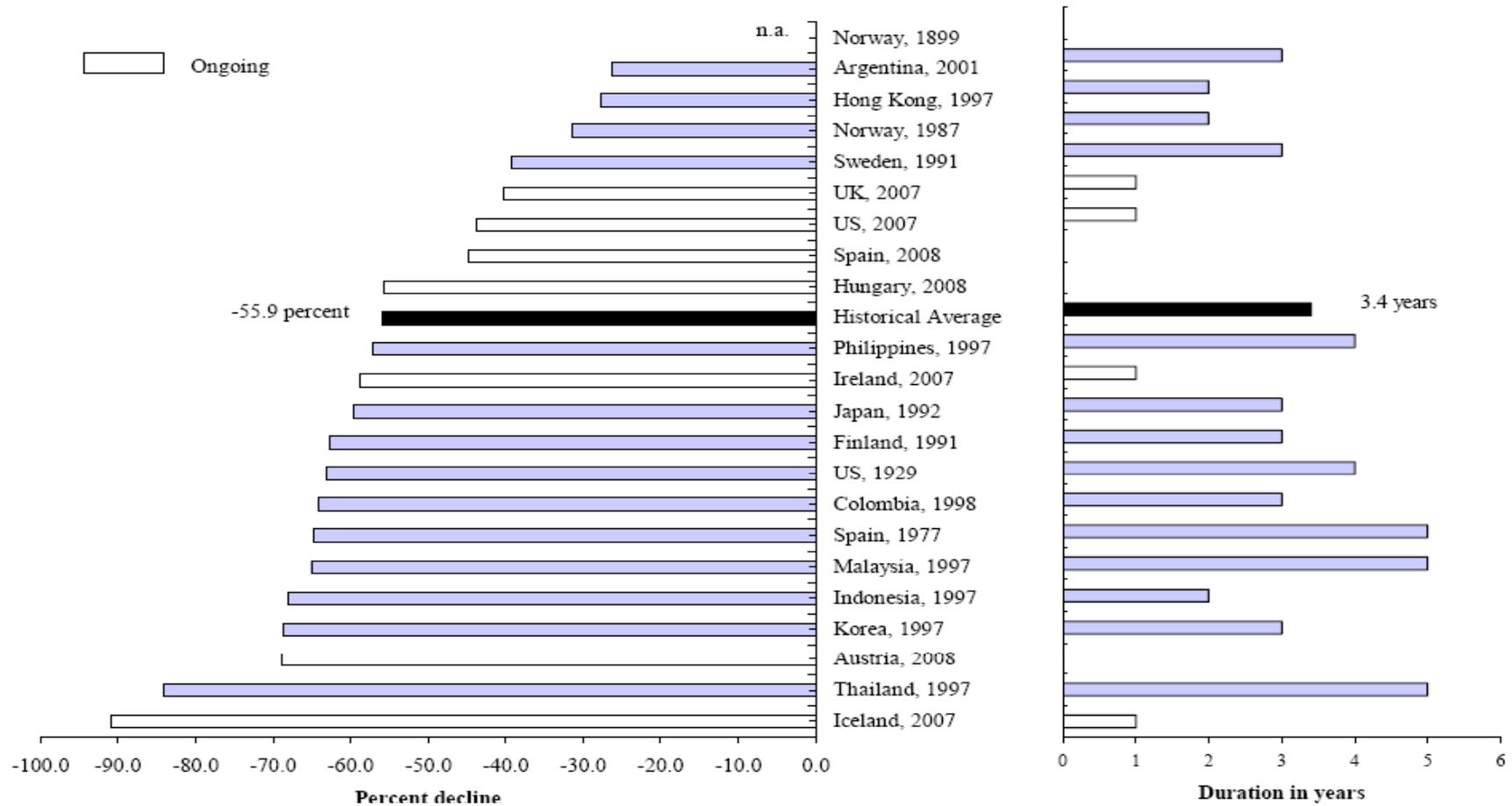
Peak-to-trough Price Declines (left panel) and Years Duration of Downturn (right panel)



Sources: Reinhart and Rogoff (2008b) and sources cited therein.

Past and Ongoing Real Equity Price Cycles and Banking Crises:

Peak-to-trough Price Declines (left panel) and Years Duration of Downturn (right panel)



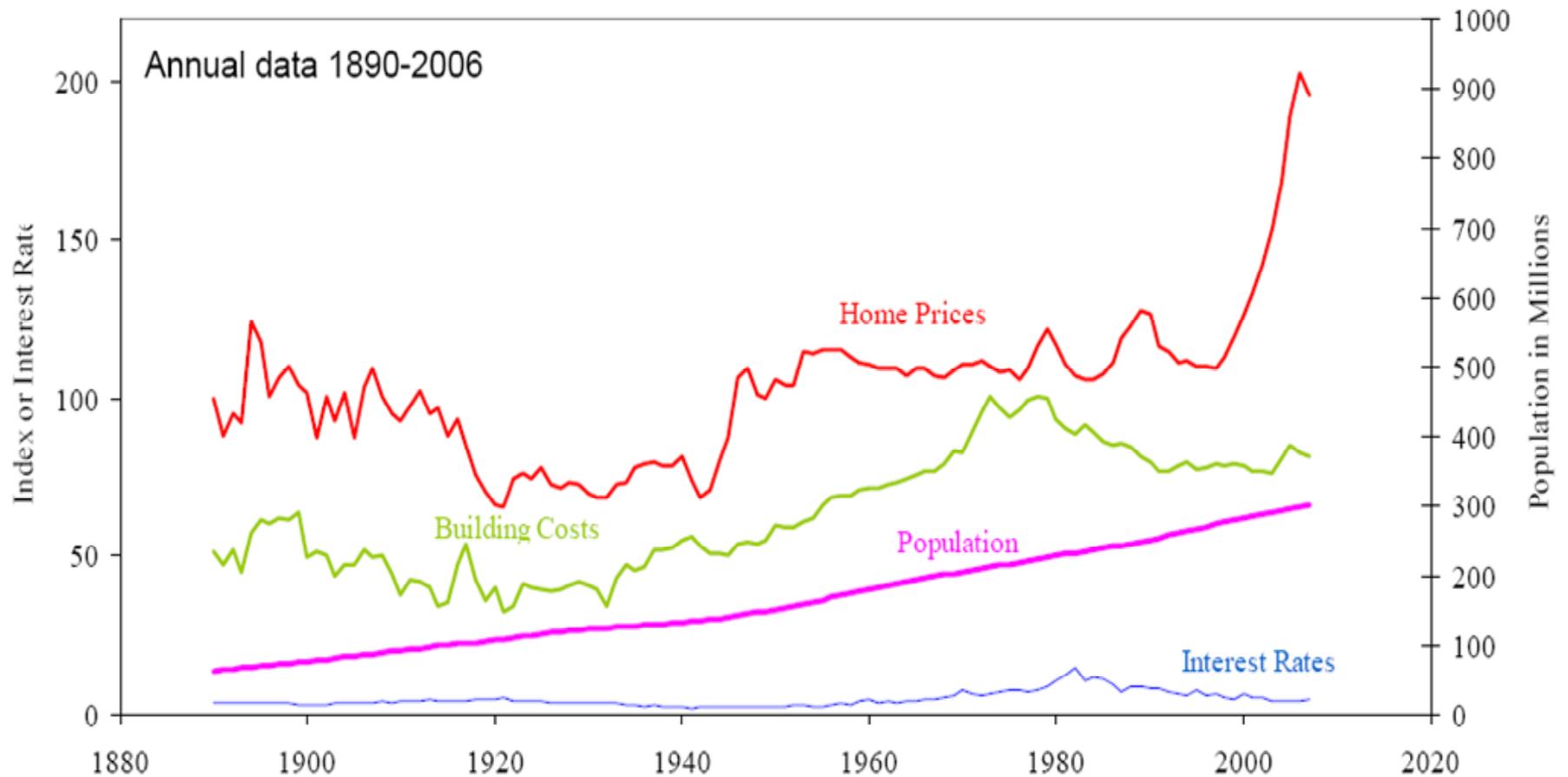
Sources: Reinhart and Rogoff (2008b) and sources cited therein

Which markets are prone to bubbles?

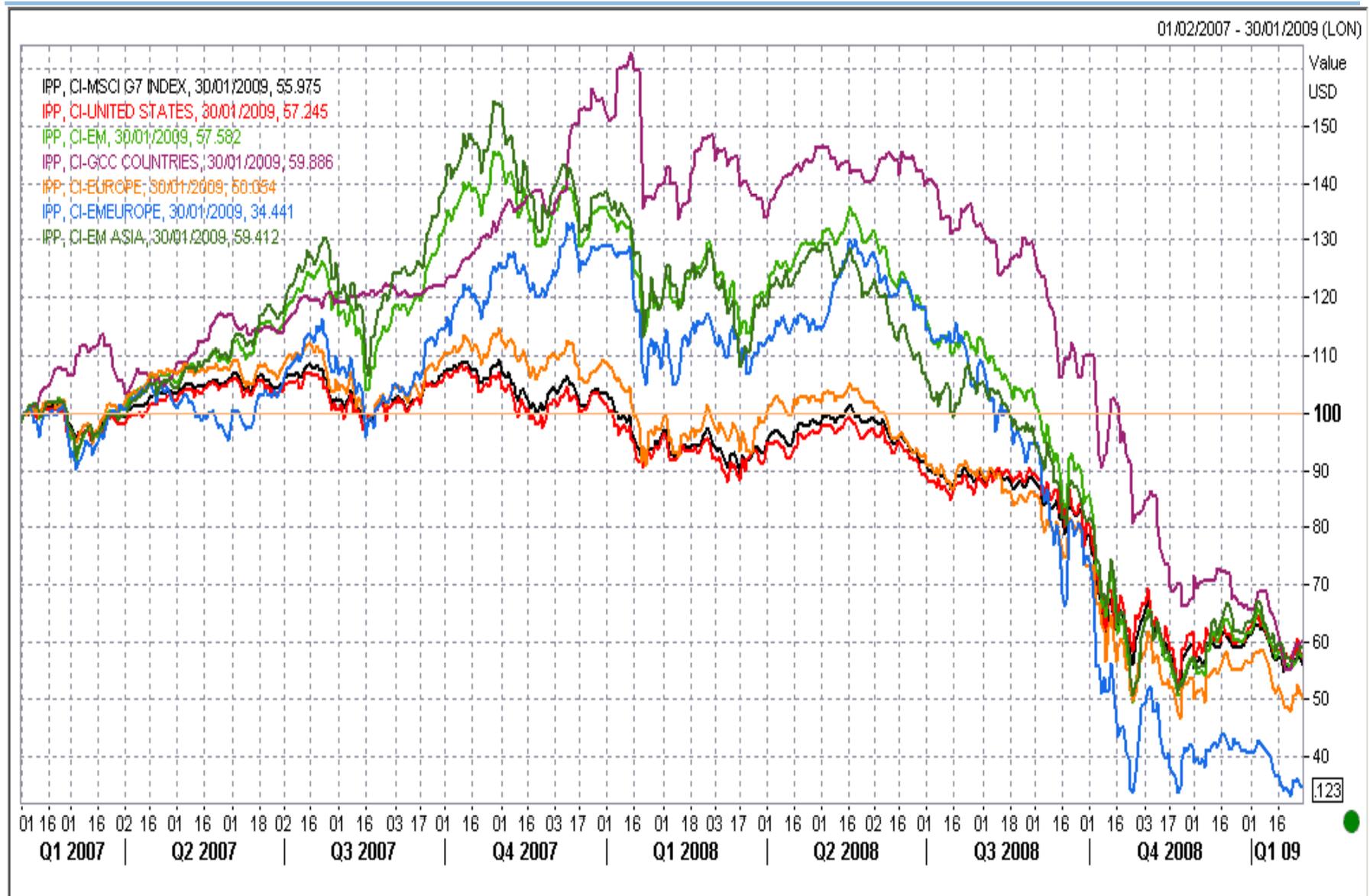


- All markets are at risk of unsustainable valuations (tulips, dotcoms, real estate, commodities, optic fiber)
- This happens when price expectations get out of line with economic fundamentals and “risk adjusted” long term real rates of return on assets
- Compounded by mal-governance and bad risk management and incentive structures
- Role of the authorities is also crucial: current crisis is the result of a monumental failure by supervisory bodies in developed markets, that were supposed to set best practices

USA: Housing prices since 1880



Emerging Markets vs. G7 Equities

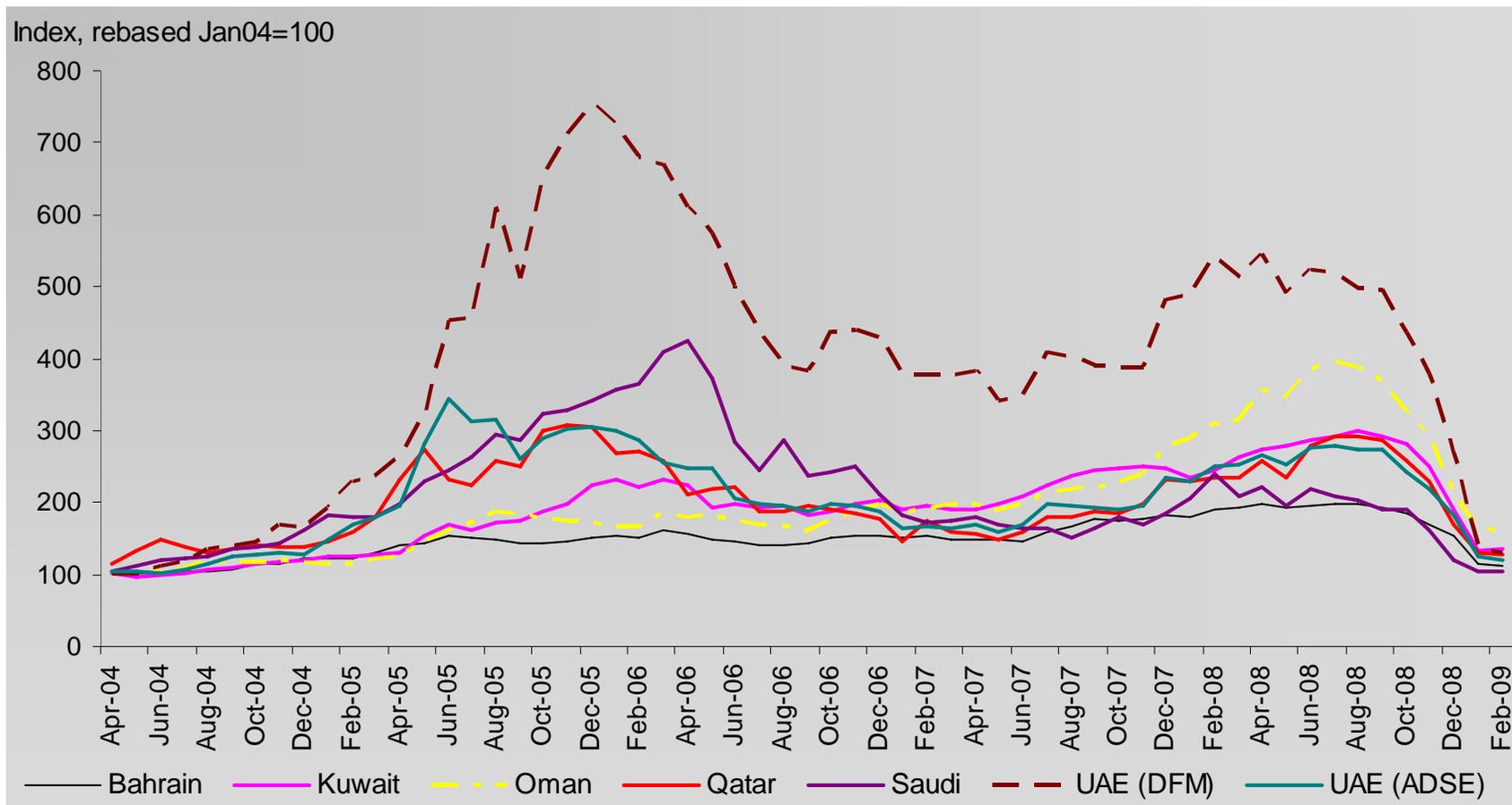


Source: Reuters 3000Xtra, DIFC Economics

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GCC Stock Market Performance

- ❖ After the spectacular performance of 2005, markets suffered from sell-off signaling the need for reform to restore investors as well issuer confidence.
- ❖ Since mid-2007, in the wake of spectacular growth, there was a rebound which has been affected by the sub-prime credit crisis, but to a lesser extent than in major markets. Strong economic and financial fundamentals should restore investor confidence in the medium-term.



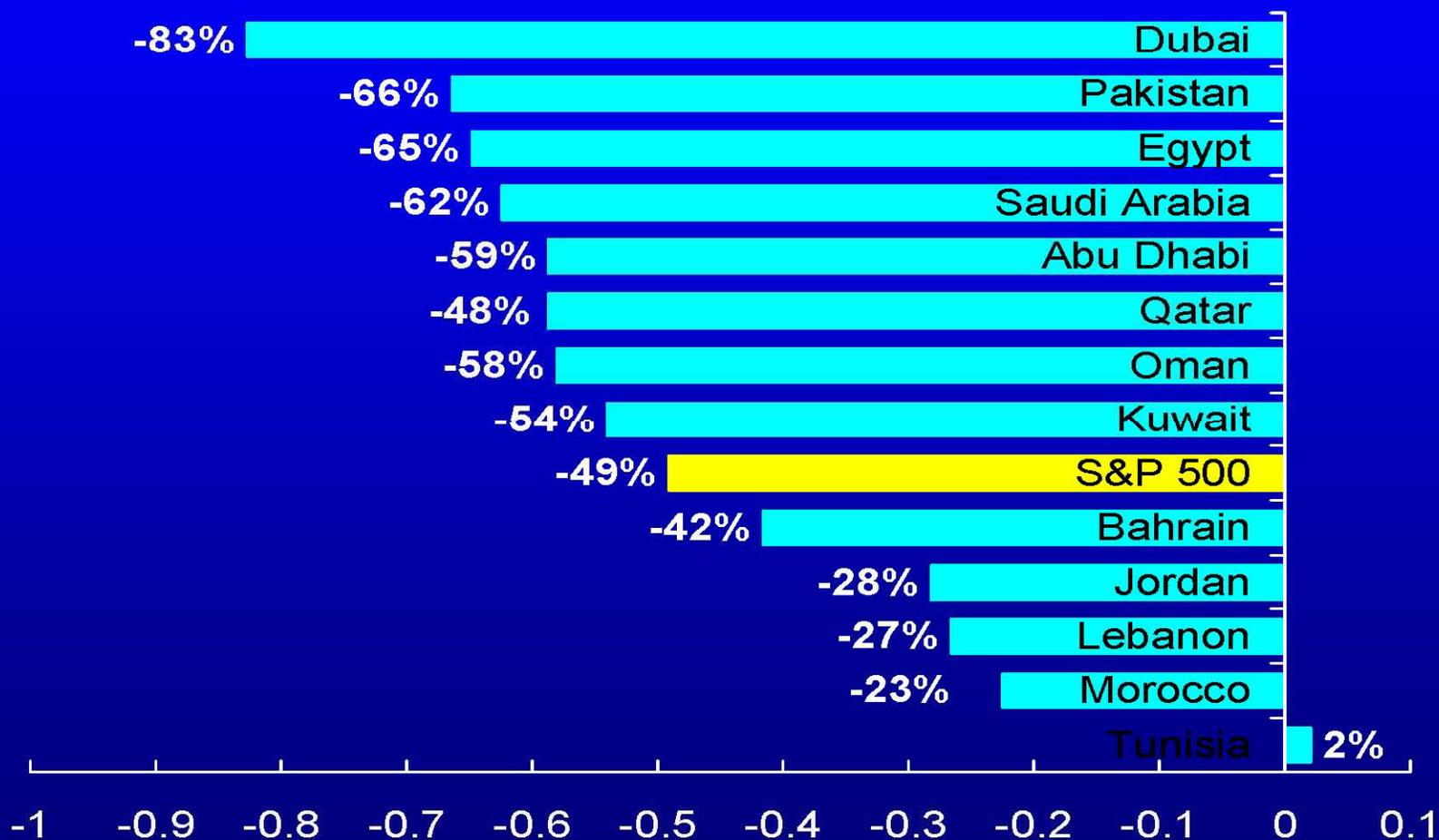
Source: Reuters 3000Xtra, DIFC Economics.

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Asset price corrections deepen further

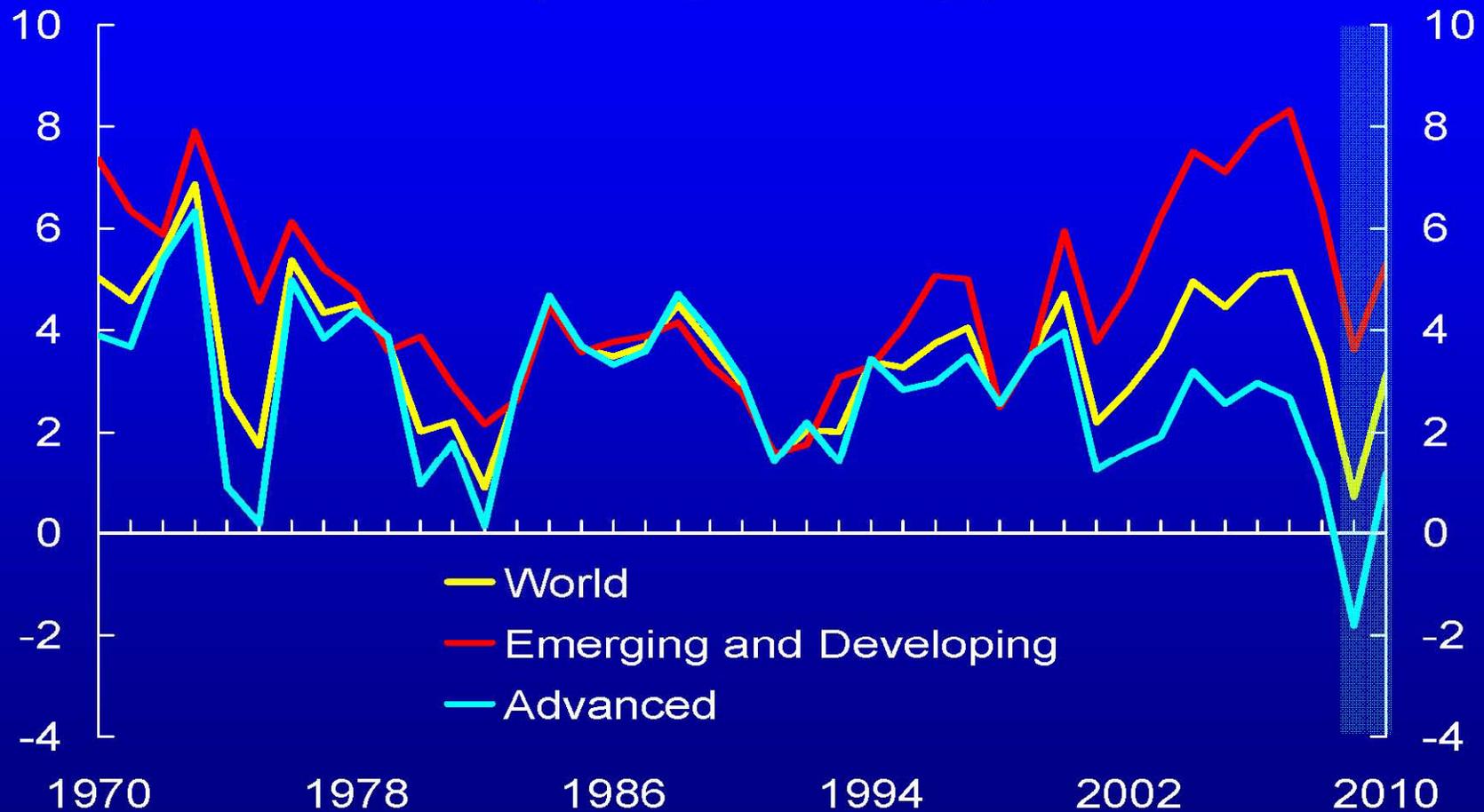
Change in Stock Market Indices

(Jan 01, 2008 – Jan 23, 2009, in U.S. dollars)



Global economy heading for major downturn

Real GDP Growth
(Annual percent change)

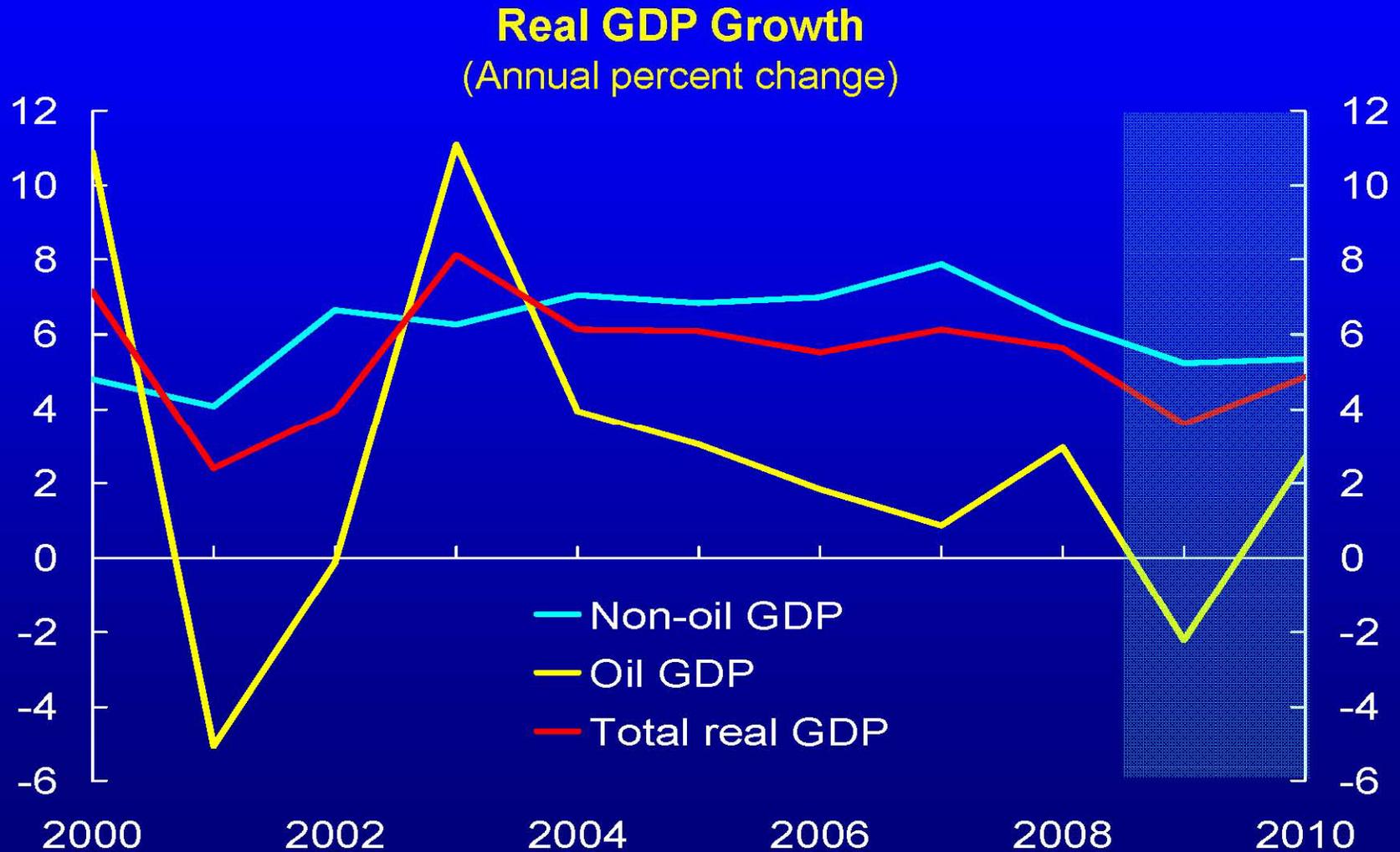


All regions affected...

Overview of the World Economic Outlook Projections (Year on Year)

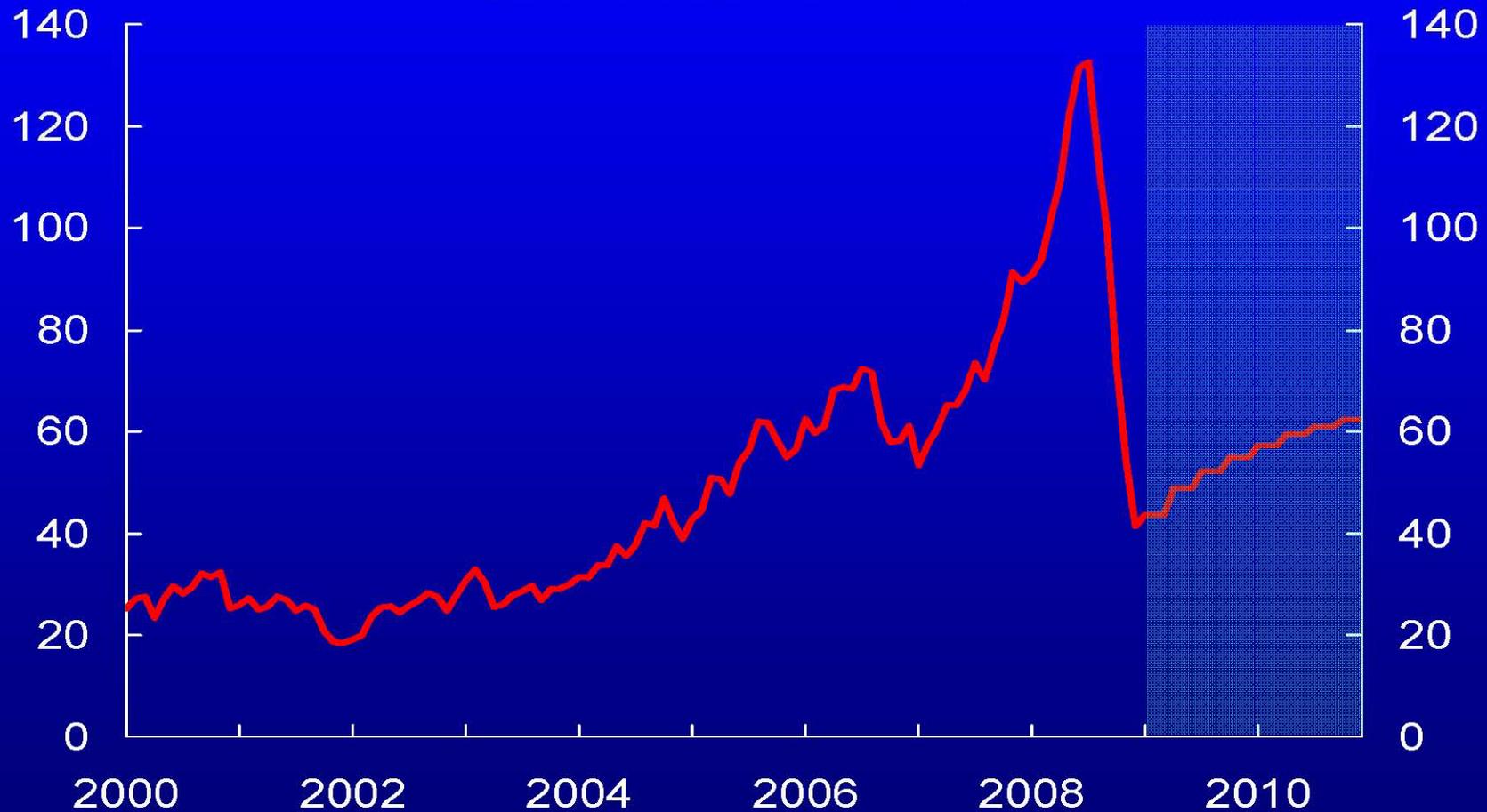
	<u>Projections</u>				Difference from Nov. 2008 WEO Projections	
	2007	2008	2009	2010	2009	2010
World output	5.2	3.4	0.5	3.0	-1.7	-0.8
Advanced Economies	2.7	1.0	-2.0	1.1	-1.7	-0.5
United States	2.0	1.1	-1.6	1.6	-0.9	0.1
Euro Area	2.6	1.0	-2.0	0.2	-1.5	-0.7
Emerging and Developing economies	8.3	6.3	3.3	5.0	-1.8	-1.2

Growth in MENAP oil producers is expected to slow...



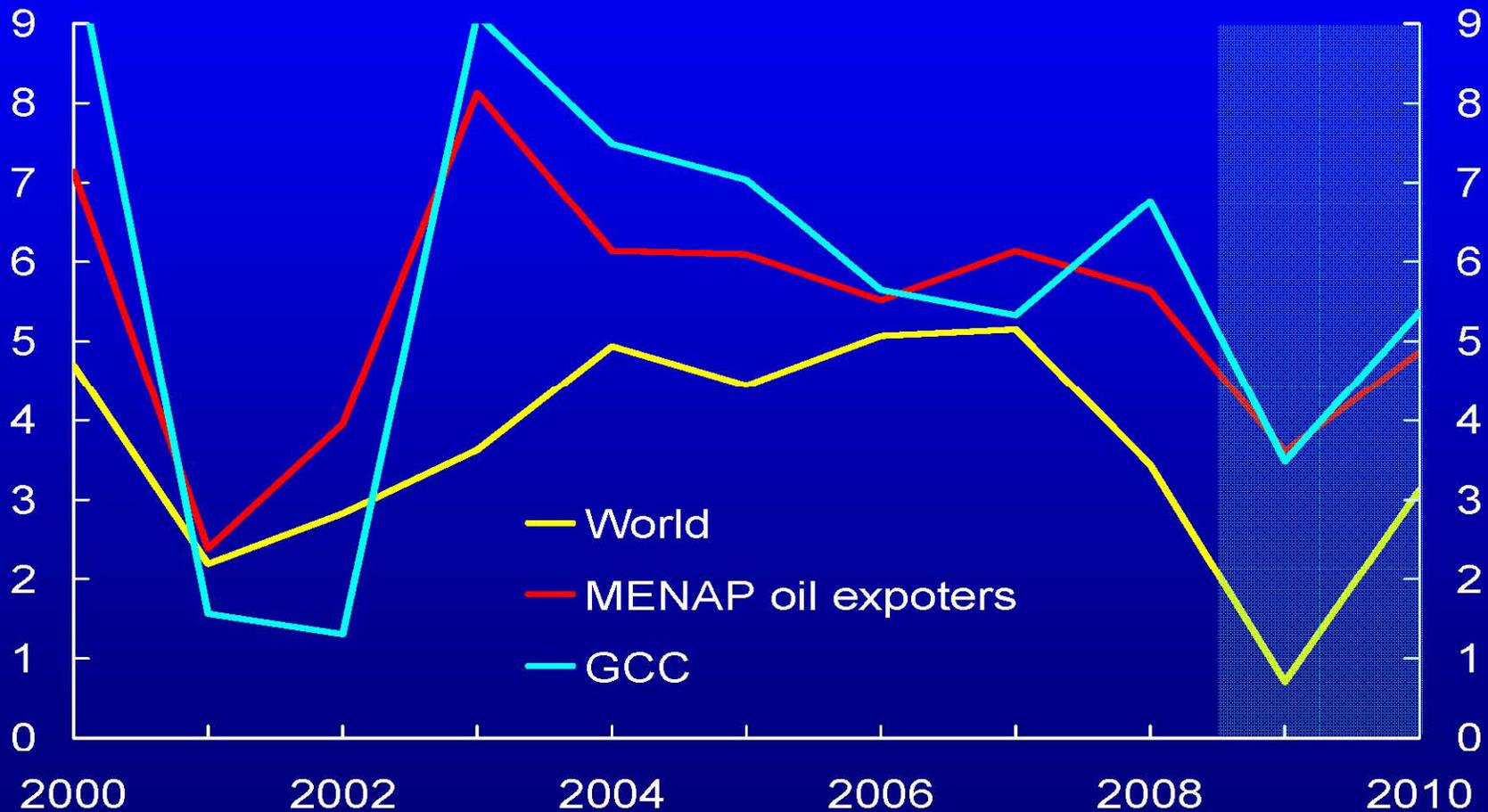
The slump in global demand has led to a collapse in commodity prices

Oil Prices
(In U.S. dollars per barrel)



Growth in oil producers is expected to slow...

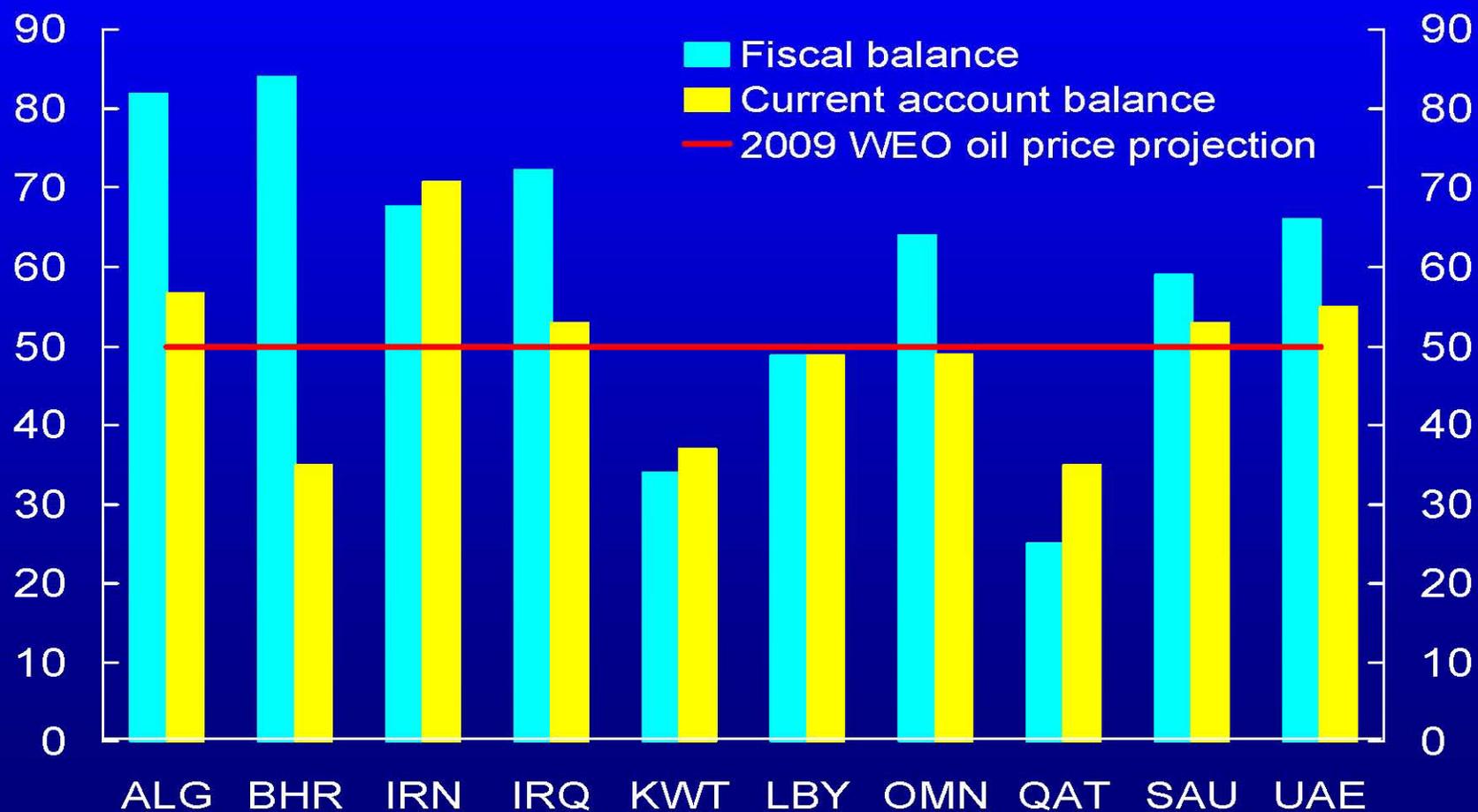
Real GDP Growth, Oil-Exporting Countries
(Annual percent change)



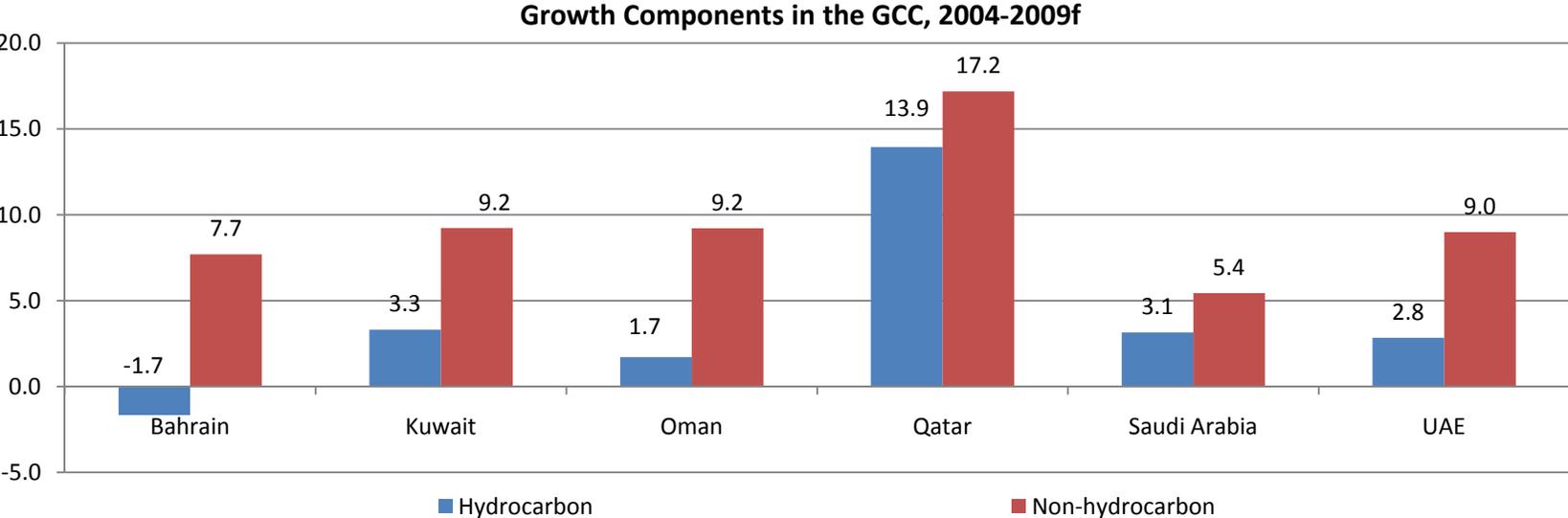
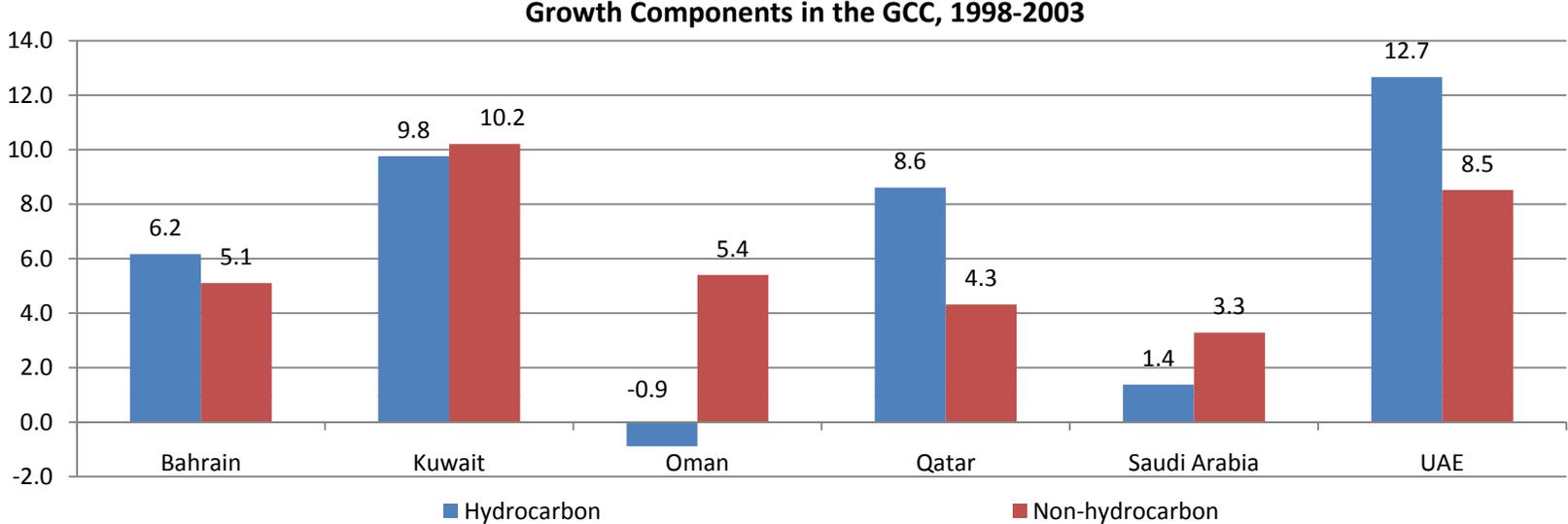
Oil prices do not recover as expected

Oil Break Even Prices, 2009

(U.S. dollar per barrel)



GCC Increasingly Diversified: non-oil growing faster



Source: IIF, DIFC Economics

The GCC were not affected by toxic assets



-
- More stringent supervisory framework
 - More conservative risk management
 - Islamic finance principles & growth of IFIs
 - Skeptical attitude towards derivatives
 - Buoyant economic environment which did not induce a search for high yields
 - Contagion came from the equities slump as a result of deleveraging, the ensuing global credit crunch, and -- needless to say -- a drop in commodity prices

Islamic finance outlook

- **Securitization constitutes a natural tool in Islamic finance and has the potential to be the most important product for Islamic banks and IFIs**
- **Islamic finance, backed by physical assets and transactions, was expected to benefit from the construction, housing and infrastructure boom**
- **However securitizations have been hampered by a concerns on Islamic structuring schemes, differences in scholar opinions and interpretations and the usual emerging markets predicaments.**

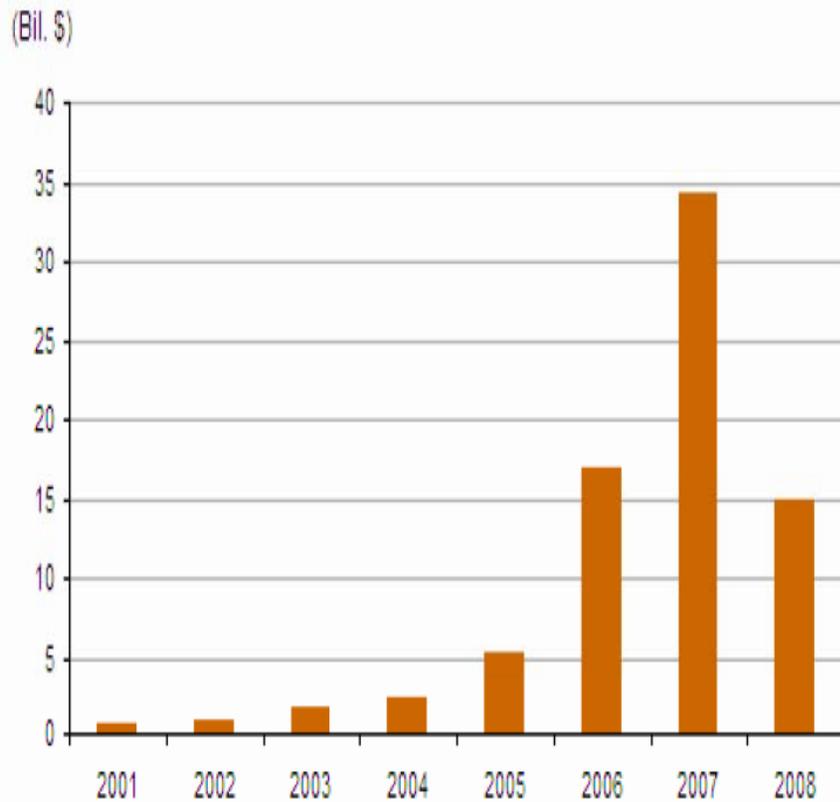
Effects of the global crisis

- **Gulf mortgage firms and banks were keen last year to announce sales of asset-backed bonds**
- **With risk aversion prevailing mortgage-backed bonds have come under especially intense scrutiny**
- **Relatively few Gulf Islamic bonds are assigned credit ratings. Fewer still are broken up into tranches that allow ratings agencies to assess the risk of specific types of assets more accurately.**
- **Global credit crisis has sapped appetite for securitization, delaying development of a potential \$250 billion market in Islamic finance and Islamic securitization especially in housing and finance**
- **E.g. Amlak Finance sold asset-backed bonds in July 2008, but has no plans for another sale due to the crisis**

Sukuk Issuance - 2008

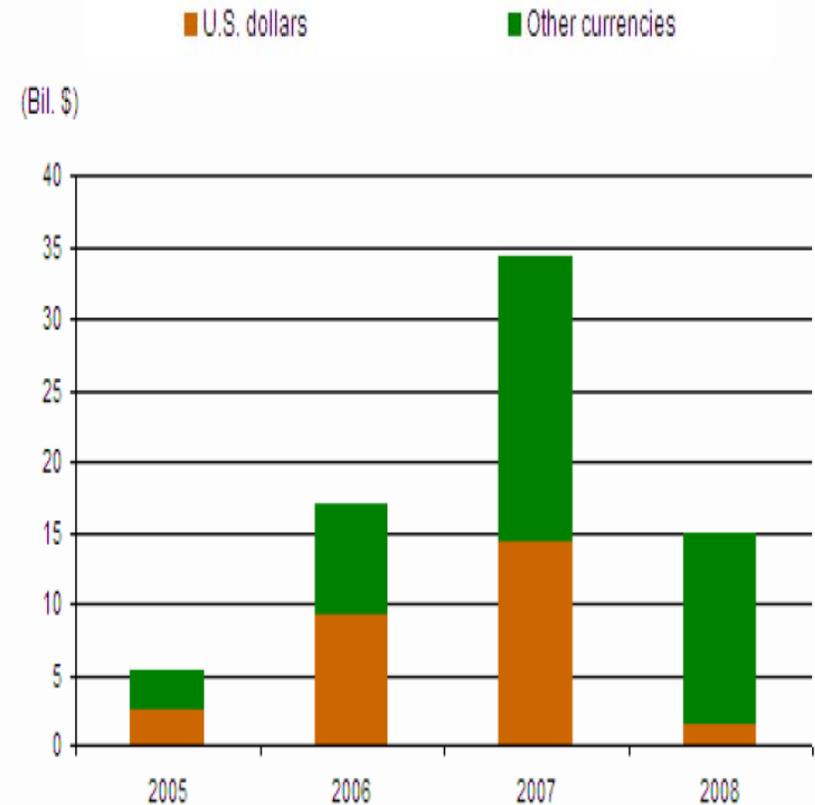


Total Sukuk Issuance (2001-2008)



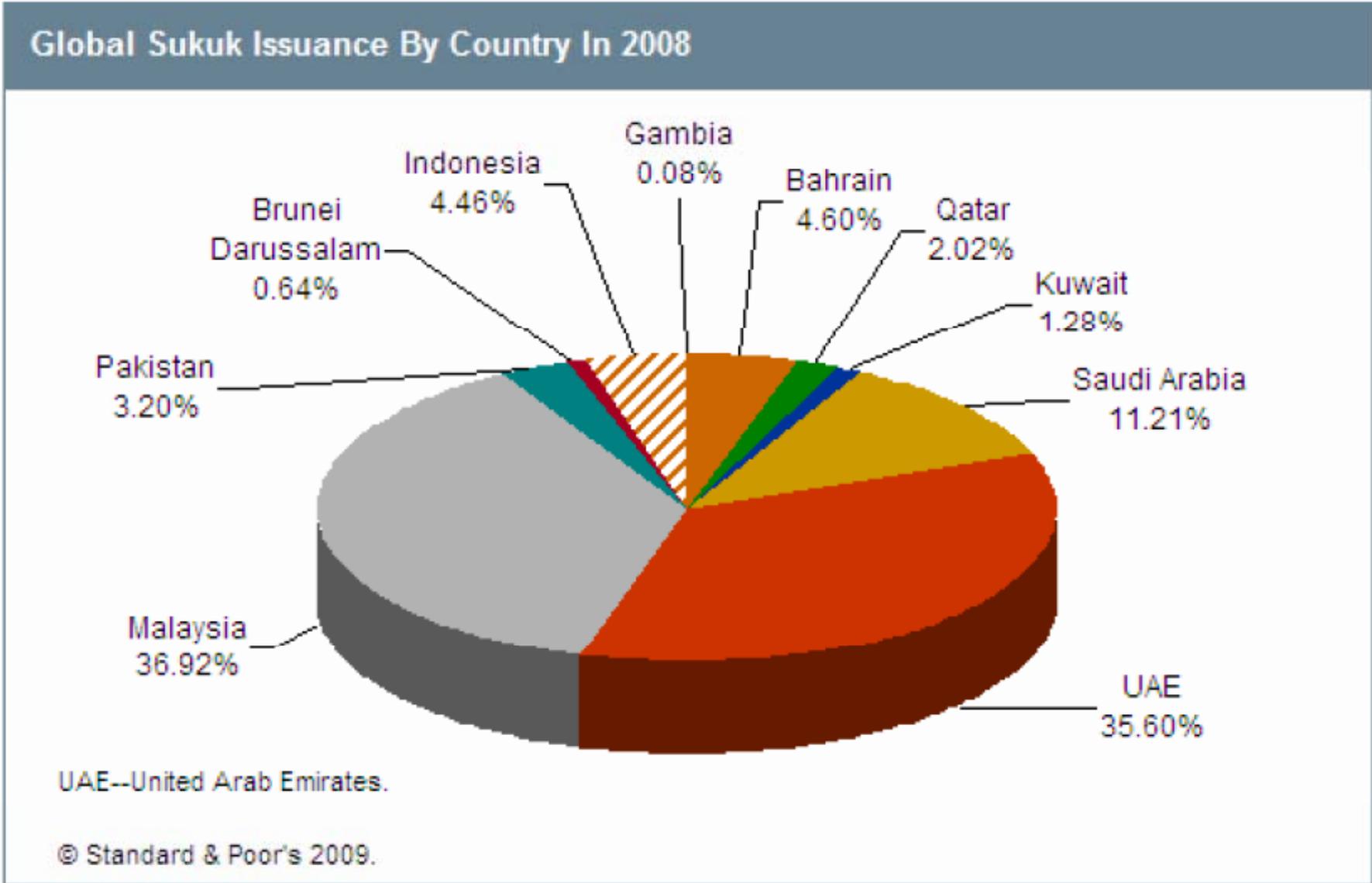
© Standard & Poor's 2009.

Global Sukuk Issuance By Currency (2005-2008)



© Standard & Poor's 2009.

Sukuk issuance by country



Smoothing the economic cycle



- **Contra-cyclical fiscal has a major role to play in mitigating the effects of global financial crisis**
- **The GCC governments have spent heavily to launch infrastructure projects, these should be continued.**
- **Oil price shock implies that governments should manage their debt effectively especially in the current environment**
- **An efficient public debt management policy would allow governments to smooth the boom and bust cycle induced by oil price fluctuations**
- **Reforms in public finance management and transparency in the use of resources would be necessary to efficiently tap the markets**
- **In the future they could resort to project financing in the form of Islamic securitization thereby contributing to create a deep and liquid market**

- **Timing is right for governments/multilateral institutions to create a deep and liquid market in Islamic securities and Shari'a compliant government securities**
- **Necessary to enact a multiyear plan of sizeable issuances staggered at regular intervals which would constitute the market benchmarks**
- **Sovereign benchmarks would set the reference for all other issuers and investors**
- **Secondary market would be strengthened if the central banks enabled use of these securities for their liquidity operations**

Islamic Finance at the DIFC

- DIFC has a sophisticated framework of laws, regulations and controls to support Sukuk issuance
- The DIFC has created an international base for providers of Islamic financial products, including Sukuk, that meet the needs of both institutional and individual investors.
- The DIFC also offers a new domicile for the registration of Islamic collective investment schemes, reflecting an increasing investor preference for Shari'a-compliant investment products originating and managed in the region.
- The DIFC, through the Nasdaq Dubai offers an electronic platform for the primary listing and secondary trading of sophisticated Islamic financial instruments, such as Sukuk.
- Nasdaq Dubai is currently the largest exchange with listed value of Sukuk.

Sukuk Listed on the NASDAQ Dubai



 Nakheel Development 3 Ltd AED 3,600,000,000 Trust certificates Due 2010 May 13, 2008	 Almana Sukuk Ltd AED 600,000,000 Trust certificates Due 2013 May 20, 2006	 TID Global Sukuk Ltd US \$ 150,000,000 Trust certificates Due 2011 October 16, 2006	 Nakheel Development Ltd US \$ 4,270,000,000 Trust certificates Due 2009 & 2011 January 17, 2008 & December 14, 2006	 DIB Sukuk Company Ltd US \$ 750,000,000 Trust certificates Due 2012 March 26, 2007	 DAAR International Sukuk Ltd US \$ 600,000,000 Trust certificates Due 2010 May 28, 2007
 IIG Funding Ltd US \$ 200,000,000 Trust certificates Due 2012 June 14, 2007	 Dubai Sukuk Centre Ltd US \$ 1,250,000,000 Trust certificates Due 2012 June 18, 2007	 DP World Sukuk Ltd US \$ 1,500,000,000 Trust certificates Due 2012 July 3, 2007	 Cherating Capital Ltd US \$ 850,000,000 Trust certificates Due 2012 July 6, 2007	 Dar Al Arkan International Sukuk Ltd US \$ 1,000,000,000 Trust certificates Due 2010 July 23, 2007	 Ras Al Khaimah Investment Authority US \$ 325,000,000 Trust certificates Due 2012 December 9, 2007
 Tamweel Sukuk Ltd AED 1,835,000,000 Trust certificates Due 2013 July 29, 2008	 Tamweel Funding Ltd USD 300,000,000 Trust Certificates due 2013 April 2, 2008	 Paka Capital USD 550,000,000 Trust certificates Due 2013 May 20, 2008	 DEWA Funding Limited AED 2,000,000,000 Trust certificates Due 2013 June 18, 2008	 JAFZ Sukuk Ltd US \$ 2,040,000,000 Trust certificates Due 2012 December 9, 2007	Villamar sukuk Ltd US \$ 190,000,000 Trust certificates Due 2013 May 20, 2008

Summary

- **The fallout from the subprime crisis is likely to constitute a temporary setback for the securitization market.**
- **The embryonic stage of the Middle Eastern securitization market makes development more difficult in times of risk aversion.**
- **Quality in the assets and structure will be at premium**
- **Definition of benchmarks, regular issuance plans, development of secondary market**
- **Contra-cyclical fiscal policy requires the development of public debt management and an active programme of debt, including Sukuk to finance projects and infrastructure**
- **Governments should take an active role in developing a deep and liquid market for Islamic securities**

Thank You!



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