GOLCER

Lancaster University
MANAGEMENT SCHOOL

GULF ONE LANCASTER CENTRE FOR ECONOMIC RESEARCH

Islamic Finance Monthly Bulletin

December 2011

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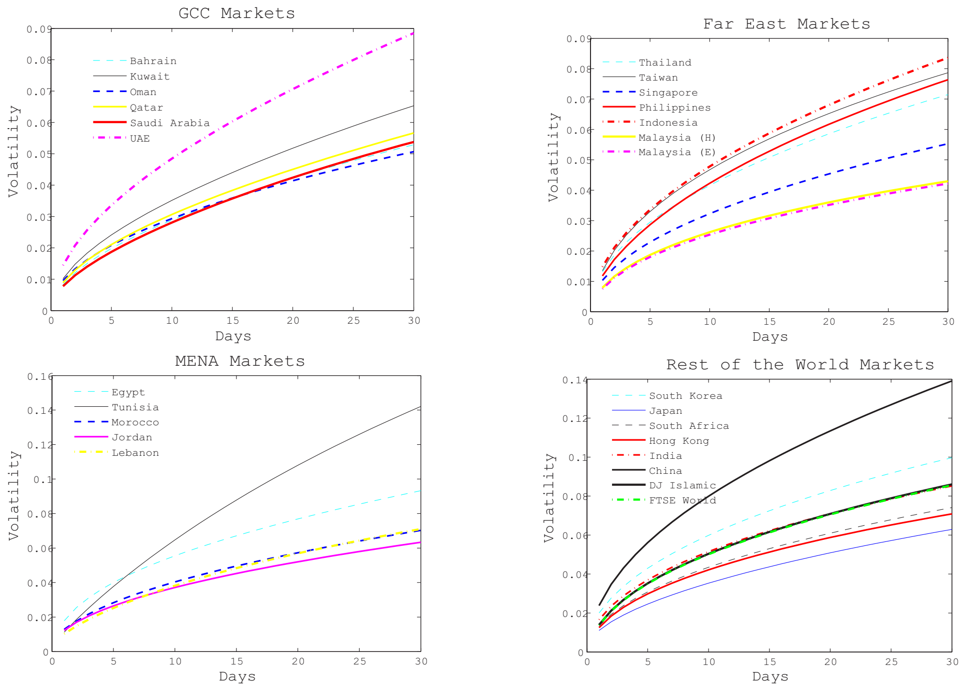
The Kuwait Towers are three concrete towers in the Kuwait City. The tower on the right hosts a restaurant and a viewing sphere which completes a full turn every 30 minutes. The tower on the left is a water tower which supplies with water the city.
Year of construction: 1979
Max Height: 187m
Coordinates: 29°23′24″N 48°0′12″E

	Country	Index	MTM Return	Volatility	Value at Risk
GCC	Bahrain	S&P Bahrain Shariah	3.33%	0.59%	-0.79%
	Kuwait	S&P Kuwait Shariah	-1.61%	0.70%	-1.78%
	Oman	S&P Oman Shariah	-1.00%	0.10%	-0.23%
	Qatar	FTSE Nasdaq Dubai Qatar 10 Shariah	-0.12%	0.67%	-1.49%
	Saudi Arabia	S&P Saudi Arabia Shariah	-1.78%	0.35%	-0.76%
	UAE	FTSE Nasdaq Dubai UAE 20	-7.82%	1.07%	-2.99%
MENA	Egypt	MSCI Egypt Islamic	-12.89%	2.46%	-5.12%
	Tunisia	S&P Tunisia Shariah	-3.73%	1.08%	-1.45%
	Morocco	S&P Morocco Shariah	-4.33%	1.39%	-3.16%
	Jordan	S&P Jordan Shariah	-1.96%	1.26%	-2.83%
	Lebanon	S&P Lebanon Shariah	-7.72%	1.42%	-2.35%
Far East	Thailand	SPGI BMI Thailand Shariah	4.10%	1.38%	-2.08%
	Taiwan	SPGI BMI Taiwan Shariah	-8.97%	1.41%	-2.54%
	Singapore	SPGI BMI Singapore	-6.61%	0.97%	-1.56%
	Philippines	SPGI BMI Philippines Shariah	1.68%	0.88%	-1.78%
	Indonesia	Jakarta SE Islamic	-3.86%	1.58%	-2.22%
	Malaysia (H)	FTSE Bursa Malaysia Hijrah Shariah	-2.55%	0.77%	-1.25%
	Malaysia (E)	FTSE Bursa Malaysia Emas Shariah	-2.64%	0.74%	-1.16%
Rest of the World	South Korea	SPGI BMI Republic of Korea Shariah	-5.49%	2.46%	-4.63%
	Japan	S&P Japan 500 Shariah	-7.86%	1.08%	-2.16%
	South Africa	FTSE South Africa Shariah	-4.06%	1.39%	-2.46%
	Hong Kong	SPGI Hong Kong Shariah	-4.81%	1.26%	-2.61%
	India	FTSE Shariah India	-17.04%	1.42%	-3.41%
	China	FTSE Shariah China	-9.81%	2.23%	-4.04%
	DJ Islamic	DJ Islamic	-9.55%	1.34%	-2.61%
	FTSE World	FTSE Shariah World	-9.87%	1.27%	-2.46%

Table 1 (above): Evolution of Islamic Stock Markets in November 2011 for GCC, Far East, Middle East North Africa (MENA) and Rest of the World markets. Percentage Month-to-Month(MTM) Returns, Percentage Volatility, Percentage Value-at-Risk(VaR). Volatility is a measure of uncertaincy of market returns. Value at Risk (VaR) estimates the worst possible return that can happen tomorrow with a given confidence (here 95%). *Source: Datastream*

Figure 2 (below): 30-Day ahead volatility forecast for the GCC, Far East, MENA and Rest of the World markets. The 30 day period starts on the 1st day of the bulletin's month. The plot represents the standard deviation of returns expected if you hold the indices for the next 30 days. The value on the 30th day is the volatility forecast of the expected return if you purchased the indices on the first day and held it for 30 days.



In Brief

Markets across the globe have taken their cue from the European debt crisis. Quoting Josef Ackermann, Deutsche Bank AG CEO, "unless the Euro zone has a 'firewall' the crisis is likely to spread." Ackermann was in line with what Mervyn King said later this month - the unsettled Euro crisis could lead to a systemic financial crisis.

GCC Markets

Shariah compliant indices exclude industries whose lines of business incorporate forbidden goods or where debts/assets ratios exceed 33%. The increasing popularity of Islamic finance has led to the establishment of Shariah compliant stock indices in many stock markets across the world, even where local Muslim populations are relatively small, such as in China and Japan.

GCC markets have been really hit in November. With the exception of the Bahrain market that went up by 3.33%, the others have declined markedly. UAE market dropped to a seven year low, dipping by 7.82%. The drop in oil prices and the US economy growing at a pace less than what was expected has also affected the fall in these markets. With the advancement in oil prices, Qatar has brought down its losses and has now dropped by less than 0.15% in November.

As predicted using the *volatility forecasts** last month, UAE was the riskiest market in the GCC region with VaR at -2.99% and volatility at 1%, closely followed by Kuwait and Qatar with VaRs at -1.78%,-1.49% and volatilities at 0.70% and 0.67% respectively. Investors say that it is the continued loss in liquidity which is increasing the risk levels in UAE markets. In the coming month, we expect the volatilities for these markets to continue the trend.

MENA Region Markets

Middle East and North Africa (MENA) regional markets are less developed than those in the GCC and some Far Eastern markets. Nevertheless, good investment opportunities do exist, particularly for investors willing to take extra risk.

In spite of the predicted economic stability in Egypt with the elections, the stock markets in Egypt have declined drastically by more than 12%. Investors have concerns over security in the country which may lead to a decline in business and foreign investments. Another cause of concern is the lowering foreign reserves in the country. The political instability in Syria is said to have affected the Lebanese stock markets as it dipped by 7.8% in November. The country's sovereign debt which directly impacts the risks in the banking industry is also seen to have caused the fall in the market.

Egypt was the riskiest market in the MENA region with VaR at -5 % and volatility at 2.46%.Morroco and Lebanon were also on the higher risk side with VaRs at -3.16%, -2.35% and volatilities at 1.39% and 1.42% respectively. Volatility forecasts show that, in December, Tunisia and Egypt would be the riskiest markets to invest in while; Jordan would be a comparatively less risky market.

Far East Markets

There has been a drop in the stock markets in the far eastern markets with the exception of Thailand. Taiwan was the worst hit, falling by 8.97%, closely followed by Singapore, where the markets fell by 6.61%. It is said that foreign investors have been selling their shares of local stock which could possibly be signaling towards a slower domestic growth. There has also been a weakening of the Taiwan dollar against USD. There is more undeniable evidence on the effects of the Euro crisis in the Asian markets. Non- oil exports have fallen drastically in Singapore last month. Oil stock piles have also reduced in the country. The markets in Indonesia fall by 3.86% as its currency weakens and its economic growth slows down. Indonesian central bank has eased its monetary policy to curb an upcoming rise in inflation in the country. Analysts have commented that the change in policy would only be beneficial on a short term basis. As the Thai Baht strengthened in November, the markets have gone up by 4.10%.

Taiwan was the riskiest market in this region with VaR at -2.54% and volatility at 1.41%. Malaysia was the least risky market with VaR at -1.20%. Using the volatility forecasts, we predict Indonesia and Taiwan to be the riskiest markets to invest in. Malaysia is seen as a safer market in the coming month.

Rest of the World

Market elsewhere in the world have fallen markedly in November owing to the concerns over a repeat of 2008. The fiscal position in the US coupled with the European debt crisis have hit the Indian rupee, as it dropped by 18% in the last month and thereby leading to a significant drop in the stock markets, going down by 17%. The weakening of the rupee has also led to concerns in the corporate sector in India. After an announcement of a tighter monetary policy in China by a central bank advisor, the stock markets in the country have fallen by 9.8%. The investors had expected a looser policy in the future and now they have realized that it is not going to happen. With a cut in consumer spending in Europe, there is a decrease in the demand for good from China.

South Korea, China and India were the riskiest markets in November as it had VaRs at -4.63%, -4% and -3.41% and volatilities at 2.46%, 2.23% and 1.42% respectively. From the volatility forecasts we expect China and South Korea to be the riskiest markets to invest in.

**The plot represents the standard deviation of returns expected if you hold the indices for the next 30 days. The value on the 30th day is the volatility forecast of the expected return if you purchased the indices on the first day and held it for 30 days.*

Source: FT, Bloomberg

The Dow Jones Citigroup Sukuk Index (DJCSI) measuring the performance of Sukuk bonds around the world. Source: Djindexes

This index, launched by Dow Jones Indexes and Citigroup Index LLC in 2006, measures the performance of global bonds that comply with Islamic investment guidelines. The index is made up of investment-grade, US dollar-denominated Islamic bonds—also known as Sukuk. The index was created as a benchmark for investors seeking exposure to Shariah-compliant fixed-income investments. The index shares design criteria and calculation assumptions with the broader Citigroup fixed-income index family, and its screens for Shariah compliance are consistent with the Dow Jones Islamic Market (DJIM) Indexes. Bond issues included in the index must comply with Shariah Law and the Bahrain-based Auditing & Accounting Organization of Islamic Financial Institutions (AAOIFI) standards for tradable Sukuk. It must also have a minimum maturity of one year, a minimum issue size of $200 million, and an explicit or implicit rating of at least BBB-/Baa3 by leading rating agencies.

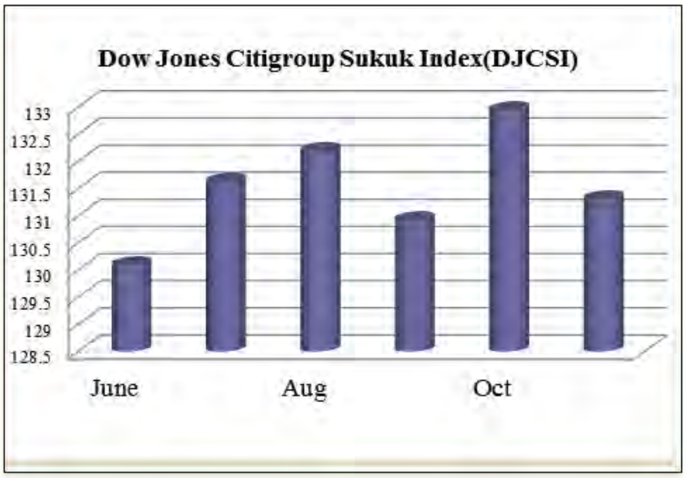


Figure 5: The Dow Jones Citigroup Sukuk Index (DJCSI) measures the performance of sukuk bonds around the world. Graph displays the index level at the current month's end. Source: Djindexes

The Dow Jones Citigroup Sukuk Index, decreased during the month of November by .1% closing at 131.3 as opposed to last month's closing index level of 132.9. Although, Sukuk activity in GCC and far east Asian countries is heating up backed by investor appetite and potentially cheaper costs than conventional funding options as firms in these regions have lined up to issue in the coming months, yet the current downturn in European markets is affecting the performance of asset classes elsewhere as well. This has affected the Sukuk market performance translating into thin trading and minimal Sukuk movement. However, analysts in the Islamic markets forecast the market for Sukuk issuance to rise in the coming months.

Source: Arab News, Djindex

Commodity	Units	MTM Return	Volatility	Value at Risk
Brent Oil	US $/bbl	-3.34%	1.42%	-0.79%
Dubai Oil	US $/bbl	0.91%	1.32%	-1.78%
WTI Oil	US $/bbl	3.14%	1.63%	-0.23%
Natural Gas	US $/MMBTU	-34.70%	4.44%	-1.49%
Gold	US $/Troy Ounce	-1.91%	1.30%	-0.76%
Copper	US $/MT	-10.22%	1.47%	-2.99%
Sugar	US c/LB	-11.73%	1.07%	-2.08%
Palm Oil	US $/MT	0.73%	1.29%	-2.54%

Table 2: Evolution of highly traded commodities in November 2011. MTM Percentage Returns, Percentage Volatilities and Percentage VaRs. US $ and US c indicate United States Dollar and United States cent respectively. bbl=billion barrels, MMBTU=Million British Thermal Units, MT=Metric Tonne and LB=Pound. *Source: Datastream*

In Brief

November has brought about another twist in the commodity markets as they have been down across different sectors. The common cause has been the crisis in Europe and the position of the US economy.

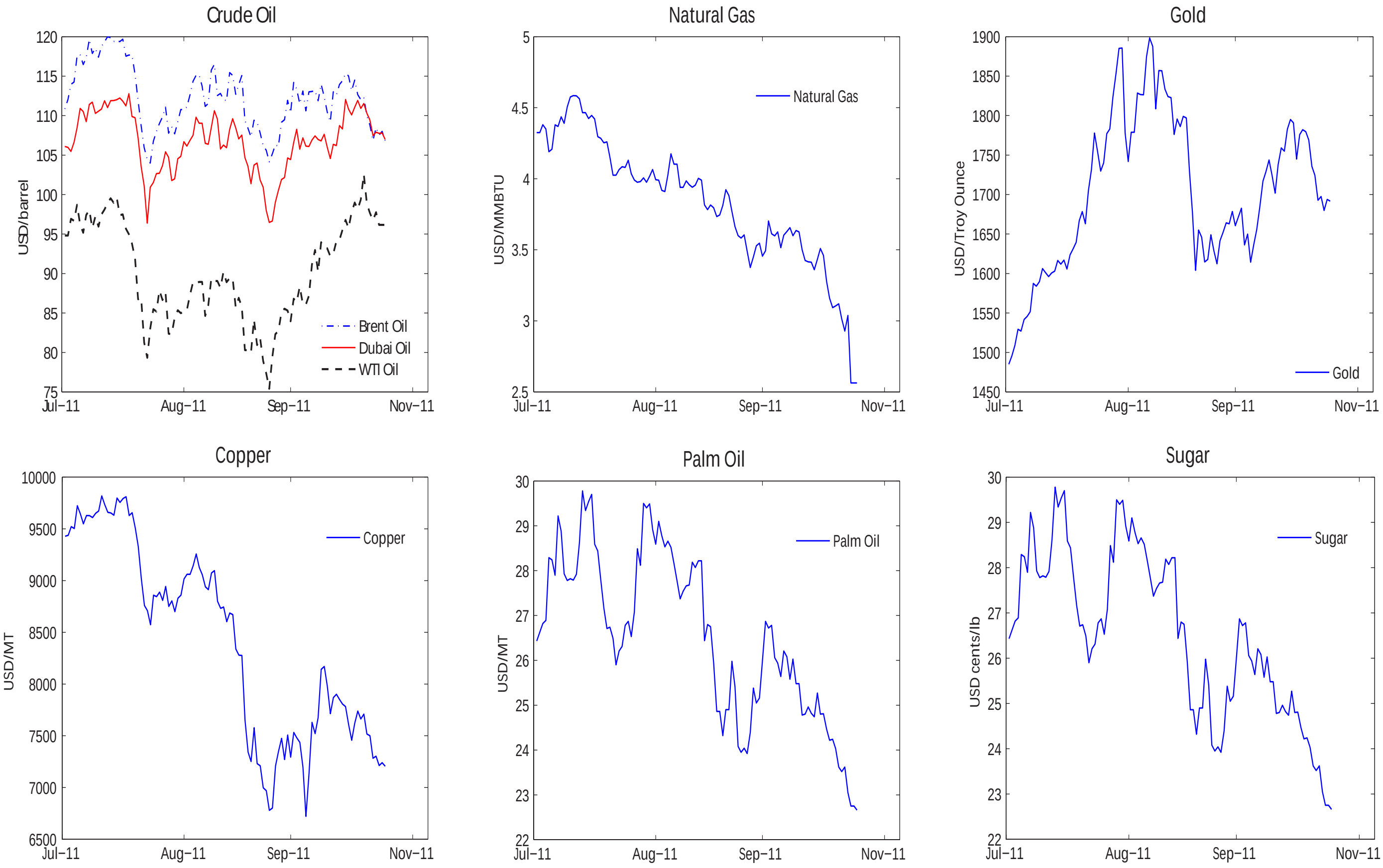


Figure 3: Evolution of highly traded commodities (prices) in July 2011 - November 2011. *Source: Datastream*

Crude Oil

Oil prices (Brent) has dropped by 3.34% as there has been concerns over the Chinese economy. The bearish macro picture across the globe has had a direct impact on the price drop. On the other hand, WTI prices rise by 3.14% after fear of boycott by Iran, the world's third largest exporter. Volatility in the oil prices were at 1.5% and VaRs at -0.5%.

Natural Gas

The fall in natural gas prices was extreme in November as it dipped by 34.70%. The low demand in the US may have caused this huge decline. It's said to be one of the most volatile commodities this period as it had a volatility of 4.44% and VaR was at -1.49%.

Gold

There was a sudden decrease in demand for the precious metal as investors were turning towards the dollar as a means to protect their wealth during the crisis. Analysts say that the metal has become a victim of an excess volatility across the markets. Gold prices have gone down by 1.91%. In spite of the fall in prices, investors seem confident about future prices of gold as they say that the demand side would remain robust and there would indeed be supply constraints. This may be why it still remains a less risky commodity to invest in as it has a VaR at -0.76 and volatility at 1.3%.

Copper

Copper has dropped by 10.22% as ratings fell for major US lenders and hence leading to a fear of slump in the economy. The fall in China's stocks may also have contributed to the decline in copper prices. Some investors are still confident about future copper prices. The metal had a VaR at -3% and volatility at 1.47%. The risk is highly dependent on the global crisis.

Palm Oil

Palm oil prices have gained after a decrease in production in Malaysia due to the end of the peak harvest season. Typical peak seasons for the oil seed is between July and October. The crop has moved up by 0.73%. It was quite risky last month as it had a VaR at -2.54% and volatility at 1.29%.

Sugar

An increase in production of raw sugar in Brazil and an increase in exports from India has led to a fall in sugar prices by 11.73% in November. It is estimated that the supply of raw sugar would exceed its demand in 2011-2012. This may keep the markets from any risk premium for some time. Sugar had a volatility of 1.07% and VaR at -2.08%.

Source: FT, Bloomberg, Reuters.

Recent Developments in the Islamic Finance Industry

Bahrain Financial Exchange (BFX) approves MAC Securities

BFX a strong trading market for Islamic finance and conventional financial instruments in the Middle East and North Africa region granted approval for MAC securities as a new Trading Member.

Source: Bahrain Financial Exchange – Press Release

The Launch of Islamic Interbank Benchmark Rate (IIBR) by Thomson Reuters

A Shariah-compliant interbank lending was launched on 22nd of November at the 18th annual World Islamic Banking Conference in Bahrain. The IIBR is established based on the contribution of 16 Islamic Banks in the GCC area giving an indicator for the average expected return on Islamic-based short-term interbank funding. With the significant growth of Islamic finance international market of 15% per year, the IIBR is increasingly appealing to international banks. Current negotiations of expanding the contributing banks to include other international commercial banks are running.

Source: Thomson Reuters

The Release of World Islamic Banking Competitiveness Report 2011/2012

The 18th annual World Islamic Banking Conference (WIBC) was held from 21st of November to 23rd of November gathering the most influential leaders in the Islamic finance industry and launching the World Islamic Banking Competitiveness Report 2011/2012 in cooperation with Ernest & Young. The report highlighted the expected global growth of Islamic-based financial products with commercial banks reaching US$1.1 trillion in 2012 growing by 33% compared to 2010.

Source: Oman Daily Observer

150 Countries in the Middle East Banking Innovation Summit 2012 in Dubai

The two-day agenda of the summit features the main patterns of technological innovation and growth trends in the Islamic finance industry. Leading Islamic finance market players are brought together with technology experts from KPMG, IBM, Dubai Bank, Al Hilal Bank and Qatar Islamic Bank to discuss recent banking innovation including intelligent electronic statements and bank 2.0 new era of engagement banking.

Source:Global Islamic Finance Magazine

Shariah- Compliant Swaps Hedging Transactional Exchange Rate Risks

International Islamic Financial Market (IIFM) is preparing a template for standardising profit rate swap based on the Islamic finance principals hedging currency volatility for sukuk transactions. It is reported that this new financial Islamic product is expected to be soon launched after being tested by some leading Islamic banks.

Source: Gulfnews

Regional Political Unrest Discourages Private Equity Firms

The MENA political turmoil adversely affected main private equity players in the region dropping private equity and venture capital deals from 24 in 2010 to 8 closed deals in the first seven months of 2011. The political unrest is the second adverse incidence significantly impacting the performance of private equity market after the global financial crisis of 2008/2009 dropping deals from 97 deals with total value of US$7.5 in 2007 to 24 smaller deals of US$148million in 2010.

Source: Arab News

Qatar Bond Sale of US$ 5 billion

Qatar one of the rapidly growing economies with the third highest investment rank at Standard & Poor rating, sold dollar securities due in five, 10 and 30 years with a value of US$5 billion. In the context of international debt crisis and Arab spring, global investments and credit tends are directed to oil-rich Gulf region; publicly-owned Abu Dhabi Islamic Bank raised more than US$2 billion for its US$500 million sukuk this month while Islamic bonds dealings in Bahrain and Abu Dhabi Commercial Bank reached US$750 million and US$500 million respectively.

Source: Global Islamic Finance Magazine

Tamkeen Banking Scheme for Small and Medium Enterprises (SMEs) Second Expansion in a Year

For the second time in less than a year BMI bank expands its booming Shariah- compliant financing scheme for SMEs seeking investment expansion and productivity growth. The scheme that ranges from BD10,000 to BD500,000 will present a spectrum of financial instruments such as Murabha financing covering machinery, equipment and working capital besides Ijara financing with a subsidized rate of 4% per year.

Source: BMI Bank Press Release

US$1 billion International Sukuk Issuance by the Republic of Indonesia

Monday 21st of November witnessed the closure of issuance of US$1billion of Sukuk Al-Ijara with 4% dividends per year and seven years maturity terms. The issuance which was based on Shariah-compliant structure and governed by English law was moderated and managed by Citigroup, HSBC and Standard Chartered Bank as joint book runners and joint lead managers.

Source: Islamic Banks Networking

Standard & Poor assigned the highest credit ratings to Islamic Development Bank

At the same credit rating of the European Investment Bank and International Bank fro Reconstruction adn Development, Standard & Poor placed the Islamic Development Bank at the highest ranking of AAA+ for the 10th successive year for the long run credit rating and A-1 for short run credit rating. The reports which was released on 29th of September 2011 is subjected to the Bank's reputable position in terms of strong capitalization based on shareholder equity of Special Drawing Rights reaching US$9.9 billion equivalent to 85% of the gross finance lent to member states. Strong liquidity that exceeded 15% of total assets compiled with reputable asset performing portfolio along the past few years played a major role in keeping the strong credit rating of the bank despite the political turbulences occurring in number of its prominent member states.

Source: Standard & Poor Supranational Report

Elfaf Bank and Ohad Trust BSC (Ohad) fund forming a Bahraini joint venture opened its first branches at Malaysia

A joint venture deal between Elfaf Bank and Ohad Trust that are licensed by the Central Bank of Bahrain granted the first opportunity for Bahrani Islamic banks to exist in Malaysia. The new existence of Ohod Trust Bhd that enjoy a strategic partnership of two the biggest Bahraini bodies in Islamic finance has obtained its trust license by the Labuan Financial Services Authorities. The CEO of Alfaf Bank expressed his aspirations about this new existence that open the door for wide spectrum of Islamic financial and banking services not just in GCC region but also in South East Asia continent.

Source: Islamic Finance News

Islamic Banking in Turkey Gaining a New Potential by the Islamic Development Bank finance of US$75 million

Turkye Finans Participation Bank; one of the leading Turkish banks in Islamic financial services was granted on 19th of October a financial line of US$75 million by the Islamic Development Bank. The agreement was signed at the sidelines of Economic and Commercial Cooperation of the Organization of Islamic Cooperation 27th Committee meeting at Istanbul, Turkey. The granted finance aimed to serve long-run purposes of economic growth led by empowering small and medium enterprises across wide range of economic activities under the auspices of Islamic financial principles of Ijara and Istisna'a modes (Sale of Instalments system). Remarkably, this financial cooperation in the field of Islamic banking comes under a full package of US$2 billion financial and technical support programme offered to Turkey by Islamic Development Bank for enthroning efforts of private sector development and export promotion.

Source: Islamic Development Bank

The Gulf One Lancaster Centre for Economic Research (GOLCER) was established in May 2008 by Lancaster University Management School and Gulf One Investment Bank. The centre is funded by a donation from Gulf One Bank.
The main purpose of the Centre is to conduct empirical research focused on key economic and financial developments in the Middle East and North Africa (MENA) region, with special emphasis on the Gulf region. This region includes Bahrain, Kuwait, Oman, Qatar, Saudi Arabia and United Arab Emirates, countries that form the Gulf Cooperation Council.
GOLCER's research agenda will include, as primary topics, energy economics, Islamic banking and finance, telecommunication and infrastructure economics. Recent developments in these fields will be assessed in the light of their impact on the economy of the Gulf region.
In addition to its research activities, GOLCER will provide tailored training courses in specialised areas, including quantitative methods and applications of state-of-the-art econometric and statistical software packages to economic and financial phenomena. GOLCER will also provide consultancy services.

Research Team

Professor David Peel
General Director, GOLCER
d.peel@lancaster.ac.uk

Dr Marwan Izzeldin
Executive Director, GOLCER
m.izzeldin@lancaster.ac.uk

Dr Gerald Steele
Proof-Reader and Copy Editor
g.steeele@lancaster.ac.uk

Mr Vasileios Pappas
PhD Student (GOLCER)
v.pappas@lancaster.ac.uk

Ms Momna Saeed
PhD Student (GOLCER)
saeedm@exchange.lancs.ac.uk

Ms Rhea George
PhD Student (GOLCER)
r.george@lancaster.ac.uk

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GOLCER

Lancaster University
Management School

Gulf One Lancaster Centre For Economic Research