SHARED RISK & REWARD

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Dim Sum Sukuk should not be ignored

Hong Kong is considering finally passing a bill to make it easier for companies to issue dim sum sukuk (those denominated in Chinese yuan). One of the most interesting aspects is how muted the reaction is to a law which would come into effect in the first half of 2013, mostly due to the delay until the demand for dim sum bonds and sukuk had fallen. I found a post on my blog that the necessary legal changes were "almost done"…in February 2009.

Yet the underlying rationale for dim sum sukuk—the growth of China—may have slowed in the near-term, but unless the economy suffers a hard landing, there will be a return of demand for RMB sukuk. The Malaysian cellular company Axiata Group just issued its first (and the second ever) RMB-denominated sukuk for RMB1 billion ($160 million) which received strong demand (oversubscribed 3.5 times and priced at the bottom end of the expected range).

But the fall in demand is not just for dim sum sukuk; bonds are having a much slower year in 2012 due to slower Chinese economic growth. But should legislation be passed only when the market is pushing the hardest for it? I think that the appropriate time to put in place legislation for Islamic finance is when demand is slackest. This will provide an opportunity for the legislation to be thought through in a more thorough manner, and not be rushed into place.

It is also prudent to consider the factors that will keep RMB sukuk demand vibrant, allow longer tenor issuance and not require developing the ability for foreign issuers to use Shari'ah-compliant currency swaps to issue into the RMB market. In order to do so, there will have to be a pickup of growth for Chinese companies so that they have demand for sukuk issuance, and a source of funds to buy them.

This will be based on the trade flows between China and countries where Islamic finance is large (Malaysia and the GCC). According to Chinese customs data compiled by the US-China Business Council, Malaysia was the 7th largest supplier of imports to China while Saudi Arabia was the 10th with combined exports to China of $83.2 billion in 2010 and growth over 2009 of 55.9% and 39.2%, respectively.

China is trying to expand the international use of yuan in trade, and the currency is not freely convertible, so companies that export to China and get paid in yuan will seek investment opportunities in RMB, and some of those from countries like Malaysia and Saudi Arabia will seek sukuk rather than bonds, which should provide a stable and growing source of liquidity for the RMB sukuk market, which Hong Kong should be ready to pick up. If it fails to, it may lose the business to Malaysia, where the Axiata sukuk is listed.

Until next week,
Blake Goud

Reading List

Hong Kong's sukuk bill on track but local interest dim (Reuters)

Malaysia's Axiata prices world's biggest yuan Islamic bond (link)

Issuance of dim sum bonds falls sharply (FT)

Blog Posts This Week

Sukuk plans from Oman company a savvy move

On eve of Islamic banks' launch, Oman loan growth slows

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