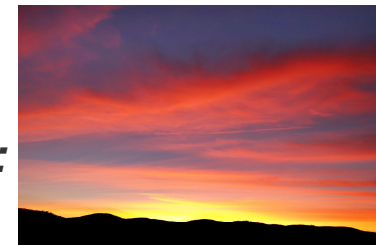

Towards Enhancing Efficient Liquidity Management Framework

***Addressing Liquidity Issues for Cross-border Transactions:
Perspective from the Islamic Finance Industry***



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24 November 2009

Bank Negara Malaysia

High Level Conference on Financial Stability

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Since 1980s, Islamic finance is well known as the “providers of capital” in OIC economies

“Popularity” with corporations in the OIC economies

OIC (1969) and IDB (1975) were created to foster collaboration and intra-OIC trade flows:

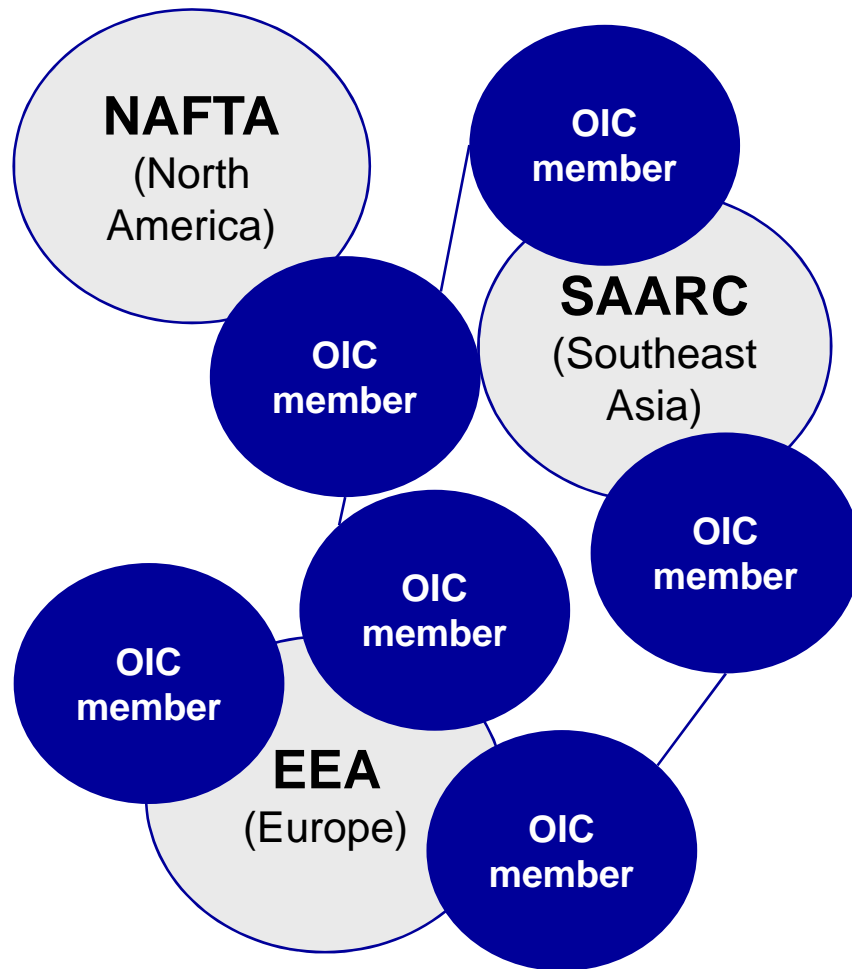
- Pakistan: Rice Export Corporation, Pakistan State Oil
- Turkey: Turkish Toprash Company, Municipality of Istanbul
- India: India Oil Corporation
- International Islamic Trade Finance Corporation (IFTFC) was established in 2006, with aim of raising intra-OIC trade from 14% in 2006 to 20% by 2015

Competitive product options for cross-border transactions

- Bahrain – first hub of syndicated murabahah
- Malaysia – emergence of Sukuk as first cross-border liquidity instrument
- Emergence of Sukuk as cross-border liquidity provider
- Country risk funding through commodity murabahah
- Shari’a-compliant ECA financing
- Increasing usage by MNC’s

Islamic finance has been the “product of choice” for cross-border funding in the OIC economies

Globalisation has highlighted the ever growing importance of cross-border transactions (within and beyond the OIC economies)

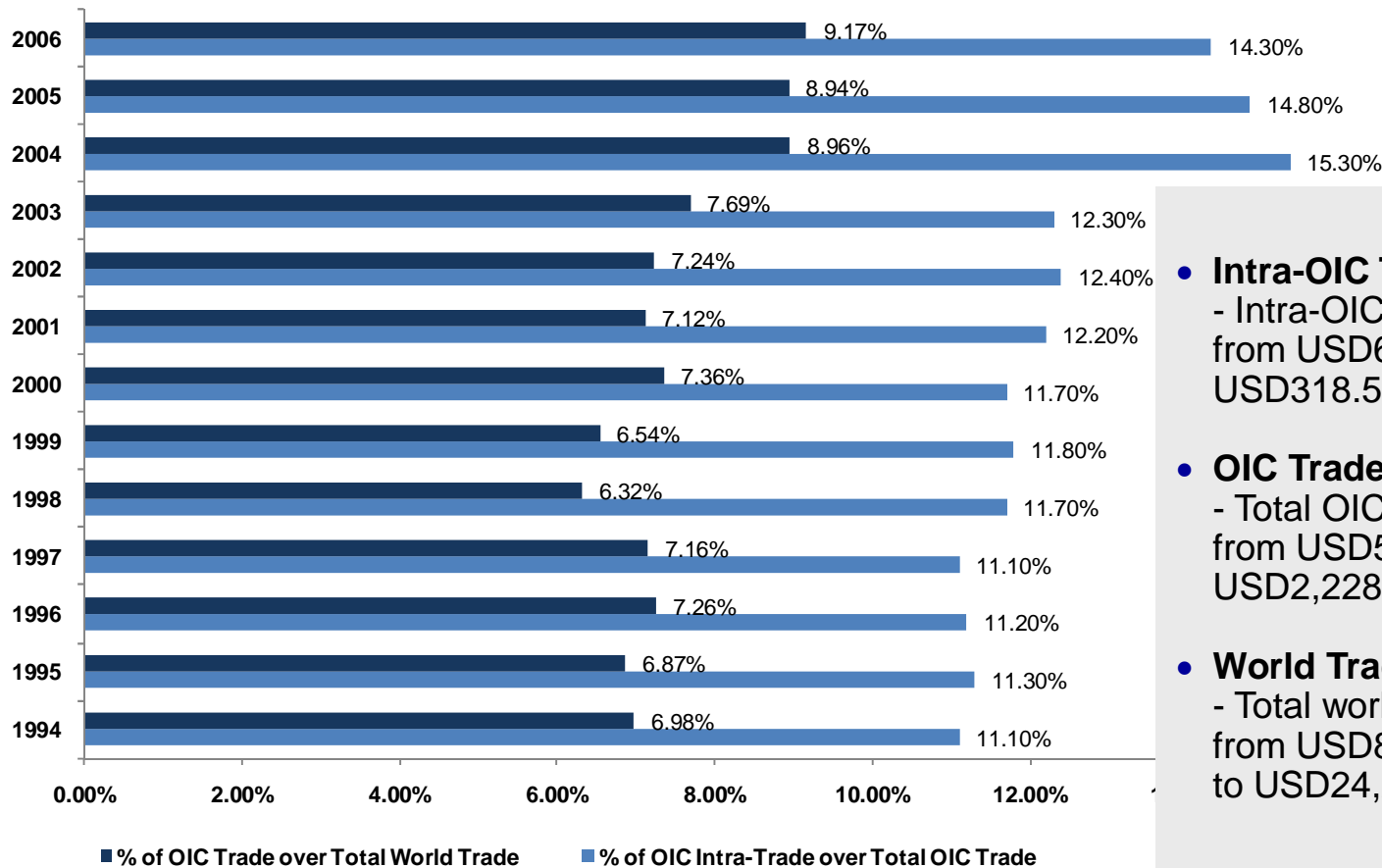


- **OIC intra-trade flows and collaboration are historically limited**
 - Trade and capital flows are getting stronger but could be expanded
- **Commercial partnerships exist but are limited**
 - Cross-border ventures are on the increase
- **Trade and investment programs have largely focussed beyond OIC linking**
 - Individual OIC countries with OECD markets
 - Gradual shift to OIC common market and OIC economic community
 - Harnessing human capital flows through Makkah visa
- **Enhancing infrastructure linkages within OIC countries**
 - Rebuilding of Silk Road
 - Revival of the Hijjaz railway
 - Increasing the embedded capital of OIC countries

Increasing OIC trading, investment, and infrastructure links will build competitive advantages

Cross-border transactions plays an increasingly significant role in the OIC economies over the last decade

Evolution of OIC Trade (1994-2006)



- Intra-OIC Trade:**
 - Intra-OIC trade has increased from USD66.4 billion in 1994 to USD318.5 billion in 2006
- OIC Trade:**
 - Total OIC trade has increased from USD597.3 billion in 1994 to USD2,228.7 billion in 2006
- World Trade:**
 - Total world trade has increased from USD8,562.7 billion in 1994 to USD24,299.2 billion in 2006

Source: World Trade Organisation (2009), IMF (2007-2008), IFTC (2008)

OIC cross-border transactions are still relatively minor in comparison to the global trade activities

Illiquidity is a fundamental challenge in cross-border transactions in the OIC economies

Current situation leaves much to expectation

- Although OIC has approximately 22% of the world's population, its member countries only produced approximately 10% of the total world's export
- Example of countries which are paying the price for capital illiquidity include Sudan and Iran
- A 5% increase in overall trade volume in OIC member countries will enhance economic growth by 0.3%:

Access to capital financing

- Creditors are inclined to “tighten their purse” in light of the global crisis
- Unfavourable financing terms

Restrain in capital flow

- Risk weightage imposed by some central banks sometime acts as “capital embargo” in restricting flow of capital
- Pools of liquidity in the OIC world have to be redirected to the OIC real economy investments
- Central banks and reserve managers should increase allocation for the OIC world and Islamic finance instruments

Institutional framework

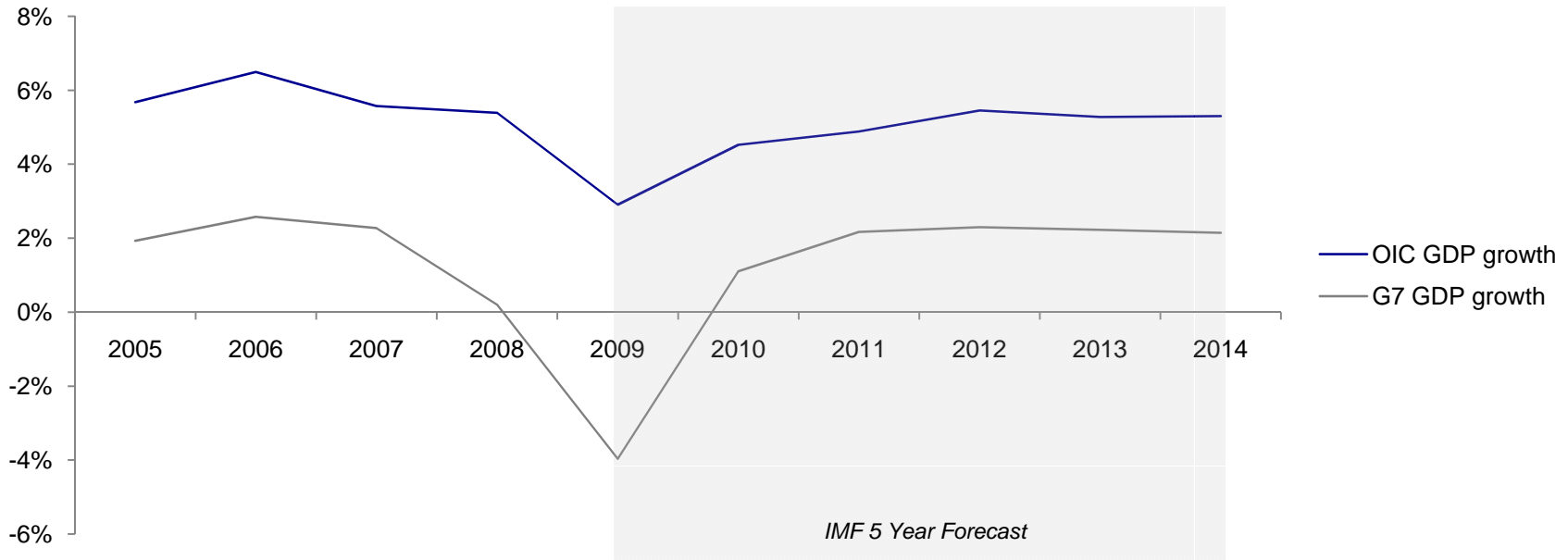
- There is a need for more rated Islamic instruments by leading issuers in the OIC world (e.g. central banks, reserve managers, IDB, etc.)
- Government to create framework and funding allocation for investments in infrastructure, SME sector, venture capital, and microfinance
- However, management of this has to be done by experienced asset managers with track record in these asset classes

Source: World Islamic Economic Forum (2008)

The global economic crisis highlights the need for directing liquidity of the OIC world into the OIC economies and Islamic financial instruments

Despite crisis halving OIC GDP growth, outlook remains positive due to strong fundamentals

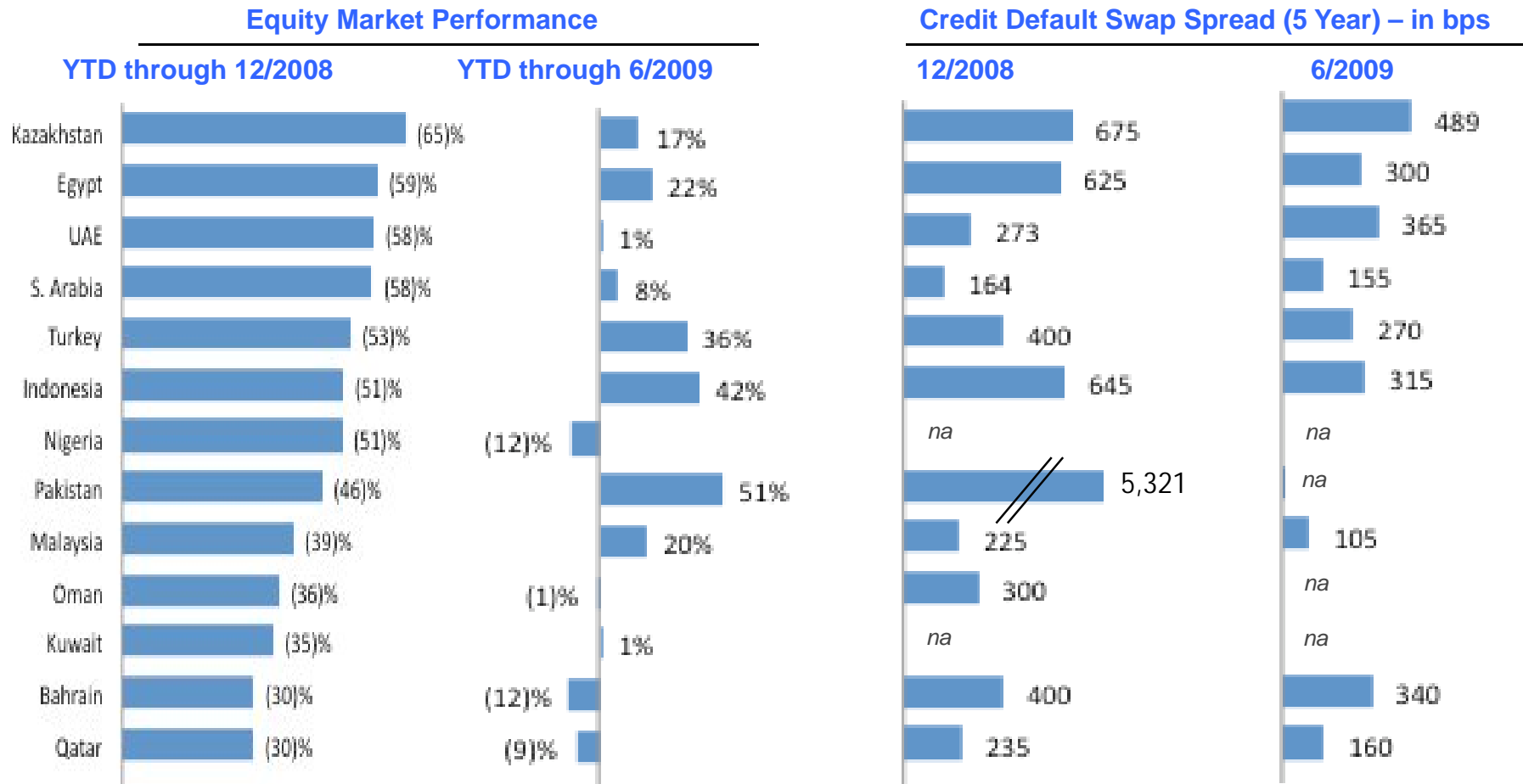
Crisis caused OIC average GDP growth to fall from 5.4% to 2.9%



Source: IMF, World Economic Outlook Database, October 2009

Demographic dynamics and real economy investment opportunities will see the OIC economies benefiting from capital inflows

OIC equity markets are recovering from 2008 losses with narrowing of CDS spreads indicating lowered risk premiums



Source: Bloomberg

Policy responses of the OIC economies to the global crisis

	Deposit Guarantee	Liquidity Support	Capital Injection	Equity Purchase	Monetary Easing	Fiscal Stimulus
Bahrain		x			x	
Brunei		x			x	x
Indonesia					x	x
KSA	x	x			x	x
Kuwait	x	x	x	x	x	
Malaysia		x	x		x	x
Oman		x		x	x	
Qatar		x	x	x		x
Turkey		x			x	x
UAE	x	x	x		x	x

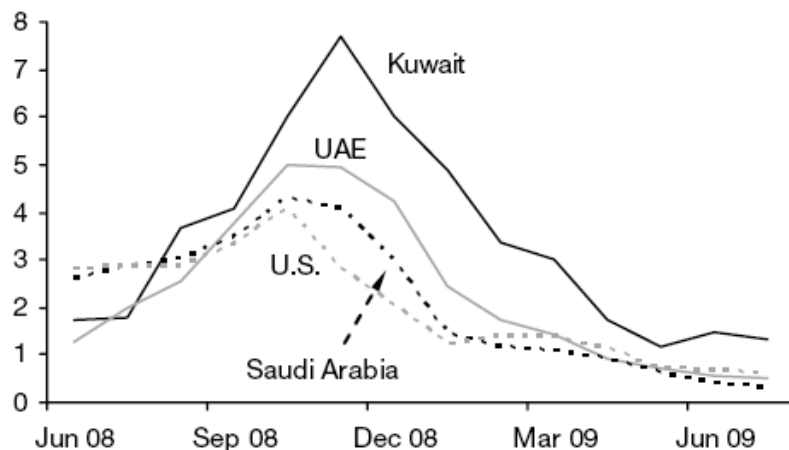
– Financial contagion reaches the OIC, in particular the GCC region

Extraordinary measures adopted to ensure normal functioning of financial markets and reputation of certain hubs as financial centres

E.g. UAE central bank guarantees all 24 local bank deposits and inter-bank lending and required a USD14 bn fund to boost liquidity in 2008

Interbank 3 Months Deposit Rates

percent



Source: Saudi Arabian Monetary Authority

– Monetary easing has lowered funding costs

Authorities are taking proactive action in restoring confidence and stability to prevent a downward spiral

Governments are also using fiscal stimuli spending on social sectors and infrastructure to cushion the downturn

E.g. Saudi Arabia USD400 bn package over 5 years

Source: (1) IIF 28 Sep 2009, (2) Asian Development Bank 2009, (3) World Bank 2009

Addressing illiquidity gap remains key factor in promoting cross-border liquidity flows in the OIC economies

- **Enhancing governance in OIC countries**
 - Rule of Law
 - Ease of doing business
- **Effective promotion of cross-border transactions**
 - Reorientation of member countries' risk profiles and appetites among financiers and investors
 - Direct exporter / importer linkage creation
 - Strengthening banking relationship (e.g. structured financing and innovative mechanism – Bilateral Payment Arrangements)
 - Encouraging sovereign wealth and reserve funds' investments in the OIC markets and Islamic finance instruments
- **Credit enhancement of OIC member countries**
 - Active engagement with the Islamic Corporation for Investment and Export Credit (ICIEC), a member of the IDB Group
- **Participation in international aid activities**
 - Collaboration with the IFFIm Framework in accelerating aid commitments to the Global Anti Viral Immunisation Fund
 - Invitation to aid agencies to co-invest through an Accelerated Aid Vehicle

Cross-border transactions in the OIC economies can be further promoted with effective participation and collaboration by regulators, corporations, and Islamic finance institutions

Concluding Remarks

- **Islamic finance has historically been a competitive “product of choice” for cross-border liquidity flows in the OIC economies**
 - Popularity with corporations both in the OIC and OECD world
 - Competitive “product of choice”
- **Illiquidity gap still remains the key challenge in promoting promoting cross-border liquidity flows in the OIC economies**
 - OIC cross-border transactions are still relatively minor in comparison to the global trade activities
 - The global economic crisis highlights the need for directing liquidity of the OIC world into the OIC economies and Islamic financial instruments
- **Effective participation and collaboration by regulators, corporations, and Islamic finance institutions is paramount in addressing the illiquidity gap**
 - Cross-border liquidity flows in the OIC economies can be further promoted with effective promotion and enhanced governance measures in addressing the ever prevailing illiquidity gap



Thank you

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