

Islamic banking escapes fallout of global financial crunch

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Islamic banking has largely escaped the fallout from the global financial crisis, thanks to rules that forbid the sort of risky business that is felling mainstream institutions.

But experts say that because of its heavy reliance on property investments and private equity, the booming 1.0 trillion dollar global industry could be hit if the turmoil worsens and real assets start to crumble.

"In the current financial turmoil, it is interesting to note that Islamic financing may have prevented a majority of the mess created by the conventional banking and financial institutions," Kuwait Finance House said in a report.

"The outlook for Islamic financing is bright and will likely take the lead in terms of providing funding for major projects as the conventional banking system reevaluates its business model."

The rules of Islamic banking and finance - which incorporate principles of syariah or Islamic law - read like a how-to guide on avoiding the kind of disaster that is currently gripping world markets.

Islamic law prohibits the payment and collection of interest, which is seen as a form of gambling, so highly complex instruments such as derivatives and other creative accounting practices are banned.

Transactions must be backed by real assets - not shady repackaged subprime mortgages - and because risk is shared between the bank and the depositor there is an incentive for the institutions to ensure the deal is sound.

Investors have a right to know how their funds are being used, and the sector is overseen by dedicated supervisory boards as well as the usual national regulatory authorities.

There will be an impact

"Islamic banking has, thus far, remained positive, despite the current challenging global financial environment," said Zeti Akhtar Aziz, the central bank governor of Malaysia, which is Southeast Asia's leader in Islamic banking.

Zeti said this month that because of the slowing global economy, plans for Islamic "sukuk" bonds had been postponed or scrapped by companies including Kuwait's Abyaar Real Estate Development Co and Malaysia's Perisai Petroleum.

And Jennifer Chang, a partner at Pricewaterhouse Coopers in Kuala Lumpur, said that given the extent of the global crisis, Islamic banks may suffer damage despite their strong position.

"Islamic banks, especially in the Middle East, got heavily into private equity and real estate investments, and a lot of loans may be backed by properties. So if the property market goes down, there will be an impact," she said.

"If a borrower is not able to pay then the bank will foreclose and the question is - can you sell the property in the market and at what value? These are issues which all banks can face."

There have been calls for the conventional banking industry to take a leaf out of the book of Islamic finance, which also shuns investments in gaming, alcohol and pornography in favour of ethical investments.

Influential Sunni cleric Sheikh Yusuf al-Qaradawi earlier this month called on Muslims to take advantage of the turmoil to build an economic system compatible with Islamic principles.

"The collapse of the capitalist system based on usury and paper and not on goods traded on the market is proof that it is in crisis and shows that Islamic economic philosophy is holding up," said the Egyptian-born, Qatar-based cleric.

No safe harbours

In recent years the sector has broken out of its niche and been embraced by mainstream banks. As well as basic bank deposits and investment accounts, it has expanded into areas including equity funds, bonds and Islamic hedge funds.

Abhishek Kumar, a senior research analyst at Financial Insights, a company under market research and analysis firm International Data Corp (IDC), said recent events may further boost the sector.

"More and more institutions will be interested in providing Islamic services to diversify their risk portfolio," he said, while warning that in the current financial storm there were no absolutely safe harbours.

"We're not really sure what the real extent of the impact is, and whether we've passed the worst of it or not, But the extent is not going to be as bad as in the mainstream sector," he said.