

Islamic Finance & Oil Prices Today

Commercial banks started offering Islamic finance in the mid-1970s. During that period, there were major developments in the Muslim world which included the rise of Pan-Islamism and the oil boom. Islamic finance started blossoming into a global industry and is today estimated to have total assets of more than USD 2.6 trillion.

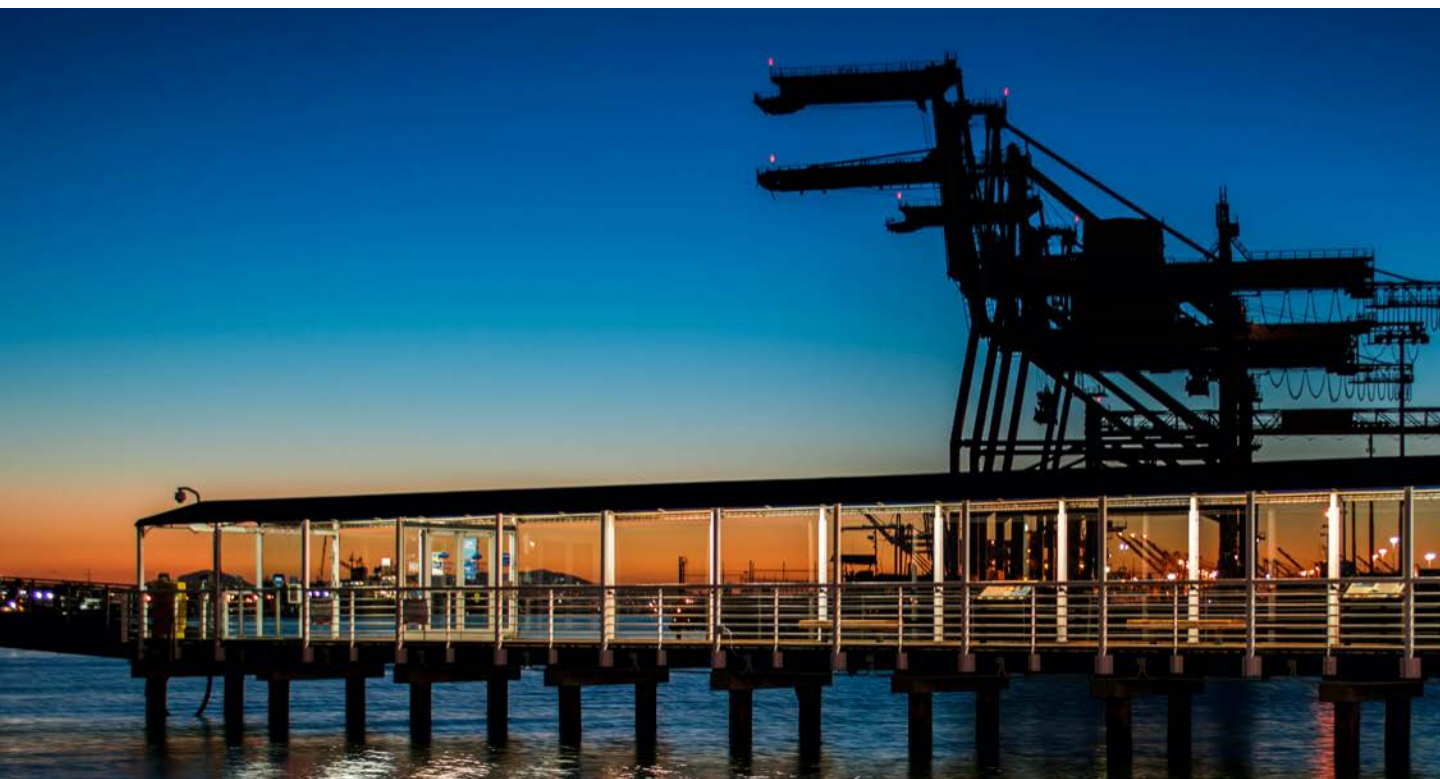
Approximately 72% of this USD 2.6 trillion in assets lies with Islamic Banking including the Islamic divisions (otherwise known as 'Islamic Windows') of conventional banks. Islamic Capital Markets accounts for approximately 27% of the total assets and finally, the remaining portion is taken up by Takaful (Islamic insurance) according to the IFSB's Islamic Financial Services Industry Stability Report 2019.

During the past decade, Islamic banking has been outperforming conventional banking in several jurisdictions within the Middle East and Asia.

This is reflected by the increased penetration rate of Islamic banking of above 15% in those markets. Islamic finance assets grew at a double-digit rate in the years from 2005 to 2015.

With the global decline in oil prices and the looming US interest rate rise, this pace of growth stagnated somewhat in 2016 and 2017 but started to recover in 2018 which saw an increase of 6.9% year on year. Despite its growing spread, Islamic finance assets remains concentrated in the Gulf Co-operation Council (GCC) countries, Malaysia and Turkey and represent less than one percent of global financial assets.

Today, the industry is facing renewed challenges from the recent history making decline in oil prices, changes in the global regulatory framework for banks and insurance companies as well as the COVID-19 pandemic.



What is the impact in Islamic Finance given the current levels oil prices are at?

Oil-exporting countries are the core markets for the Islamic finance industry. As such, those countries' public finances will be most affected by the decline in the oil prices and this impact will be felt by the Islamic finance industry as well.

Oil Prices reached a low of USD 11.26 per barrel, the lowest level since 2002

Crude averaged at USD 57.05 per barrel for 2019 compared to USD 64.00 per barrel in 2018. Owing to 2020's events that are crippling world economies, oil prices reached a low of USD 11.26 per barrel, the lowest level since 2002.

While prices now and 20 years ago are similar, the differences in the oil markets between the two periods are significant.

The last time oil was at these levels, prices were on their way up, not down. China's oil imports were rising at a double-digit-percentage pace to fuel a rapidly expanding economy. The Organization of the Petroleum Exporting Countries was limiting output to keep prices aloft while Iraq was still repairing wells that had been damaged by the U.S. invasion.

Fast Forward to Today

Oil prices have now dropped around 30% since the beginning of 2020 with the reduction in demand owing to the COVID-19 outbreak and further fell by 60% due to production-level wars between two oil producing giants. With an agreement now on, leading to an overall production cut of 10% of global supply, these efforts only make up for one third of the loss in demand.

The variation of crude prices would not just affect the Islamic banking industry specifically but have a systemic effect on the entire banking field.

The way in which a particular bank is run, including its type of investment portfolio, would also have a large role to play in its success, rather than whether it opts for

Islamic or conventional banking. Hence, it would be difficult to conclude that the Islamic banking system is in a more vulnerable position compared to the conventional system should the oil prices remain at current levels.

In addition to the aforementioned factors, it is noted that oil producing jurisdictions are better positioned from other in the context of legal and regulatory frameworks for Islamic Finance.

The overarching policy infrastructure facilitates a more stabilized platform of Shari'ah compliant institutions to absorb economic shocks, ceteris paribus.

On the flip side, Islamic banks are, given their business model and nature, risk averse. Given their prohibition against gambling, uncertainty and speculation, they should be better positioned to protect themselves against high risk and toxic investments and this was largely shown to be the case during the credit crunch.

Overall, we expect that Islamic banks should be better protected against any fallout which may occur from the declining oil prices, and thus better placed for recovery, should a financial crisis occur. Islamic banks only seem more affected by this drop solely due to that fact that majority of the concentration of Islamic banking takes place in oil rich regions.

Conversely however, the performance of Islamic banks in comparison to conventional banks during this time of crisis is relatively better given the higher capitalization of Islamic banks and its high liquidity reserves.

Reach out:**Samer Hijazi**

Partner & Head of Grant
Thornton Abu Dhabi

+971 56 742 3109

samer.hijazi@ae.gt.com

**Mazin Khalil**

Manager – Advisory & Deputy
Head of Islamic Finance

+971 50 772 8644

mazin.khalil@ae.gt.com

**Lancia Sequeira**

Manager - Advisory

+971 55 940 9432

lancia.sequeira@ae.gt.com

© 2020 Grant Thornton UAE.
All rights reserved.

Grant Thornton refers to the brand under which the Grant Thornton member firms provide assistance, tax and advisory services to their clients and/or refers to one or more member firms, as the context requires.

Dubai

Rolex Tower, 23 Floor
Sheikh Zayed Road
PO Box 1620
Dubai, UAE

T +971 4 388 9925
F +971 4 388 9915

Abu Dhabi

Al Kamala Tower
Office 1101, 11 Floor
Zayed the 1st Street
Abu Dhabi, UAE

T +971 2 666 9750
F +971 2 666 9816

Sharjah

Al Bakr Tower
Office 305
7/9 Al Khan Street
Sharjah, UAE

T +971 6 525 9691
F +971 6 525 9690