

# Comparing bonds and sukuk

This research compares sukuk and bond markets to understand their trends and dynamics. It offers valuable insights into the constantly evolving functional, structural, and geographical aspects of the sukuk market





# Introduction

Global bond and sukuk markets play vital roles in the global financial system, providing companies, governments, and other organizations with the means to raise long-term financing. However, despite their similarities, bonds and sukuk exhibit distinct characteristics that are crucial to consider when analyzing and investing.

Let us begin by comparing the size of these markets. Global bond market size reached \$133 trillion in 2022. Global bond issuance in 2022 totaled \$7.7 trillion, down 29.4% from 2021.

Bonds encompass various types, including government bonds, corporate bonds, and municipal bonds. Notably, emerging bond types such as green bonds and social bonds have garnered attention, as they are specifically designed to finance environmentally and socially responsible projects.

On the other hand, the global sukuk market has a more focused nature, representing an instrument of Islamic finance. According to International Islamic Financial Market, the global sukuk market size reached \$794 billion in 2022, down 2.87% from 2021. Sukuk are Islamic bonds that adhere to the principles of Shariah law, and they are based on participation in assets or projects rather than interest-bearing debt.

In this article, we will look at the main differences between bonds and sukuk, as well as analyze the latest trends in both markets.

<sup>1</sup> WORLD ECONOMIC FORUM, APR 17 2023

<sup>2</sup> CBONDS, FINVIZIER CALCULATIONS

<sup>3</sup> IIFM SUKUK REPORT, AUGUST 2023





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# Comparing Bonds and Sukuk: definitions, similarities and differences

The main difference between bonds and sukuk lies in their underlying structures and compliance with different financial principles

## Compliance with Islamic Principles

**Bonds:** Bonds operate within conventional financial systems and are not bound by specific religious or ethical requirements

**Sukuk:** Sukuk comply with the principles of Islamic finance, which prohibit earning or payment of interest (riba) as well as engagement in certain industries, such as alcohol, pork, or gambling. Sukuk structures are designed to align with Shariah principles

## Nature of Returns

**Bonds:** In most cases, bondholders receive predetermined fixed interest payments (coupons) throughout the bond's life, regardless of the issuer's profitability.

**Sukuk:** Sukuk holders participate in the profits or returns generated by the underlying assets, projects, or businesses. The returns are not fixed but depend on the performance of the underlying investment

## Legal Ownership

**Bonds:** Bondholders are creditors of the issuer and hold a claim on the issuer's assets in case of default or bankruptcy

**Sukuk:** Sukuk holders have an undivided beneficial ownership or investment in the underlying assets, projects, or businesses. They hold an equitable share of the assets

## Structure

**Bonds:** Bonds are debt instruments where the issuer borrows money from investors and promises to repay the principal amount along with periodic interest payments (in most cases)

**Sukuk:** Sukuk, on the other hand, represent ownership or investment in underlying tangible assets, projects, or businesses. Sukuk holders earn profits or returns generated by the assets instead of receiving fixed interest payments



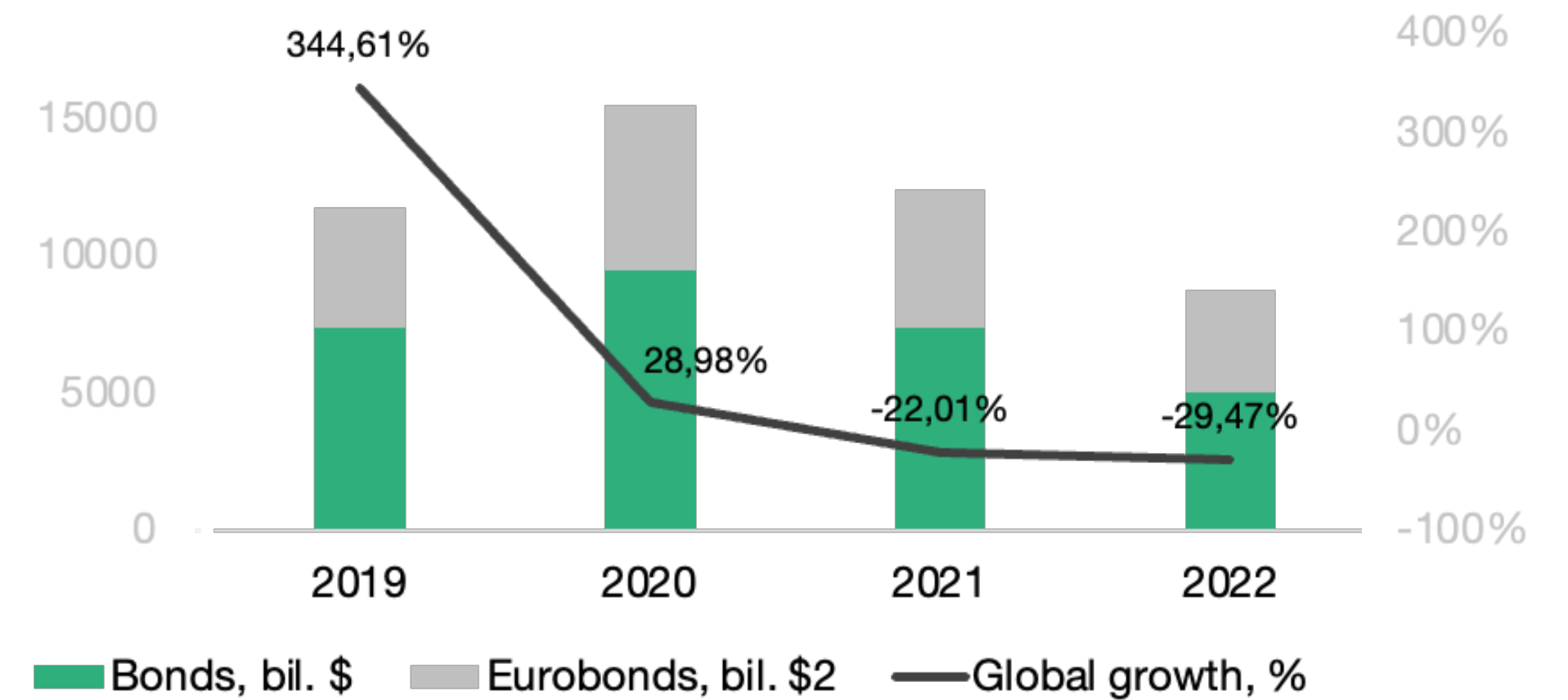
# Comparing Bonds and Sukuk: market dynamics

According to International Islamic Financial Market **total sukuk issuance decreased by 2.87% in 2022**, while **total bond issuance fell by 29.5%**. The global bond market here encompasses two primary segments: Eurobonds and bonds. The significant proportion of the total issuance volume was represented by bonds, accounting for 57.3% in 2022 (while Eurobonds constituted the remaining 42.7%). The reduction in bond issuance volume was uniform across both market segments, with bond issuance decreasing by 32.2%, while Eurobonds declined by 25.5%.

Analyzing trends in the sukuk market, one can observe continuous growth in issuances from 2015 to 2021, rising from \$67.818 million to \$188.121 million. In 2022, there was a decrease of 2.96%, with issuances totaling \$182.715 million. Notably, long-term issuances decreased by 10.4%, while short-term issuances increased by 15.7%. This may indicate that companies and financial institutions used sukuk to support their liquidity and financial needs. The decrease in long-term issuances is primarily attributed to global inflation and rising interest rates worldwide. It is also related to reduced financing needs in Islamic finance countries due to higher oil prices.

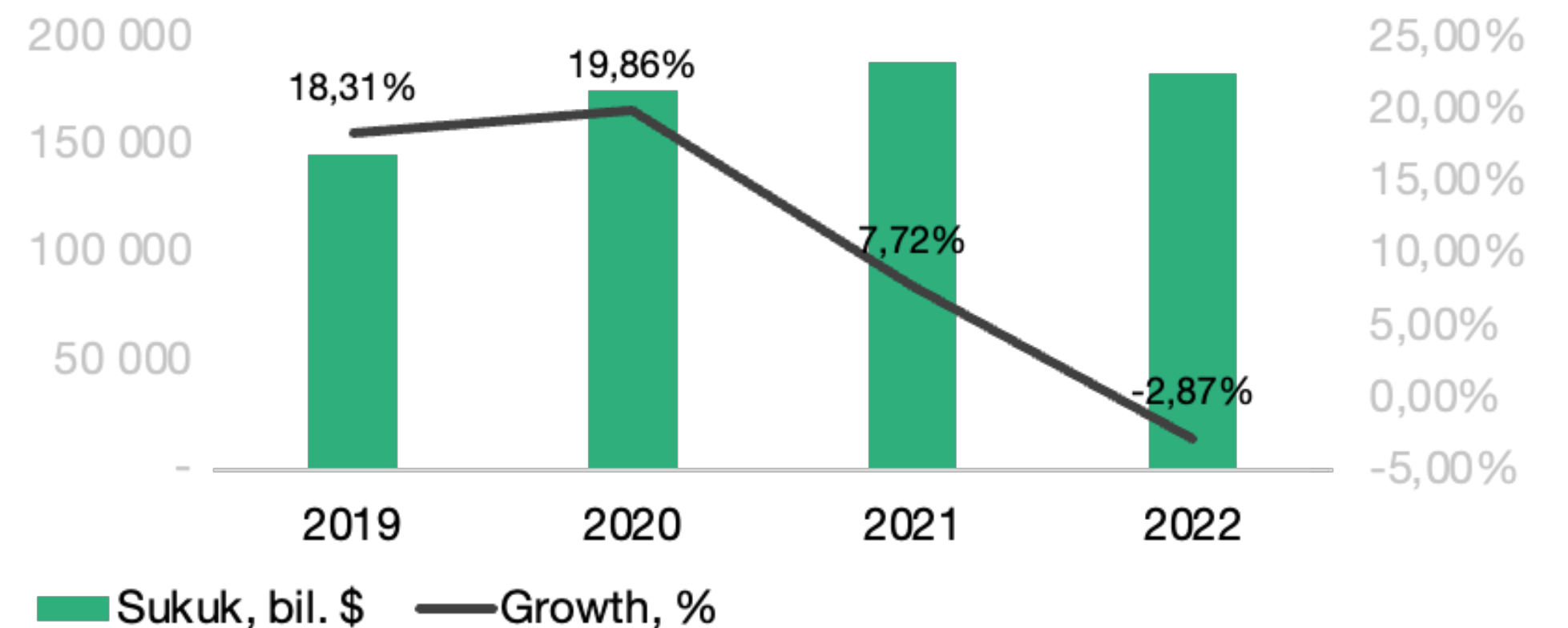
In the first half of 2023, the Sukuk market appears to remain stable or even experience moderate growth, despite global inflationary pressures and rising benchmark rates, which may limit issuances to moderate growth. Furthermore, the Sukuk issuance pipeline for 2023 also suggests a stable year for the Sukuk market.

Total global bond issuances



SOURCE: IMF, FINVIZIER CONSULTANCIES CALCULATIONS BONDS AND EUROBONDS, EXCLUDING JAPAN

Total global sukuk issuances



SOURCE: IIFM SUKUK REPORT, AUGUST 2023

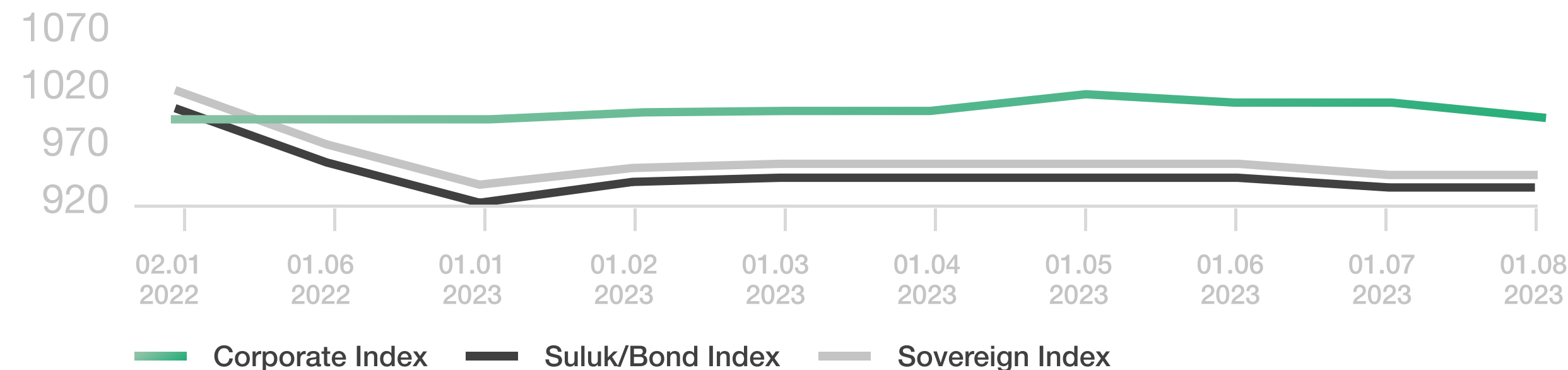


# Comparing Bonds and Sukuk: structure of issuance

According to IIFM, decline in global sukuk issuance in 2022 primarily reflects a reduction in quasi-sovereign sukuk issuance (-21%). Corporate issuers (including FIS) also experienced a slight decrease, the issuance decreased by 2%. However, the decrease occurred solely due to FIS, which dropped by 25.1%, while corporations, on the contrary, increased by 19.7%. The decrease in FIS issuance volumes is primarily attributed to the global rise in benchmark interest rates and the need for effective liquidity management by financial institutions. In the Gulf countries, high oil prices have reduced the financing needs of governments, impacting their sukuk issuance.

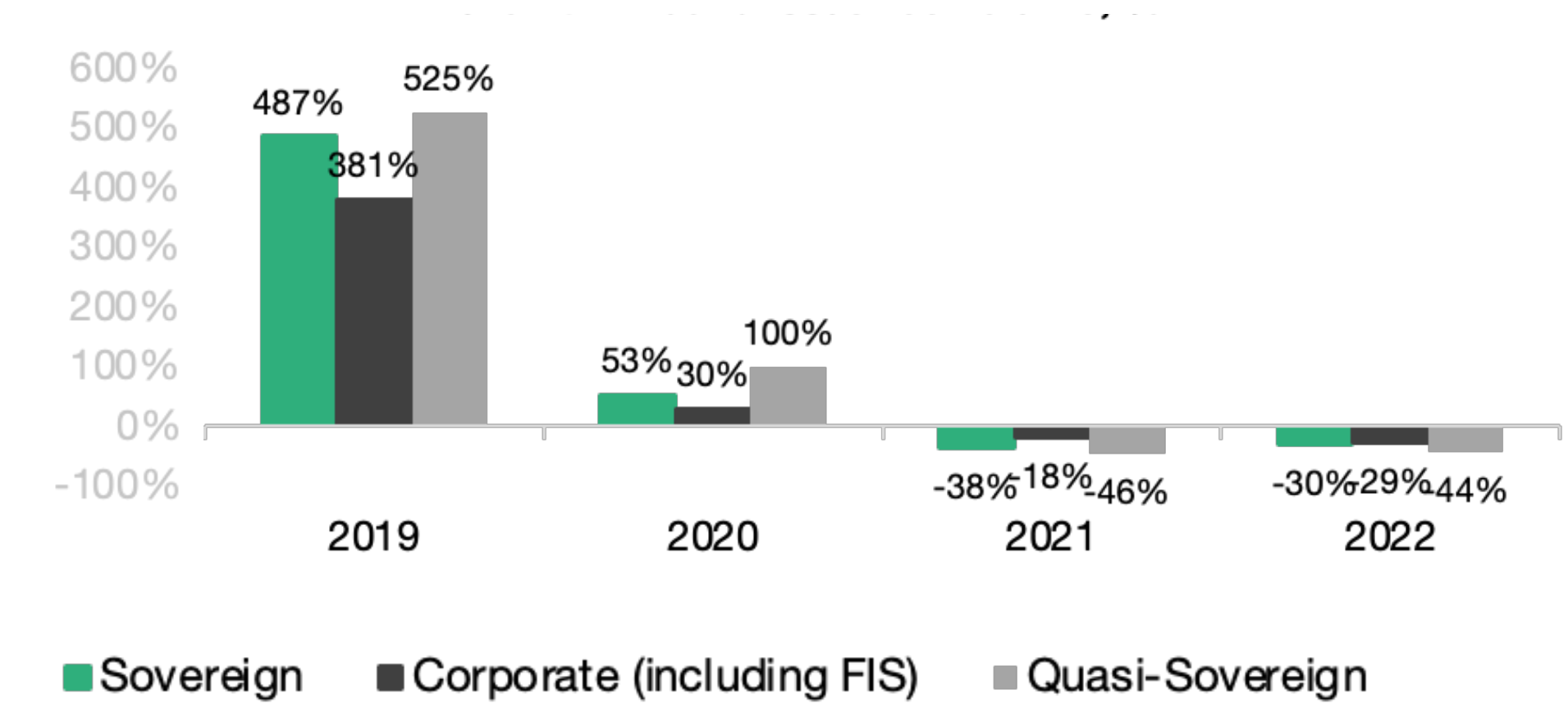
According to Saudi Exchange Sukuk/Bond Market Index declined from 1003.85 to 929.72 (-7.38%) during year 2022. In January 2023, there was a slight recovery in the market compared to the end of the previous year.

Sukuk/Bond Market Watch



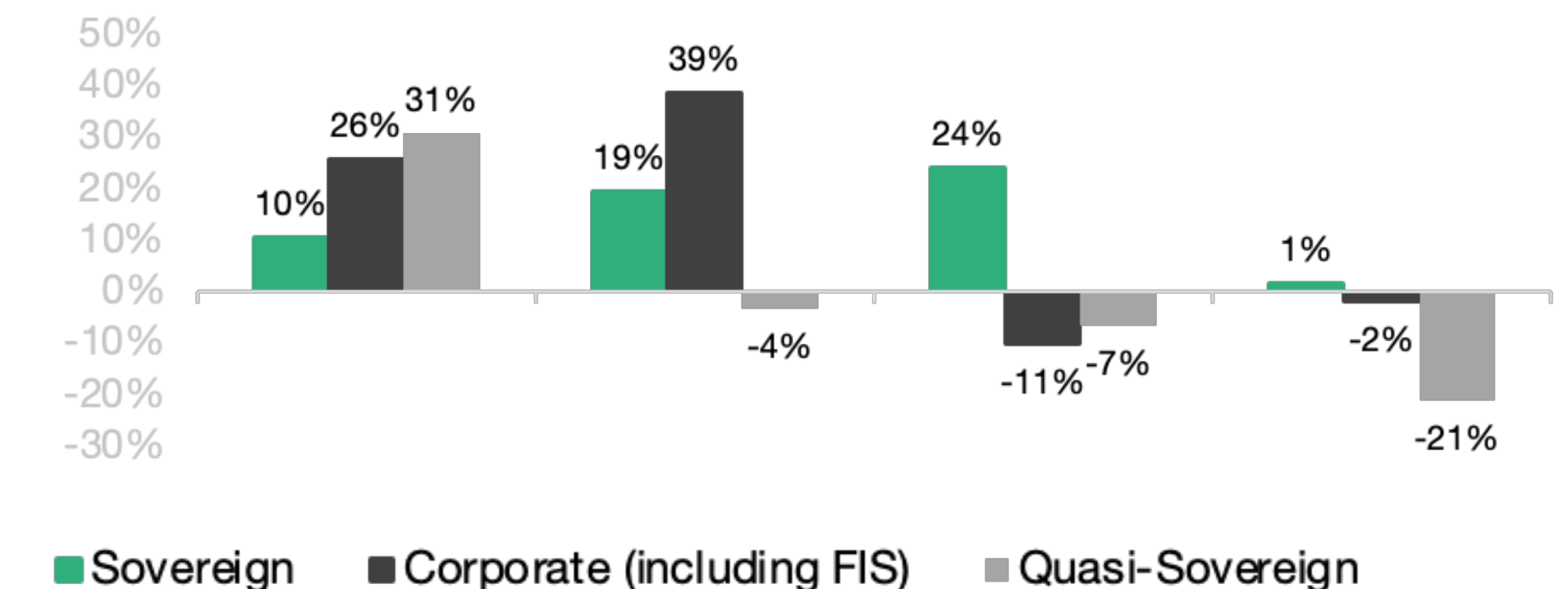
SOURCE: SAUDI EXCHANGE, SUKUK/BOND MARKET WATCH

Growth in bond issuance volume, %



SOURCE: IMF, FINVIZIER CONSULTANCIES CALCULATIONS BONDS AND EURO BONDS, EXCLUDING JAPAN

Growth in sukuk issuance volume, %



SOURCE: IIFM SUKUK REPORT, AUGUST 2023



# Comparing Bonds and Sukuk: analysis of current trends

SOURCE: IIFM SUKUK REPORT, AUGUST 2023  
WORLD ECONOMIC FORUM, APR 17 2023

## POSITIVE TRENDS

### Sukuk

- **ESG Investment Focus:** Increasing interest in investments aligned with Environmental, Social, and Governance (ESG) principles, both from investors and various business sectors
- **Digitization of the sukuk market:** The adoption of digital sukuk could offer benefits such as quicker and cheaper access to Islamic finance markets, improved transaction security, and compliance with Sharia. Reliable technology, accommodating legal frameworks, and standard legal documents are necessary for this digital transformation
- **Legal Infrastructure Development:** Government initiatives are underway to establish the necessary legal infrastructure for project-based sukuk, including broadening the range of sukuk initiators
- **Geographic expansion:** The sukuk market is expanding globally, attracting issuers and investors from various regions. This trend reflects the increasing international popularity of sukuk as an Islamic financial instrument capable of raising capital and financing projects not only in Islamic countries but also beyond their borders

### Bonds

- **ESG:** The integration of ESG contributes to the positive development of the bond market, aligning investments with responsible and sustainable practices, improving risk management, and attracting a broad range of investors, ultimately fostering a more sustainable and responsible financial environment
- **Fiscal Stimulus:** Government spending through fiscal stimulus can lead to increased issuance of government bonds to finance the stimulus



# Comparing Bonds and Sukuk: analysis of current trends

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WORLD ECONOMIC FORUM, APR 17 2023

## NEGATIVE TRENDS

### Sukuk

- **Reduced Financing Needs:** The decrease in the global sukuk market volume is attributed to decreased financing needs in Islamic finance countries due to higher oil prices
- **Inflationary Pressures and Benchmark Rates:** Global inflationary pressures and rising benchmark rates may limit issuances to moderate growth in the first half of 2024
- **Geopolitical Tensions:** The conflict in the Middle East may pose challenges to the Islamic finance market and influence sukuk issuances in the medium term

### Bonds

- **Global Challenges:** With the rise in interest rates and inflation, additional pressures may emerge on global bond markets, which have rapidly expanded during a period of accommodative monetary policy and low interest rates
- **Geopolitical and Fiscal Factors:** Downside risks persist, including uncertainty surrounding China's reopening, the Russia-Ukraine conflict. Potential disruptions to energy supplies, fiscal spending, and China's reopening could impact future inflation trends



# Geographic analysis of the sukuk market

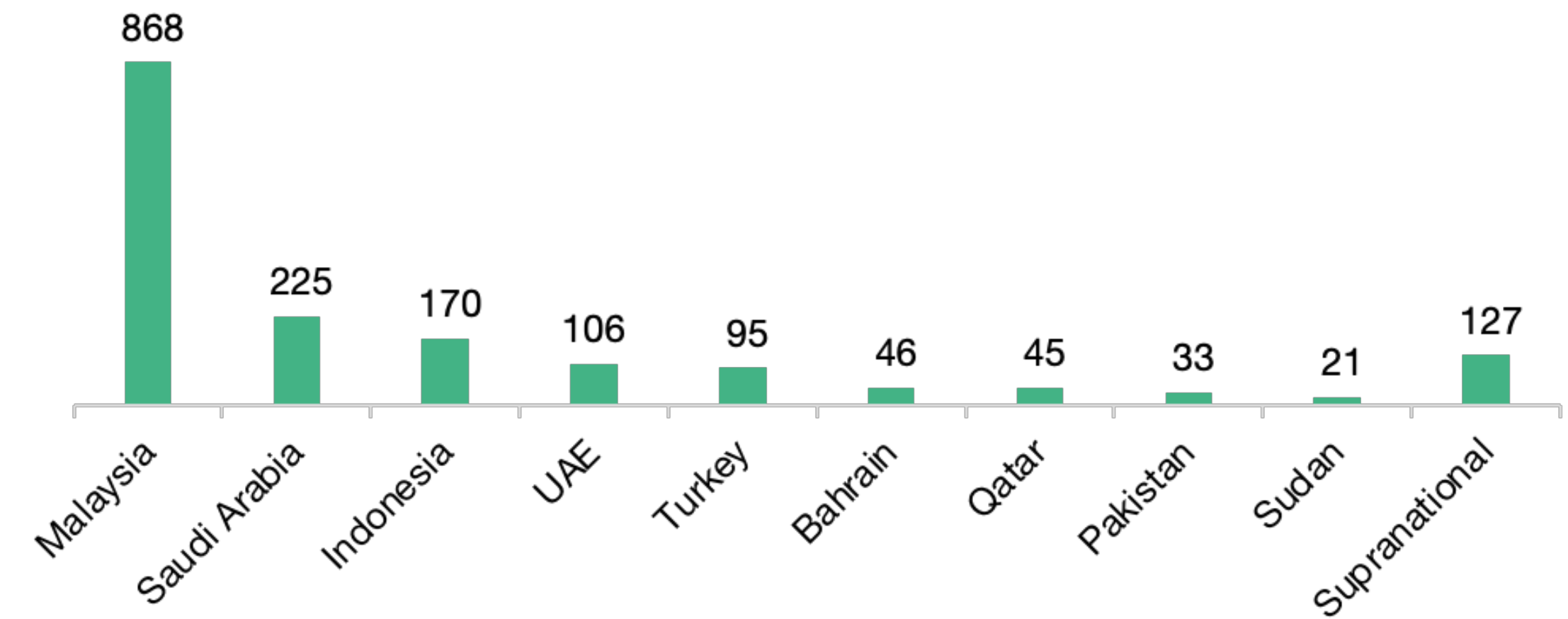
Since inception of Sukuk market in 2001, **Asia** has consistently been the dominant player in the global sukuk market, holding a **61%** market share (global volume for 2001-2022), followed by the **GCC&Middle East at 25%**. Supranational entities, particularly the **Islamic Development Bank**, also play a significant role in Sukuk market development with a 7% share.

In 2022, **Malaysia, Saudi Arabia, and Indonesia** are the market leaders, holding **37%, 23%, and 12%** of the market share, respectively. A relatively new entrant, **Nigeria**, is emerging as a key issuer of Sukuk in the African region with a **0.20%** market share. The increasing number of jurisdictions issuing Sukuk directly or indirectly each year contributes to the resilience and dynamism of the Sukuk market.

In 2022, Sukuk issuances decreased across most key markets. Malaysia saw a 12% decrease compared to 2021, Indonesia dropped by 4.5%, the UAE by 8%, Turkey by 44%, and Bahrain by 23%. Meanwhile, Qatar experienced a 142% increase in volume, Pakistan saw a 40% increase, and Saudi Arabia's volume remained at the 2021 level.

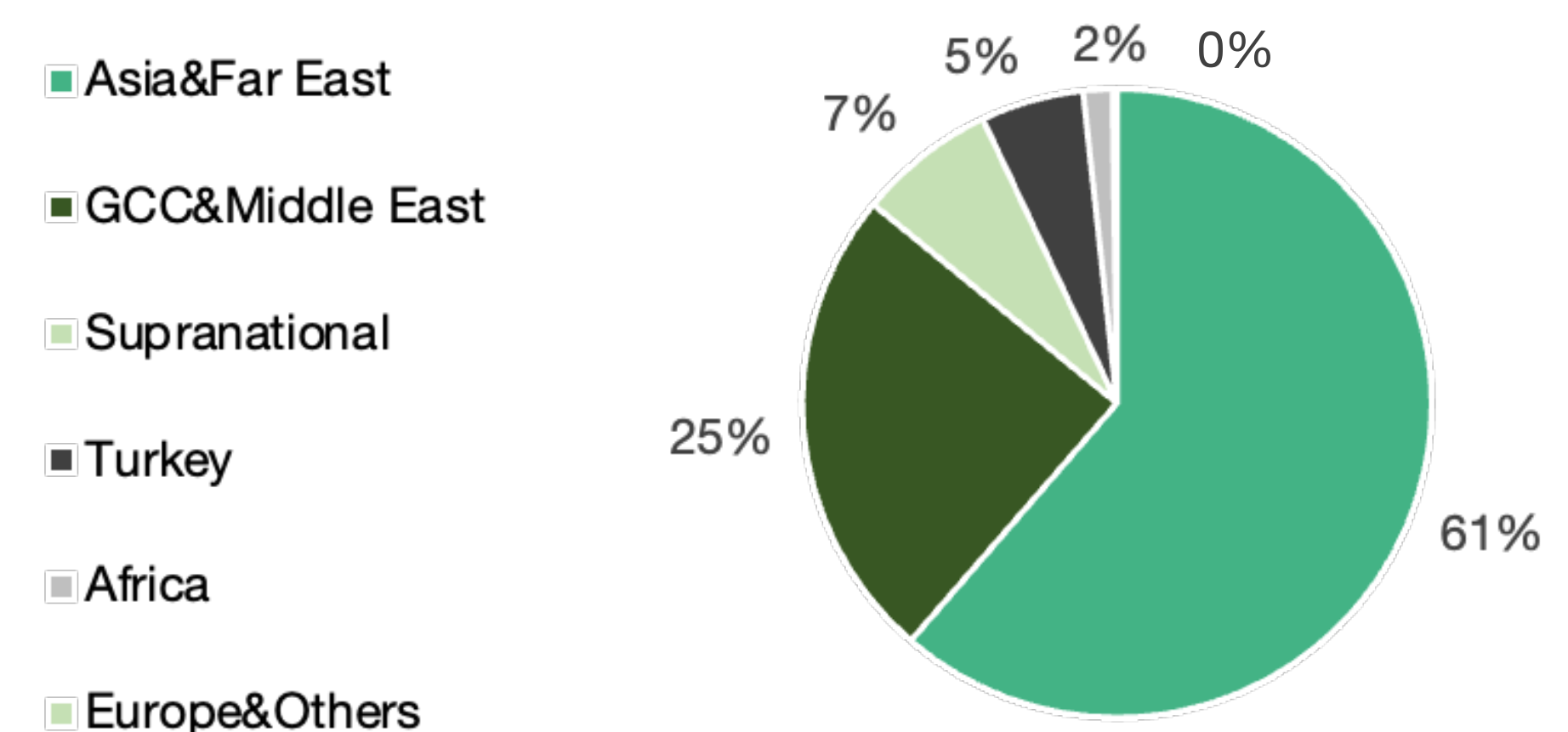
Asia continues to maintain its dominant position in the sukuk market despite declines in key markets. We also note activity in the sukuk market in new regions, such as Nigeria, which is an indicator of the expansion of the traditional geography of sukuk

Regional break-up of Global sukuk issuances, 2001 – 2022, Bil. \$



SOURCE: IIFM SUKUK REPORT, AUGUST 2023

Regional break-up of Global sukuk issuances, 2001 – 2022, Bil. \$



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# Key takeaways: factors shaping trends in bond and sukuk markets

- 01** One key factor influencing the bond and sukuk markets is changes in the **regulatory environment**. Government policies, legislation, and regulatory measures can have a significant impact on these markets. For instance, changes in tax rates, rules, and regulations can affect the attractiveness and yield of bond and sukuk investments. Alterations in regulatory rules can also impact the availability and conditions of bond and sukuk issuances.
- 02** The **digitization of the sukuk market** has the potential to drive an expansion in volumes, offering expedited and cost-effective access to Islamic finance markets. By leveraging digital platforms and distributed ledger technology, digital sukuk streamline issuance, trading, and settlement processes, attracting a broader investor base and reducing administrative costs. This transformation enhances transparency, improves market liquidity, and revolutionizes the industry.
- 03** Another important factor is **investment flows**. External and internal factors can influence the inflow or outflow of capital into these markets. For example, changes in international economic conditions, political instability, or shifts in risk assessment can influence investors' preferences and their decision to allocate funds to bonds and sukuk.
- 04** **Macro-economic environment** is another crucial aspect. Economic factors such as inflation, interest rates, unemployment rates, GDP growth, and currency stability can influence the bond and sukuk markets. Changes in the macro-economic situation can alter investors' expectations regarding the yield and risks associated with these instruments.
- 05** **Potential rise in interest rates and high inflation** may impact the growth of the bond and sukuk markets. However, according to the S&P 500 Bond Index, there is an observed increase in bond issuance activity towards the end of this year, starting from November, of approximately 9%.



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