

## Advancements in Liquidity Management in Islamic Finance

A robust and efficient liquidity management framework is integral to the development of a comprehensive and stable Islamic financial system. Such a framework is an important component for the operations of Islamic financial institutions in conducting funding and investment activities. Over the recent decade, liquidity management in Islamic finance has become increasingly important with the significant growth in Islamic banking deposits. The growth in Islamic banking deposits has outpaced its conventional counterpart by almost three times, growing at a 10-year average annual rate of 17.6%, compared to 7.1% for the conventional deposits. The continuous demands and challenges of effectively managing liquidity and the associated asset-liability maturity mismatches, as illustrated in Chart 1, have provided the impetus for wide-ranging efforts to further enhance the liquidity management framework in Islamic finance.

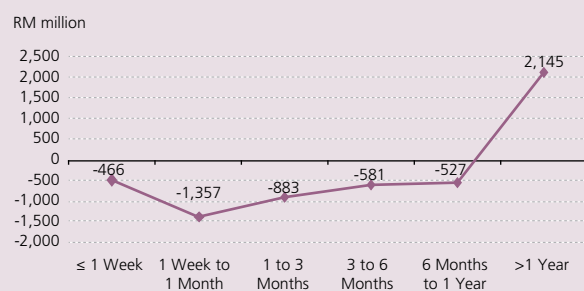
The measures that have been introduced have focused on developing and strengthening six key components that support more effective liquidity management, namely: (i) introducing wide-ranging Shariah-compliant liquidity instruments; (ii) establishing an efficient infrastructure to facilitate the issuance of Islamic financial instruments; (iii) promoting an active secondary market; (iv) ensuring a sound regulatory, supervisory and Shariah framework; (v) securing a strong financial safety net; and (vi) putting in place robust institutional policies and procedures. For each of these components, the important milestones and ongoing efforts are presented in Diagram 1.

These measures have collectively contributed towards the advancements in Islamic liquidity management, including the following:

- The development of a deep and vibrant Islamic money market with 55 registered interbank players and an annual trading volume exceeding RM1 trillion (Chart 2). This enables Islamic financial institutions to obtain and manage funds in a cost-efficient manner.
- The size of the Malaysian sovereign and corporate sukuk market has almost tripled from a total of RM120 billion in 2005 to RM353 billion in 2011, with an upward trend in total sukuk issuances (Chart 3). Malaysia remains the global leader in the sukuk market with a market share of 60% or USD108 billion in outstanding sukuk as at end-2011. Issuances of foreign currency-denominated sukuk in Malaysia have also increased steadily, accounting for 14.5% of US dollar-denominated sukuk issued globally (Chart 4). This provides Islamic financial institutions with a wider choice of investment avenues in managing the portfolio liquidity and expected returns of fund providers.
- The financing-to-deposit ratio of Islamic banks has gradually increased to stabilise within the range of 60% to 80% as Islamic finance continues to facilitate the efficient mobilisation of savings to finance economic activity (Chart 5).

Chart 1

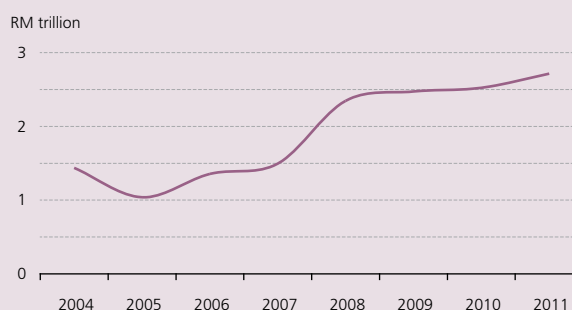
Assets Net of Liabilities of Islamic Banks by Contractual Maturity Buckets as at end-2011



Source: Bank Negara Malaysia

Chart 2

Islamic Interbank Money Market Transactions



Source: Bank Negara Malaysia

Diagram 1

Advancements in Liquidity Management in Islamic Finance

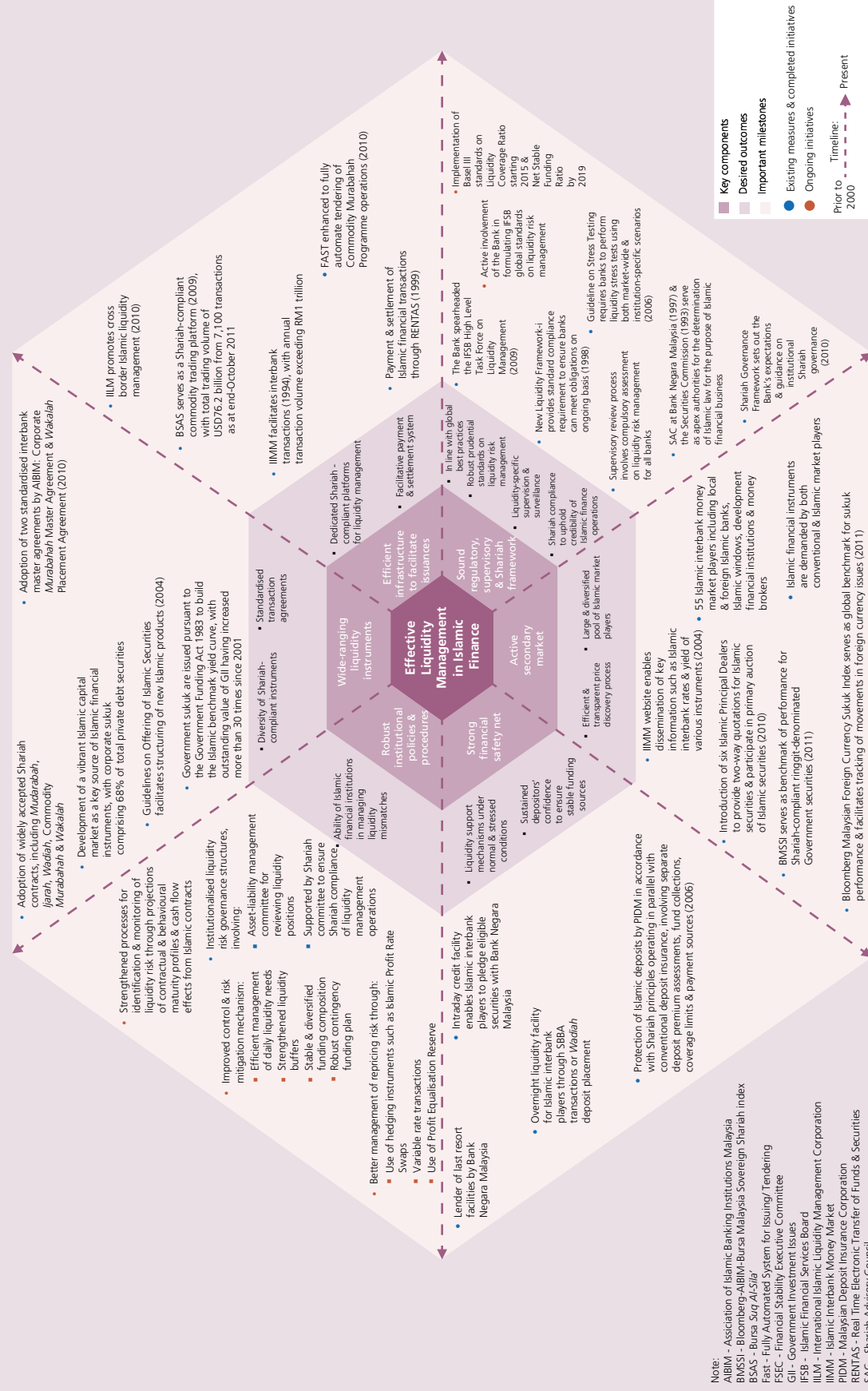


Chart 3

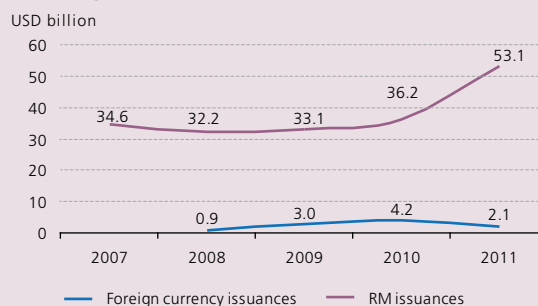
## Total Government and Corporate Sukuk Outstanding



Source: Bond Pricing Agency Malaysia

Chart 4

## Total Ringgit and Foreign Currency Sukuk Issuances in Malaysia



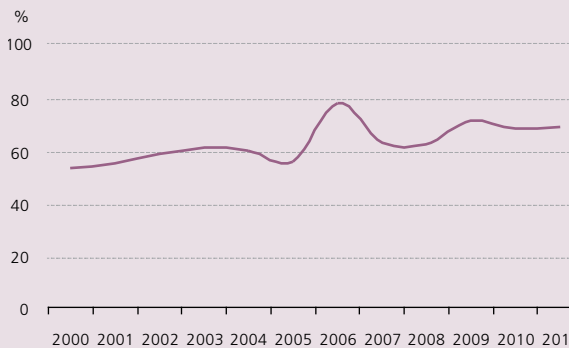
Source: Bank Negara Malaysia

- Innovations in Islamic finance have seen Islamic financial institutions offer a wider range of Shariah-compliant deposit and investment products, with more than 100 types of products and services currently available in Malaysia, providing competitive returns comparable to the offerings of conventional financial institutions. While sukuk in Malaysia used to be predominantly structured using debt-based contracts, the composition of sukuk structured using non-debt-based contracts such as *ijarah*, *wakalah*, and *musyarakah* contracts has now doubled from 12% in 2001 to 24% as at 31 December 2011 (Chart 6). Such continuous innovation widens the range of available financial solutions, enabling Islamic finance to fulfil the diverse financial needs of businesses and consumers.

Malaysia's framework for liquidity management in Islamic finance now encompasses all the necessary components to enable the efficient and stable functioning of the Islamic financial system. Moving forward, Malaysia, collaboratively with other Central Banks, are working towards securing a robust and resilient cross-border liquidity management infrastructure, promoting the development of globally-accepted Islamic liquidity instruments, and ensuring a conducive environment for the issuance of foreign currency instruments. The International Islamic Liquidity Management Corporation (IILM) will have a central role in such efforts towards supporting the global expansion of Islamic finance. In addition, with the implementation of the Basel III liquidity standards, efforts would also include a review of the structure and tenor of current Islamic funding sources to achieve a more stable funding base for Islamic financial institutions.

Chart 5

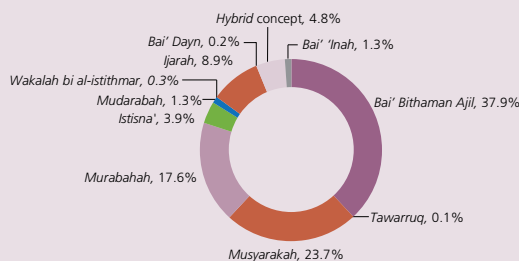
## Average Islamic Banks' Financing-to-Deposit Ratio



Source: Bank Negara Malaysia

Chart 6

## Outstanding Sukuk by Shariah Contracts in Malaysia as at end-2011



Source: Bank Negara Malaysia