Islamic Finance Development Over the Period in Terms of Profitability

Shokirova Dilnoza Olimjon qizi.

(Assistant teacher of the Shakhrisabz branch of the Tashkent Institute of Chemical Technology)

ABSTRACT

The global Islamic finance industry has been growing rapidly over the past couple of years and has witnessed a rise in the number of Islamic platforms set up around the world, to provide a range of Shari'ah compliant structured finance solutions. The core principles of Islam lay great emphasis on social justice, inclusion, and sharing of resources between the haves and the have nots. Islamic finance addresses the issue of "financial inclusion" or "access to finance" from two directions - one through promoting risk-sharing contracts that provide a viable alternative to conventional debt-based financing, and the other through specific instruments of redistribution of the wealth among the society. Use of risk-sharing financing instruments can offer Shariah-compliant microfinance, financing for small and medium enterprises, and micro-insurance to enhance access to finance.

Keywords: Islamic Financial Institutions, Shariah, Takaful, Islamic funds,Sukuk, islamic banks, business model, financial intermediation, investment, capital, financial indicators, cooperation, financial performance, profitability, financial risk

Islamic banks have grown to create a market that is competitive for conventional banks in several Islamic countries, gradually eating up their market share and offering products that match their level of service and scale of operation. The increasing need amongst Islamic population for Shariah-compliant banking has led to its growth across the Middle East, South Asia and North Africa regions. While Shariah compliance is at the core of every Islamic banking institution, there are differences in opinions related to the application or interpretation of Shariah law amongst the different regions, notably between the Middle East and Malaysia. Recently, a number of Central Banks and financial authorities have started officially adopting AAOIFI standards (Accounting and Auditing Organization for Islamic Financial Institutions) which can help financial institutions with Shariah compliance

Among the main findings of the year of assessment 2020 is that global assets for the industry maintained double-digit growth, rising 14% to $3.374 trillion. This is down from 15% growth in 2019 but is an achievement considering the painful year the COVID-19 pandemic inflicted on our communities, societies, and economies.

Considering all of these, the IFDI score for the year of assessment 2020 for 135 countries is 11, up by a hair's breadth from 10.8. Growth, albeit ever so slim. Growth achieved in an unprecedented pandemic year. And things are looking up. The IMF's July outlook projects global GDP growth of 6% in 2021, moderating to 4.9% in 2022 on the strength of vaccination campaigns.

For the global Islamic finance industry, 2020 was the year key jurisdictions accelerated digitization, which pushed fintech into the foreground even more. This sector, and increasingly important sustainability drives, will be key to more growth and developments in 2021 and beyond. IFDI projects the size of the Islamic finance industry to rise from $3.374 trillion in 2020 to $4.94 trillion in 2025, an average growth of 8% in the next five years.

2020 was a brute of a year. When COVID-19 was declared a pandemic by the World Health Organization on March 11, many around the world were bracing themselves for a crisis that could potentially paralyze finance, with flashbacks to 2007-2009.

As it turned out, our economies were in for a much, much rougher ride. Global GDP growth was -3.2% and the performance of the three most advanced Islamic finance jurisdictions (according to IFDI 2021) ranged from -5.6% for Malaysia, -4.1% for Saudi Arabia and -2.1% for Indonesia, says IMF data. The coronavirus in 2020 killed at least 1.7 million people and the crisis shut shops, schools and borders, with lockdowns emptying streets, and social and religious spaces, while at the same time making very heavy demands on our hospitals and frontline workers. But if there was a silver lining for the finance industry from the last global financial crisis, it was that governments and authorities had learned a lot of lessons.

Substantial stimulus packages were quickly rolled out and pandemic-era rules for banks and other financial institutions kicked in. Concerns included defaults that could strain banks' capital positions and profitability, and extraordinary measures were put in place to ensure that banks could prioritize lending and support businesses and individuals through the crisis. These moves were applied evenly for conventional as well as Shariah-compliant banks, which hold around 70% of the world's Islamic financial assets. By the end of 2020, the profitability of these Islamic banks were indeed pushed down under the weight of heavier non-performing loans but the sector stood its ground, registering a year-on-year double-digit growth in assets of 14%. Sukuk, the second-biggest sector in Islamic finance, grew by 16% in 2020, a nudge up from 14.7% in 2019, driven by the GCC and Southeast Asia.

Indeed, the top countries on IFDI 2021—Malaysia, Indonesia, Saudi Arabia, Bahrain, and the UAE—are all heavily invested in the expansion of their fintech sectors for several reasons, including financial inclusion and accessibility to a fast-growing digital ecosystem. With the pandemic accelerating the digitization of finance, Islamic fintech grew in visibility across these countries by continuing to provide services for businesses and individuals such as payments, financing, crowdfunding, wealth management, and integration with e-commerce, as well as getting into buy-now-pay-later and pushing forward with newer developments such as asset tokenization. It feels like only yesterday when financial authorities in these countries were introducing "sandboxes"; in 2020, Islamic fintech start-ups won not-insignificant venture capital investments and started to make moves to expand across borders. We expect more developments to report on in next year's IFDI report as the central banks of Malaysia and Saudi Arabia award their first digital banking licences. Outside of the top five Islamic finance jurisdictions, Islamic fintechs coming out of the UK and USA continue to attract attention, and eyes are also turned to newer entrants from Pakistan and Central Asia.

Considering all of these, the IFDI score for the year of assessment 2020 for 135 countries is 11, up by a hair's breadth from 10.8. Growth, albeit ever so slim. Growth achieved in an unprecedented pandemic year. And things are looking up. The IMF's July outlook projects global GDP growth of 6% in 2021, moderating to 4.9% in 2022 on the strength of vaccination campaigns. For the global Islamic finance industry, 2020 was the year key jurisdictions accelerated digitization, which pushed fintech into the foreground even more. This sector, and increasingly important sustainability drives, will be key to more growth and developments in 2021 and beyond.

IFDI projects the size of the Islamic finance industry to rise from $3.374 trillion in

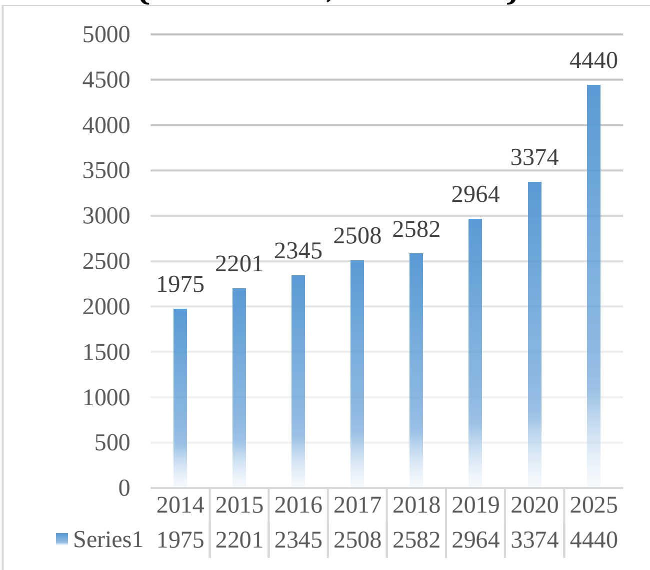
2020 to $4.94 trillion in 2025, an average growth of 8% in the next five years.

The Islamic Finance Development Indicator (IFDI) provides Islamic finance's different stakeholders such as governments, financial institutions and education providers with a detailed analysis of the key factors driving development and growth in the global industry. The indicator is the absolute barometer of the state of the Islamic finance industry during the pandemic in 2020 and provides performances and rankings for 135 countries around the world.

It draws on five indicators that are the main drivers of development in the industry: Quantitative Development, Knowledge, Governance, Corporate Social Responsibility, and Awareness. By measuring changes in these indicators over time and across different countries, the IFDI provides a vital tool in guiding policy within the industry. The IFDI also gives an indication of the strength of the ecosystem behind the industry's overall development as well as the size and growth of the different Islamic finance sectors within the many countries where it has a presence.

The IFDI 2021 indicator score looks at key metrics that shaped the pandemic year of 2020 for 135 countries. While there were movements in scores and ranking among countries and different indicators, the overall global IFDI indicator score improved slightly to 11.0 for 2021 from 10.8 for 2020. If anything, this nudge up indicates the continued strength and development of the Islamic finance industry despite the unprecedented challenges caused by the pandemic for most of 2020.

Graph 1. Islamic Finance Assets Growth (2014 - 2020, USD Billion)



The Knowledge and Governance indicators improved compared to the previous year but Awareness declined. Quantitative Development and CSR indicators stayed constant. The reasons for the movements of each of these indicators are assessed separately and in detail throughout this report.

The Southeast Asian nations Malaysia and Indonesia retained their top rankings for the second year in a row. Indonesia jumped into the top three last year and for IFDI 2021 Saudi Arabia made the same upward move. This pushed down both Bahrain and the UAE into fourth and fifth respectively, from third and fourth. We noted in last year's report that Saudi Arabia had the biggest opportunity to improve its ranking if it boosts areas in which it lags; the Kingdom in 2020 introduced new Islamic finance regulations that strengthened its Governance indicator score.

The Middle East's biggest economy also improved on its Quantitative Development, Awareness and Knowledge, and keeps its place as the leader on the CSR indicator. Other countries with notable improvements in IFDI rankings and scores include Ethiopia, India and Uzbekistan.

As many social and economic activities moved online, we encountered other risks, including technological and data disruptions that could equally be caused by nefarious agents as well as companies' own limited capabilities and capacities. These piled on the challenges that also included operational risks from remote working for a lot of employees, and shifting customer behaviors that are still impacting financial institutions. The global crisis also fueled oil price volatility and exerted pressures on the real estate sector in some Islamic financial markets.

Islamic banks continue to hold the most assets across all industry sectors. Islamic banking assets were $2.3 trillion in 2020, with a year-on-year double digit growth of 14%, down slightly from 15% in 2019. However, in comparison, growth in Islamic banking assets in 2018 was just 2%. GCC countries continue to dominate, with the region being home to the biggest Islamic banks by assets; they account for five of the top 10, indicating the systemic importance of this core region to the overall global Islamic banking industry.

Although the sector's growth was muted at the start of 2020, with several Islamic banks registering losses, the trend was reversed towards the latter half of 2020 and the start of 2021. This was due to the success of vaccination campaigns across core markets such as the GCC countries, as well as the provision of sizeable stimulus packages and liquidity injections by several Organization of Islamic Cooperation (OIC) governments to help deal with the economic fallouts from the pandemic. Consequently, Islamic banking activity emerged relatively unscathed from the pandemic, which should set the path to reach $3.3 trillion in assets by 2025.

The Islamic funds sector grew by 22% to $178 billion in assets under management in 2020. Islamic funds based in India, the U.S. and UK, that collectively accounted for 15% of global Islamic funds, rose by double digits. In larger markets, Malaysia had a growth of 8.9% while the sector in Saudi Arabia grew by 33.2%. These markets account for 48% of global Islamic funds in 2020.

The growth of the sector was also supported by the launch of 95 Islamic funds during 2020 that added $1.5 billion in assets under management. Most of these are based in Malaysia, Indonesia, Pakistan and Saudi Arabia.

Reference

1. Di Vanna, Joseph A., Understanding Islamic Banking: The Value Proposition That Transcends Cultures (Cambridge, Leonardo and Francis Press 2021).
2. Iqbal, Munawar, and Philip Moyneux, Thirty Years of Islamic Banking – History, Performance and Prospects (New York, Palgrave Macmillan 2020)
3. Mahmoud Amin El-Gamal is an Egyptian-born United States citizen who is Professor of Economics and Statistics at Rice University, Houston, Texas. He is a prolific writer on Islamic finance.
4. Islamic finance development report 2021. An LSEG BUSINESS
5. Carletti, E. and G. Ferrero (20), “Bad zero: Financial stability in a low interest rate environment”, Working paper.