

Sukuk outlook

The hype surrounding the interest rate increase in the US and the strengthening of the US dollar has, to a certain extent, been a bit overdone and both have already been priced into global Sukuk in 2015. AHMAD NAJIB NAZLAN writes.



SUKUK

By Ahmad Najib Nazlan

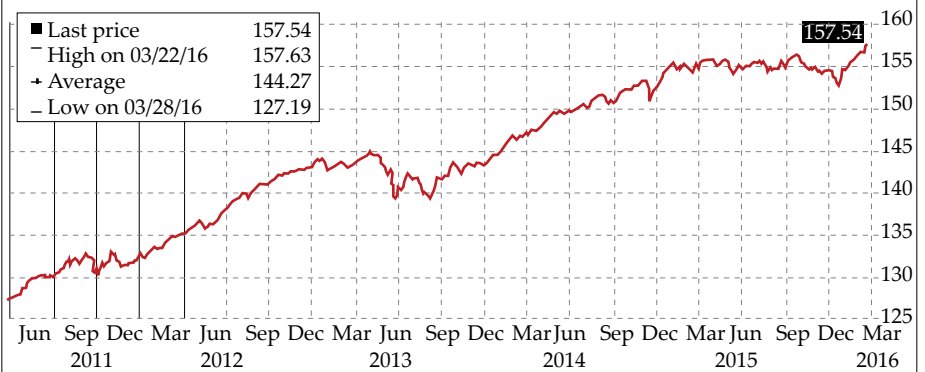
A few relevant global Sukuk indices have shown that the sell-off in the Sukuk market was overdone toward the first US rate hike in December last year and started to rationalize right after the actual hike. The rationalization or reversal came in strongly as early as January 2016 as certain economic data started to show further weaknesses and also due to the eventual acceptance by Federal Reserve (FED) members themselves that the four-time rate hike in 2016 may not be doable and have instead now targeted a two-time hike. We expect the recovery in the Sukuk market to continue as the threat of a steep increase in the US rate is dissipating fast.

US dollar strengthening

The US FED is now expecting to make only two quarter-point interest rate rises this year, bringing its forecast closer in line with market expectations. The Fed previously, before the first rate hike in December 2015, had forecasted four rate rises. This reassessment indicates that the global financial and economic turmoil in the first two months of 2016 have had a big impact on the way the FED is thinking and reflects the flexibility of the FED in manoeuvring the current volatile market data.

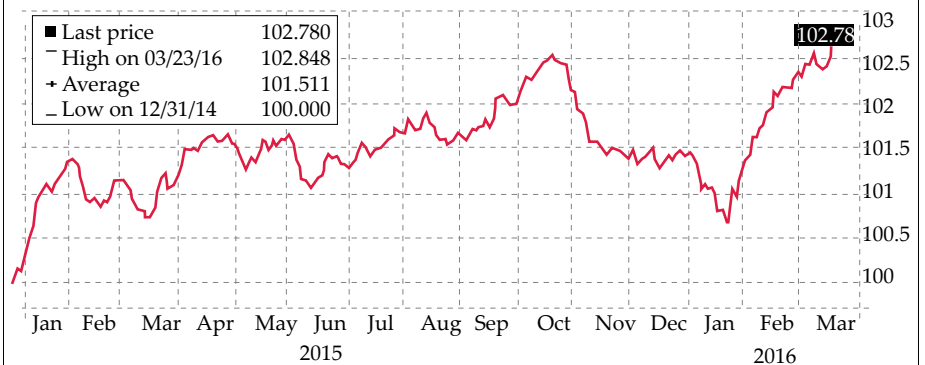
The data dependence clause for actions by the FED has become a permanent feature in past years and may also continue for a while longer. Ongoing strength in the US job market could give the FED justification for multiple interest rate increases this year. Nevertheless, our inclination is toward lower interest rates for a longer period as we believe that newer jobs created in the US market do not really translate into meaningful wage growth, which could spur inflation to justify multiple rate hikes beyond two times this year. Based on our view of the lower interest rates for a longer period, we are cautiously optimistic for the Sukuk market, especially on credits as

Chart 1: Dow Jones Sukuk Index



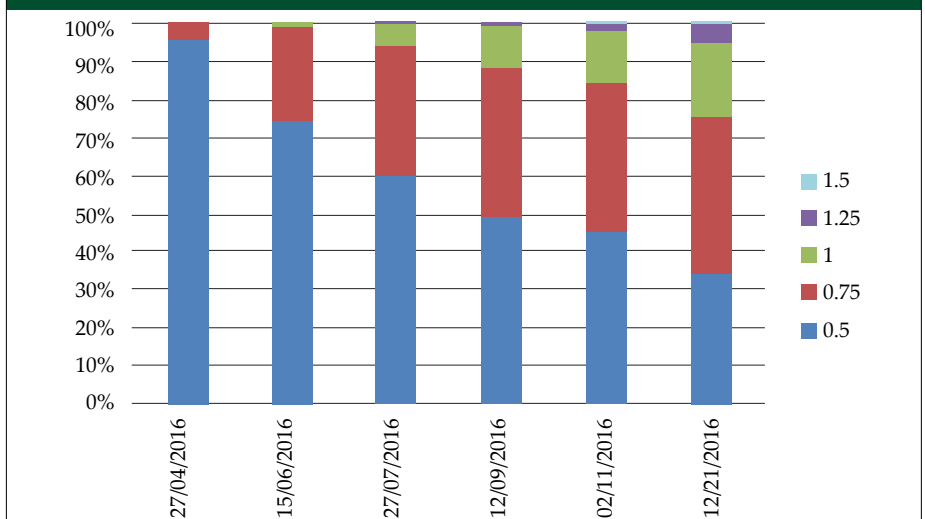
Source: Bloomberg

Chart 2: Global Sukuk ex-MYR



Source: Bloomberg

Chart 3: FED rate expectation based on CME Group 30-Day Fed Fund futures prices as at the 4th April 2016



Source: CME Group