



FINANCIAL COOPERATION

OIC/COMCEC-FC/32-16/D(...)



COMCEC

CCO BRIEF ON FINANCIAL COOPERATION

COMCEC COORDINATION OFFICE

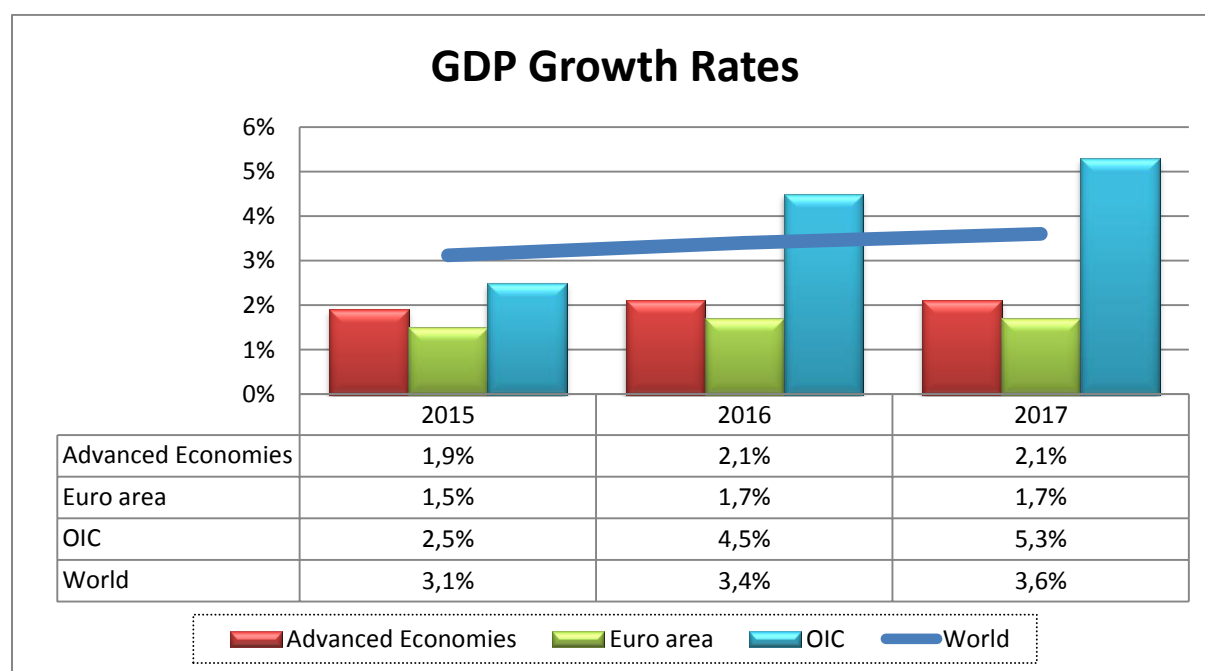
April 2016

CCO BRIEF ON FINANCIAL COOPERATION

Global economy continues its moderate recovery. It is expected that growth in the advanced economies prudently increases in 2015 and 2016. Although there is a multipolar structure that varies according to the region and economy, a weak economic outlook generally dominates emerging economies, due to declining growth rates for five years.

- According to IMF forecast US GDP growth rate will be 2.8 percent in 2016 and 2017. Additionally, Unemployment rate is back below 5% for the first time since the 2008 financial crisis. In light of the recent developments in the US economy, FED lifted the interest rate from the zero lower bound for the first time since 2006.
- The gradual slowdown and rebalancing of economic activity in China reduce investment and manufacturing of consumer goods and services. It is expected that Overall growth in China will gradually decrease in the following years and will be 6 percent in 2017.
- European Central Bank (ECB) monetary expansion policy would last until March 2017 with the amount of sixty billion Euros every month. ECB has cut the Eurozone interest rate to zero for supporting economic recovery in Euro Area in March 2016. Despite the monetary easing, inflation in Euro Area is still in an irregular path. Inflation rate was minus 0.2 percent in February 2016. On the other hand, credit conditions are improving and credit demand is picking up, but government debt, unemployment and low nominal growth pose downside risks for Euro Area.
- OIC Member States average growth rate will be moderate in 2015 but will accelerate in 2016 and 2017 with the growth rate of 4.5 and 5.3 percent, respectively.

Figure 1: GDP Growth Rates



Source: IMF Database

DEVELOPING ISLAMIC FINANCE STRATEGIES IN THE OIC MEMBER COUNTRIES

Islamic Finance is one of the crucial issues of the COMCEC Financial Cooperation Group, established in line with the implementation of the COMCEC Strategy. The 3rd Meeting of the Financial Cooperation Working Group was held with the theme of “Risk Management in Islamic Finance Instruments. The 6th Meeting was held with the theme of “Developing Islamic Finance Strategies in the OIC Member Countries”. Furthermore, The Financial Cooperation Working Group has devoted its next three meetings to the various dimensions of Islamic finance.

Islamic finance has become an important part of the international financial system and has certainly been one of its fastest growing components over the last decades. In the wake of the financial crisis, there has been a renewed debate on the role that Islamic finance can play, with its strong ethical principles and asset-based approach, in the stabilization of the global financial system.¹

Despite this, it has mostly grown in a limited number of regions. There is an opportunity for the Islamic Finance industry to grow further by increasing public awareness, as well as building a stronger financial infrastructure and means of enforcement of transparency and adherence to Islamic law and principles². In this vein, to better utilize this opportunity, developing a National Islamic Finance Strategy is of particular importance for boosting the Islamic Finance industry.

On the other hand, member countries are confronted with some challenges and problems:

- Weak regulatory systems
- Inadequate Shariah governance infrastructure
- Inadequate necessary institutional infrastructure
- Inadequate Islamic financial instruments and services
- Inadequate specialized Islamic finance academic and training programs
- Inadequate initiatives, i.e. campaigns on increasing public awareness, to promote Islamic finance
- Inadequate diversified Islamic Finance Strategies/Policies targeting the various needs of investors
- Inadequate SMEs access to finance
- Low level of integration of Islamic Finance to the global financial system
- Inadequate liquidity framework for Islamic Banks
- Inadequate high quality research and intellectual discussions

To address these challenges and problems, a national Islamic finance strategy should be developed. It would play a crucial role by providing a roadmap for the Islamic Finance Industry and facilitating the creation of the necessary legal, regulatory and supervisory framework, etc.

According to the analytical study titled “*Developing Islamic Finance Strategies in the OIC Member Countries*”, which was discussed by the 6th Meeting of the Financial Cooperation Working Group held on 17-18 March 2016 in Ankara, the answers of the Member Countries to the questionnaire circulated by the CCO indicated that The Gambia, Indonesia, Pakistan,

¹ Financial Outlook of the OIC Member Countries 2014

² HASSAN Prof. M. Kabir (2016), Developing Islamic Finance Strategies in the OIC Member Countries

Qatar, Tunisia, Turkey and Uganda have a national strategy/plan/act to develop Islamic Finance.

The said study reveals a road map for developing Islamic finance strategies. The road map is designed under six components: regulatory, Shariah, infrastructure, products and services, initiatives, and talent development. The Study also includes 24 policy recommendations under each component of the road map for developing Islamic finance strategies.

- **Islamic Finance Assets**

According to the Global Islamic Finance Report 2015, since the potential size of Islamic financial services industry has grown from US\$4 trillion in 2009 to US\$6.451 trillion in 2014, with an annual growth rate of 10%, the actual size of the industry was \$ 1.984 trillion. The gap between potential size and actual size is more than twice the actual size of the industry. The financial services industry has failed to cope up with the growing demand for Islamic financial services.³ The sector is led by the Islamic banking sector (%75) and global sukuk market (%15).

Table 2: Potential and Actual Size of the Islamic Financial Services Industry

	2009	2010	2011	2012	2013	2014
Potential size of the global Islamic financial services industry (US\$ trillion)	4.0	4.4	4.84	5.3	5.9	6.5
Actual size of the global Islamic financial services industry (US\$ trillion)	1.0	1.1	1.4	1,6	1.8	1.9
Size gap (US\$ trillion)	3	3.3	3.04	3.7	4.1	4.6
Growth in actual size of the global Islamic financial services industry (%)	26	9.9	19.1	20.2	12.3	9.3
Average growth rate between 2009-2014 (%)						16.1
Catch-up period - based on 10% growth in potential size and 20% growth in actual size (years)						13.5
Catch-up period - based on 10% growth in potential size and 16.1% growth in actual size (years)						22

Soruce: GIFR 2015

SELECTED FINANCIAL FIGURES

- **Banking Sector in the Member Countries**

According to World Bank database, domestic credit average provided by the financial sector in OIC member countries is way below 100%. The ratio of domestic credit given to the private sector to the GDP of OIC-HIGH⁴ countries was 50.7% in 2014, while the ratio of OIC-LIG countries was only 18.3% for the same year. Furthermore, the ratio of domestic credit given to the private sector to the GDP of the rest of the world was 61.3% while the ratio of OIC average was 33.2% in 2014.

³ Global Islamic Finance Report 2015

⁴ See Annex 1 for Country Grouping

As the largest segment of the global Islamic finance industry, the total asset of the sector is estimated at - \$1.5 trillion in 2014⁵. The Compound Annual Growth Rate (CAGR) between 2010 and 2014 was 16%⁶.

- **Foreign Direct Investments**

According to UNCTAD Databases, the total FDI flows to OIC increased from around \$ 15.4 billion in 1994 to \$132.3 billion in 2014. The shares of OIC Member Countries in global FDI flows were 6.0% in 1994 and 10.8% in 2014. Concerning the distribution of FDI flows in the OIC Member Countries, as is the case of other major macroeconomic aggregates of the OIC member countries, a few member countries attract the great majority of the FDI flows. The top 5 OIC countries⁷ with largest inward FDI flows together accounted for 49% of total FDI flows to OIC countries in 2014, whereas the top 10 countries accounted for 70%.

- **International Reserves (Including Gold)**

Global international reserves – including gold – reached \$ 12.5 trillion in 2014. Total reserves of OIC countries were \$ 1.8 trillion in 2014. On the other hand, the share of OIC countries in total reserves of the developing countries declined from 23.4% to 22.9% during 2009-2014.⁸

COOPERATION EFFORTS UNDER THE COMCEC

Financial Cooperation is one of the crucial cooperation areas of the COMCEC. Efforts for enhancing financial cooperation under the COMCEC have been intensified in recent years. These efforts are being carried out under the COMCEC Financial Cooperation Working Group and COMCEC Project Funding Mechanism as well as cooperation among the Stock Exchanges Forum, COMCEC Capital Markets Regulators Forum and Central Banks and Monetary Authorities.

- **The COMCEC Strategy: Financial Cooperation**

COMCEC Strategy, adopted by the 4th Extraordinary Islamic Summit in 2012, identified the financial cooperation as one of the cooperation areas of the COMCEC. The Strategy determines “*deepening financial cooperation among the member countries*” as the strategic objective of the COMCEC in this field. The Strategy identifies, “*Regulatory and Supervisory Cooperation*”, “*Capital Flows*”, “*Visibility of Financial Markets*”, “*Training, R&D Activities and Statistics*” as output areas in its finance section and specifies several expected outcomes under each of them.

- **COMCEC Financial Cooperation Working Group**

Within the framework of the implementation of the COMCEC Strategy for the realization of the objectives in financial cooperation, COMCEC Financial Cooperation Working Group was established. This Working Group provides a regular platform for the experts from Member Countries to discuss their common issues in the finance sector and share their knowledge and experiences.

The Sixth Meeting of the COMCEC Financial Cooperation Working Group was held on 17-18 March 2016 in Ankara with the theme of “*Developing Islamic Finance Strategies in the OIC Member Countries*”. The analytical study titled “*Developing Islamic Finance Strategies in the OIC Member Countries*” was prepared to enrich discussions during the Meeting.

⁵ Global Islamic Finance Report 2015

⁶ World Islamic Banking Competitiveness Report 2016

⁷ Indonesia, Turkey, Malaysia, UAE and Kazakhstan

⁸ OIC Economic Outlook 2015 SESRIC

“Proceedings of the Sixth Meeting of the COMCEC Financial Cooperation Working Group” was also prepared for reflecting the outcomes of the Meeting.

The Sixth Meeting of the COMCEC Financial Cooperation Working Group also considered the preparations for the Ministerial Exchange of Views Session of the 32nd COMCEC Session to be held with the theme of "Developing Islamic Finance Strategies in the OIC Member Countries in line with the relevant resolution of the 31st Session of the COMCEC. In this framework, the participants, in light of the discussions taken place during the 6th Meeting of the COMCEC Financial Cooperation Working Group and the research report prepared specifically for this Meeting, have come up with some challenges and problems, as well as the possible policy options with regard to developing Islamic Finance Strategies in the member countries⁹.

The Seventh Financial Cooperation Working Group will be held on October 20th, 2016, in Ankara with the theme of “*National and Global Islamic Financial Architecture: Problems and Possible Solutions for OIC Member Countries*”.

All the documents prepared for the Working Group Meetings are available on the COMCEC website (www.comcec.org).

- **COMCEC Project Funding Mechanism**

The second mechanism of the implementation of the COMCEC Strategy is the COMCEC Project Cycle Management (PCM). Within the framework of the PCM, the COMCEC Coordination Office provides grants to the cooperation projects of the Member States registered to the Financial Cooperation Working Group and the OIC Institutions operating in the field of economic and commercial cooperation. The projects to be financed should be in line with the objectives and the principles of the Strategy.

After the successful implementation of two project calls within the scope of the COMCEC PCM, the third call was made in September 2015. The Final List of the COMCEC-PCM was announced on January 18th, 2016. Regarding the field of Financial Cooperation, Gambia’s and SESRIC’s projects titled “*Towards an Improved Institutional Framework for Islamic Finance*” and “*Developing Islamic Financial Industry Database of OIC Countries*” have been final-listed. Both projects are expected to be implemented and finalized in 2016.

• **Ongoing Efforts under the COMCEC:**

- **OIC Member States’ Stock Exchanges Forum:** Cooperation among the Stock Exchanges was launched in 2005 by the COMCEC in line with the decision taken by the 20th Session of the COMCEC. The Forum has held 9 meetings so far. The 9th Meeting of the Forum was held on November 19th, 2015 in İstanbul.

In its 9th Meeting, the Forum mandated the Task Force on Indices to collaborate with S&P DJ Indices teams in exploring the level of demand for sub-indices in the markets. If there was sufficient demand for product creation, the Task Force would then work on launching and promoting the sub-indices, which would include companies from the emerging OIC markets. The Meeting also elaborated the feasibility report on the establishment of a Gold Exchange among the OIC Member States prepared by Borsa İstanbul as the Forum Coordinator—as requested in the 31st Session of the Follow up Committee of COMCEC. The Forum considers that this issue needs to be further studied, and that forming a task force that consists of leading Member States on gold trading will be beneficial. To this end, the Task Force on

⁹ Please see the Proceedings Report of the 6th Meeting of the Financial Cooperation Working Group

Commodities is renamed as “Task Force on Precious Metals” and will be led by Borsa Istanbul.

The detailed information regarding the activities of the forum can be available on www.oicexchanges.org.

- **COMCEC Capital Market Regulatory Forum:** The COMCEC Capital Market Regulatory Forum was established in 2011 in line with the relevant resolutions of 27th Session of the COMCEC. The Forum has held 4 meetings so far. The 4th Meeting of the COMCEC Capital Market Regulators Forum was held on November 19th, 2015 in İstanbul.

In its 4th Meeting, Forum elaborated the output of the Forum Secretariat’s report titled “Real Estate Exchange Initiative for COMCEC Member States” as requested in the 31st Session of the Follow up Committee of COMCEC. The Meeting has also focused on "Market Development", "Islamic Finance" and "Financial Literacy" Task Forces’ 2015 activities. Under the Forum activities, “Transparency Requirements, Public Disclosure Systems” (TF Market Development) and “Key Issues in Financial Literacy Improvement in Securities Markets” (TF Financial Literacy) reports were also prepared and submitted to the 4th Meeting.

The details regarding the Forum activities are available on the Forum web-site. (www.comceccmr.org)

- **Cooperation among the Central Banks and Monetary Authorities:** In line with the relevant resolution of the 24th Session of the COMCEC, cooperation among the Central Banks and Monetary Authorities of the Member Countries has been revitalized. 14 Meetings have been held so far. The 15th meeting was planned to be held on 23-24 October 2015, but has been postponed to a later date.

The detailed information regarding Cooperation among the Central Banks and Monetary Authorities can be available at <http://www.sesric.org/activities-cb-meetings.php>.

Annex 1.

Table 2: Categorization of OIC Member States

CATEGORIES	COUNTRIES	NUMBER OF COUNTRIES
OIC-Low income group US\$ 1045 or less (LIG)	Afghanistan, Benin, Burkina Faso, Chad, Comoros, The Gambia, Guinea, Guinea Bissau, Mali, Mozambique, Niger, Sierra Leone, Somalia, Togo, Uganda	15
OIC-Lower middle income group US\$ 1,046 to US\$ 4,125 (LMIG)	Bangladesh, Cameroon, Côte d'Ivoire, Djibouti, Egypt, Guyana, Indonesia, Kyrgyz Republic, Mauritania, Morocco, Nigeria, Pakistan, State of Palestine, Senegal, Sudan, Syria, Tajikistan, Uzbekistan, Yemen	19
OIC-Upper middle income US\$ 4,126 to US\$12,735 (UMIG)	Albania, Algeria, Azerbaijan, Gabon, Islamic Republic of Iran, Iraq, Jordan, Kazakhstan, Lebanon, Libya, Malaysia, Maldives, Suriname, Tunisia, Turkey, Turkmenistan	16
OIC-High income group US\$ 12,736 or more (HIGH)	Bahrain, Brunei Darussalam, Kuwait, Oman, Qatar, Saudi Arabia, United Arab Emirates	7