Research

Flow of Funds Supporting the Rise of the Islamic Economy – Oil Money and Islamic Financing

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The Islamic economy is an economic area that encompasses economic activities for Muslims in non-Islamic countries as well as Islamic countries. Given the backdrop of the increase in attention to the Islamic economy in recent years, partly due to the growth of the Islamic population, increase in funds (oil money) of oil countries associated with the sharp rise in crude oil prices, and growth in Islamic financing, the Hitachi Research Institute is conducting research into the Islamic economy.

1. Expanding Islamic Economy

1.1 Increase of Muslims to 25% of the world's population

Firstly, let us look at the position of Muslims in the world's population who comprise the Islamic economy. According to a survey by the Pew Research Center, a think tank in the U.S., Muslims in the world numbered approximately 1.6 billion people, which was 23.4% of the world's population as of 2010. By 2030, the population is estimated to increase to approximately 2.2 billion or 26.4% of the world's population. The reason for this is the high annual population increase rate of Muslims of 1.5% which is twice as high as non-Muslims (Table 1).

Table 1 World Population and Proportion of Muslims

	2000	2010	2030
World population (Billion)	4.8	5.3	6.1
Muslims (Billion)	1.3	1.6	2.2
Proportion of Muslims (%)	21.6	23.4	26.4

Prepared by Hitachi Research Institute based on data from the PEW Research Center's "The Future of the Global Muslim Population."

1.2 Foreign Direct Investment of GCC Countries in the Islamic Economy

Despite this population expansion trend in the Islamic economy, little attention has been paid to the area as an economic bloc in the past.

However, due to the continuous increases in crude oil prices, since and triggered by the Iraq War in 2003, the 6 Gulf Cooperation Countries: Saudi Arabia, United Arab Emirates, Bahrain, Kuwait, Oman, and Qatar (GCC) have acquired huge amounts of oil money. Part of this oil money is incorporated into the government finances of each country, while part is used for investment in financial markets and industries through Sovereign Wealth Funds (SWF), etc.

For example, the UAE manages an SWF which was approximately 71 times as large as its government finances as of the 2012 fiscal year (Table 2). The UAE publicly announced that its objectives in managing the funds are mainly investment in infrastructure, fostering the petrochemical industry, and diversification of domestic industries. However, a detailed breakdown of investments has not been revealed.

Table 2 Sizes of SWF Assets and Government Finances in GCC Countries

GCC Countries	(A) SWF Assets Size (Billion dollars)	(B) Government Finance Size (Billion dollars)	Ratio (A/B)
Saudi Arabia	538.1	184	2.9
UAE	804.7	11.4	70.7
Bahrain	9.1	16	0.6
Kuwai	296	79	3.7
Oman	8.2	22.9	0.4
Qatar	100	38.4	2.6

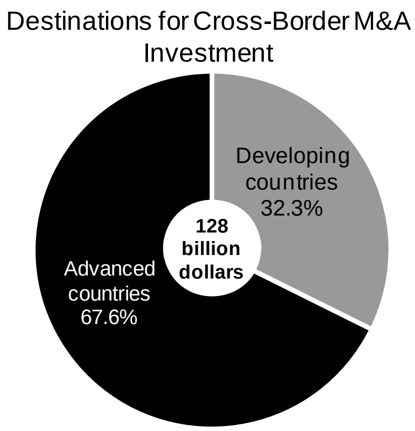
Note1: The asset size of some SWFs has not been released.
Note 2: SWF asset sizes are estimates by the SWF Institute as of September 2011. Government finance size is for fiscal 2012.

Prepared by Hitachi Research Institute based on data from publicly released materials, etc.

However, the regions and industries that are the destinations of foreign direct investment by the 6 GCC countries and their neighboring regions can be understood in the World Investment Report 2011 released by the United Nations Conference on Trade and Development (UNCTAD).

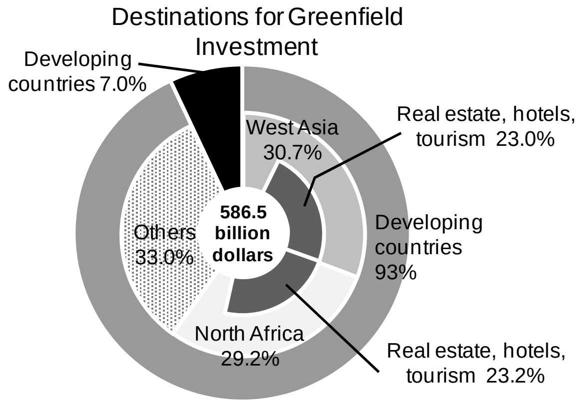
According to this report, of the total monetary amount of foreign direct investment by West Asia including the 6 GCC counties (the 6 GCC countries occupy 95% of the total investment amount) from 2004 to 2010, advanced countries accounted for two thirds or 67.6% to be exact, of investment destinations for cross-border M&As. In contrast, for the destination for Greenfield investment (investment in new business), advanced countries only occupied 7% while developing countries occupied 93%. In particular, West Asia and North Africa occupied approximately 30% respectively.

For investment in the West Asian and North African regions, the rate of investment in the real estate, hotel and tourism industries was high and occupied as much as 46.2% (Figure 1). From these facts, we can see that most Greenfield investment by GCC countries is in Islamic countries for urban development, such as in real estate in particular.



Prepared by Hitachi Research Institute based on data from World Investment Report 2011

Figure 1a: Foreign Direct Investment from West Asia (2004 to 2010 Total)



Prepared by Hitachi Research Institute based on data from World Investment Report 2011

Figure 1b: Foreign Direct Investment from West Asia (2004 to 2010 Total)

1.3 Islamic Financing Being Developed in Regions Other than the Middle East

The above was an overview of oil money investment destinations. Investment in infrastructure with this oil money uses Islamic financing, which has been receiving attention as a new financial structure. Islamic financing refers to financing in compliance with the religious principles of Islam (Sharia). The basic principles are (1) Prohibition of interest, (2) Prohibition of uncertainty, (3) Prohibition of gambling and speculation, (4) Prohibition of transactions of products (alcohol) and services prohibited by Islam. However, for example, an equivalent to interest is actually provided by combining methods such as financial contributions and leases even though the basic principles of Islam prohibit interest, and the use of financial products that are not so different from regular financing is possible. The first authentic Islam financing bank, the Dubai Islamic Bank, was established in 1975. The history of Islamic financing is still less than 40 years old. However, the scale of global Islamic financing grew to more than 1 trillion dollars in 2011 and Islamic financing is also being used by Islamic countries outside the Middle East.

For example, in Malaysia, which is an Islamic country in Southeast Asia, Islamic bonds called sukuk are actively issued. DanaInfra Nasional, which is a

Malaysian government related company, is planning the issuance of approximately 190 billion yen of sukuk during 2012 as funds for construction of a Mass Rapid Transit system (MRT) in the capital area. In addition, companies (including foreign capital companies) issue sukuk in order to locally procure business funds. As these facts show, Islamic financing plays a role in the procurement of business funds in Islamic economies.

2. Direction of Future Research

Investment trends of oil money in the Middle East and the structure of Islamic financing supporting the investment of oil money in the Middle East were introduced above.

In the past, the greatest obstacle to the growth of developing countries was a shortage of funds. In the future, if a path where oil money in the Middle East flows into other Islamic countries through SWFs and Islamic financing develops, the possibility of the Islamic economy developing further will increase.

The Hitachi Research Institute plans to continuously research the flow of funds and economic trends in the Islamic economy.

References

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