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**THE DETERMINANTS OF SUKUK MARKET
DEVELOPMENT IN SELECTED GULF
COOPERATION COUNCIL (GCC) COUNTRIES**

ARAFAT MANSOOR AHMED ALRAEAI



**DOCTOR OF PHILOSOPHY
UNIVERSITI UTARA MALAYSIA**

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**THE DETERMINANTS OF SUKUK MARKET DEVELOPMENT IN
SELECTED GULF COOPERATION COUNCIL (GCC) COUNTRIES**

By

ARAFAT MANSOOR AHMED ALRAEAI



**Thesis Submitted to
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in Fulfillment of the Requirement for the Degree of Doctor of Philosophy**



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Pemeriksa Luar : Prof. Madya Dr. Shahida Shahimi
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Tandatangan
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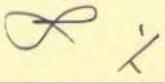
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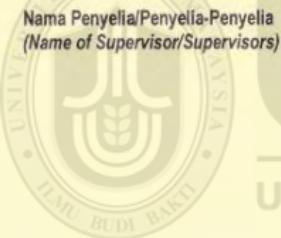
Program Pengajian
(Programme of Study)

: Doctor of Philosophy

Nama Penyelia/Penyelia-Penyelia
(Name of Supervisor/Supervisors)

: Dr. Zairy Zainol


Tandatangan



Nama Penyelia/Penyelia-Penyelia
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ABSTRACT

Sukuk is one of the Shariah-compliant financing sources offered to corporations and government. Although markets have witnessed the presence and rapid growth of sukuk certificates, the Gulf Cooperation Council (GCC) share of global sukuk issuances has decreased recently. Hence, this study aims at identifying the determinants of sukuk market development in the selected GCC countries through examining the relationship of sukuk issuance with selected key political, financial and macroeconomic factors. The analysis was based on panel data analysis using Generalized Least Squares (GLS) and Fully Modified Ordinary Least Square (FMOLS) estimations, over the period of 2001 to 2016, to achieve these objectives. The sample includes Saudi Arabia, United Arab Emirate, Bahrain, Qatar and Kuwait. The panel results indicate that a combination of macroeconomic, financial and political factors exerts a significant effect on GCC's sukuk markets. Generally, this study suggests that focusing on these determinants could contribute to the development of the GCC's sukuk market. Consequently, this study presents evidence that savings rate, exchange rate and banking system size are significant determinants of sukuk market development in GCC countries. In addition, this study shows that GDP per capita, oil price, and trade openness are associated with larger sukuk markets. The political risk was also evidenced to have a significant influence on the sukuk market. As a result, the findings of this study provide implications for investors, regulators, and market participants in terms of identifying the significant factors that are associated with the sukuk market development in the GCC countries. In addition, policy makers might employ the findings related to sukuk market development to recognise the important roles played by macroeconomic, financial factors and political risk in enhancing the sukuk market in GCC countries.

Keywords: Sukuk; Islamic Finance; Panel Data; GCC countries

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ABSTRAK

Sukuk merupakan satu sumber pembiayaan patuh Syariah yang ditawarkan kepada syarikat-syarikat dan kerajaan. Meskipun sijil sukuk semakin menonjol dan berkembang dengan pesat dalam pasaran semasa, namun bahagian terbitan sukuk secara global oleh Majlis Kerjasama Negara Teluk (GCC) semakin menurun sejak kebelakangan ini. Oleh yang demikian, kajian ini bertujuan untuk mengenal pasti penentu pembangunan pasaran sukuk di negara GCC yang terpilih dengan meneliti hubungan terbitan sukuk dengan faktor politik, kewangan dan makroekonomi terpilih. Analisis dilakukan berdasarkan analisis data panel yang menggunakan penganggaran *Generalized Least Squares (GLS)* dan *Fully Modified Ordinary Least Square (FMOLS)* dari tahun 2001 hingga 2016 untuk memenuhi objektif kajian. Sampel kajian melibatkan negara Arab Saudi, Emiriah Arab Bersatu, Bahrain, Qatar dan Kuwait. Dapatkan panel memperlihatkan bahawa kombinasi faktor makroekonomi, kewangan dan politik memberikan kesan yang signifikan terhadap pasaran sukuk GCC. Secara amnya, kajian ini, menyarankan bahawa tumpuan terhadap faktor penentu boleh menyumbang kepada pembangunan pasaran sukuk GCC. Sehubungan dengan itu, kajian ini juga membuktikan bahawa kadar tabungan, kadar pertukaran dan saiz sistem perbankan merupakan penentu yang penting dalam pembangunan pasaran sukuk di negara-negara GCC. Di samping itu, kajian juga mendedahkan bahawa Keluaran Dalam Negara Kasar (KDNK) per kapita, harga minyak dan keterbukaan perdagangan mempunyai hubung kait dengan pasaran sukuk yang lebih besar. Risiko politik juga terbukti mempunyai pengaruh yang signifikan terhadap pasaran sukuk. Hasilnya, dapatkan kajian ini mempunyai implikasi kepada para pelabur, pengawal selia dan peserta pasaran dalam mengenal pasti faktor-faktor yang signifikan yang dapat dikaitkan dengan pembangunan pasaran sukuk di negara-negara GCC. Selain itu, pembuat dasar boleh menggunakan dapatkan yang berkaitan dengan pembangunan pasaran sukuk untuk mengiktiraf peranan penting yang dimainkan oleh faktor makroekonomi, kewangan dan risiko politik dalam meningkatkan pasaran sukuk di negara-negara GCC.

Kata kunci: Sukuk, Kewangan Islam, Data Panel, Negara-Negara GCC

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LIST OF ABBREVIATIONS

AAOIFI	Accounting and Auditing Organization for Islamic Financial Institutions
ABS	Asset Backed Security
BNM	Bank Negara Malaysia's (Central Bank of Malaysia)
BOP	Brent Oil Price
BSS	Banking System Size
CPI	Consumer Price Index
EXR	Exchange Rate
FMOLS	Fully Modified Ordinary Least Square
GCC	Gulf Cooperation Council
GDP	Gross Domestic Product
GLS	Generalized Least Square
GMM	Generalized Method of Moments
IDB	Islamic Development Bank
ICRG	International Country Risk Guide
IFSB	Islamic Financial Services Board
IIFM	International Islamic Financial Market
MENA	Middle East and North Africa
OIC	Organization of Islamic Cooperation
PR	Political Risk
PRS	Political Risk Services
SR	Saving Rate
SESRIC	Statistical, Economic and Social Research and Training Centre for Islamic Countries
SMD	Sukuk Market Development
SPV	Special Purpose Vehicle
TP	Trade Openness
MIFC	Malaysia Islamic Financial Center

CHAPTER ONE

INTRODUCTION

1.1 Background of the Study

The concept and practice of Islamic finance has recently witnessed continuous and tremendous growth and expansion. Evidently, Islamic finance has attracted the interest of economists and empiricists who are keen on understanding the factors and foundations for predicting the growth and expansion of the Islamic finance. Islamic finance was also investigated to show how it can be successfully operated and how best its instruments and facilities can be used for monetary resource mobilization and attendant allocation (Grassa & Gazdar, 2014). In the past, even Muslim countries were reluctant to accept Islamic finance, but now the situation has changed (Oakley, 2009). In this regard, Woodruff (2007) reported that major financial centers round the globe have also adopted the Islamic financial system. These centers and institutions compete among themselves on the use as well as the consistent improvements of the Islamic finance system. Consequently, Islamic financial market has developed to be an essential component of the global financial system, which is a representation of the provision of financial services that are Shariah law¹ compliant (Pepinsky, 2013).

According to Klein and Weill (2016), Islamic finance has significantly grown with an increase of the Islamic financial assets from USD150 billion in the mid-1990's to USD1,400 billion at the end of 2015. The market of sukuk is the Islamic equivalent of bonds, which gathers approximately USD270 billion, representing 15% of the total

¹ Shariah considers money as a tool to measure value, and not an asset in itself. Thus, receiving income from money (or “interest”) is forbidden. Under Shariah, one should not sell or trade debts, and conventional lending is not permissible. The implication is that investment products—sukuk in this case—should be made for, and based on underlying assets.

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