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A Decomposition of GDP Growth in Sukuk Issuing Countries

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Abstract

The main components of Gross Domestic Product (GDP) are household consumption, government expenditure, investment, and net exports. The present study discomposes economic growth into its major components in ten sukuk issuing countries over the period 2015 until 2019. An analysis of the stability of each component highlights to what extent each component contributes to the stability of the overall economy. The absence of economic stability, as indicated by the degree of volatility, is measured using standard deviation. This is to investigate which GDP components will be most likely to contribute the most to economic stability during the Covid-19 pandemic. The findings indicate that most components display steadier growth, with household components being the chief contributor. The findings help policymakers identify which component is particularly important in accounting for the overall decline in volatility. The main findings offer insights into the main causes and consequences of the less volatile economy, especially during a crisis.

Keywords: Sukuk; growth decomposition; GDP components; OIC economies; Covid-19

1. Introduction

Since early 2000, many Organization of Islamic Cooperation (OIC) economies have issued sukuk as one of the fiscal instrument's tools. The economies have gone through business cycles over the years and receive numerous supply and demand shocks both domestically, and internationally. At the same time, the growth of Gross Domestic Product (GDP) and its main components namely consumption, investment, government expenditure, and net export have fluctuated during both recessions and expansions phases. It would be interesting to investigate the volatility of the major components up to the period leading to the Covid-19 pandemic. The pandemic started to impact all countries in early 2020. By mid-2021, the pandemic has not shown any sign of slowing down.

The unprecedented pandemic, which first emerged as a health crisis and later became the economic crisis, left economists perplexed. It is because it has hit the supply side hard and later affected the demand side. For the first time in decades, countries are experiencing movement control order (MCO), social distancing, and strict Standard Operating Procedure (SOP) to curb the contagion. The pandemic has introduced new normal in consumption behavior and lifestyles and therefore called for innovative economic solutions. This is where Islamic finance can be the game-changer, through sukuk as sources for long-term financing.

In Islamic finance, sukuk is one of the important Islamic capital market financial instruments. It is a fixed long-term instrument to raise financing for building infrastructure and mega-projects such as airports, dams, schools, and highways. Due to the massive fiscal stimulus implemented by many countries during the pandemic, sukuk is one of the choices available as a long-term financial instrument. Against this background, we investigate the stability of GDP components in ten selected sukuk issuing countries. The purpose is to identify which component has contributed the most to the stability of the economy before the Covid-19 outbreak. The findings of the research are useful to the policymakers in devising appropriate economic recovery programs post-pandemic.

This paper is organized as follows. Section 2 denotes the literature review. Section 3 discusses the research method while Section 4 discusses findings and analysis. Finally, Section 5 concludes the discussions and offers some policy recommendations.

2. Literature Review

The Securities Commission Malaysia defined sukuk as a "Certificate of equal value which evidence undivided ownership or investment in the assets using Shariah principles" and the concept is endorsed by the Shariah Advisory Council (SAC). Technically, sukuk has been defined as an Islamic investment trust certificate. In contrast, the conventional bond is a debt where the issuer owes to the bondholders. Sukuk is a key instrument used by issuers covering financial institutions, corporations, sovereigns, and quasi-sovereigns for project financing, infrastructures, and other purposes.

The sukuk market continues to thrive worldwide. As stated in the International Islamic Financial Market (IIFM) Sukuk Report, in 2014 the sukuk market recorded a decrease in the issuing of USD1,729 million due to external forces such as declining world oil prices and uncertainty in the global financial system. Furthermore, the declining of global sukuk issuance also occurs in 2015 amounted to USD46,267 million. The main factor that causes a slowdown in the global sukuk issuances due to the decrease in the number of domestic sukuk issuance from USD80,570 million in 2014 to USD39,813 million in 2015.

Although the main cause of decline is because of Bank Negara Malaysia's (BNM) decision to stop continuing the short-term investment sukuk issuance of USD45 billion or approximately 35 percentage, other players appeared to issue domestic sukuk in large number such as Indonesia of USD2 billion in May 2015, and Bahrain from USD1.33 billion in 2014 to USD3 billion in 2015, respectively. By September 2016, sukuk issuances have reached USD39.5 billion (Zawya Report, 2016). Three factors shape the performance of sukuk in 2016, including the development of monetary policy in the United States (US) and Europe, declining world oil price, and the possible lifting of sanctions in Iran (CIMB, 2016).

In the year 2018 and 2019, International Islamic Financial Market (IIFM) Sukuk Report stated that sukuk market has maintained it growth rate. The global sukuk market closed in 2019 with a total increase of about 18.32 percent (USD 145.70 billion). The factors that helped the sukuk market to experience a strong positive growth trend were the positive outlook of the global economy, relatively stable commodity prices like oil, and continued growth in the sovereign sukuk issuance.

In 2019, multiple activities related to sukuk development have been observed including private-sector issues and the increase in investment from countries such as Nigeria, Pakistan, Bangladesh, and others (IIFM Sukuk Report, 2019). In addition, there is continued involvement from well-established sovereigns, quasi-sovereigns, or financial institution issuers, such as the Governments of Malaysia and Bahrain. Indonesia, Malaysia, and Saudi Arabia have helped maintain the direction of growth in sukuk market industry. It is worth noting that over 50 percent of Saudi Arabia's budget deficit is funded by sukuk issuances in 2019. In addition, it is expected that Saudi Arabia, Indonesia, Malaysia, Pakistan, Bahrain, and Turkey will raise sukuk domestic shares to fulfill their fiscal deficit funding and infrastructure requirements.

The Gulf Cooperation Council (GCC) countries which consist of Middle East countries such as Saudi Arabia, Kuwait, the UAE, Qatar, Bahrain, and Oman have a tremendous growth rate in sukuk industry in the past three decades. To date, Malaysia is the largest sukuk issuer in the world. The first two months of 2020 have been promising for the sukuk market. However, the ongoing pandemic triggered by Covid-19 may have harmful effects on the global financial service sector, including the sukuk market.

3. Research Method

The study was conducted in ten selected Muslim countries namely Malaysia, Indonesia, Saudi Arabia, the United Arab Emirates (UAE), Bahrain, Qatar, Sudan, Pakistan, Kuwait, and Brunei for the period 2005 until 2019. These countries are selected because collectively, they hold the largest share of global Islamic financial assets. The data are annual in constant 2010 prices, in log values and are sourced from the Statistical, Economic and Social Research and Training Center for Islamic Countries (SESRIC), World Economic Outlook (WEO), and the World Bank. Table 1 displays selected macroeconomic indicators for the countries under study.

Table 1: Selected Macroeconomic Indicators for 10 Countries, 2004-2019

Country	Total Sukuk Issuances (USD mil)	Macroeconomic Indicators			
		GDP	Inflation (%)	Trade Openness	Exchange Rate (USD)
Malaysia	51,265.39	260,204.13	2.35	158.86	3.65
Saudi Arabia	9,616.31	562,398.77	2.77	78.98	3.75
Indonesia	6,573.44	732,863.56	6.11	48.51	11,214.25
UAE	6,171.15	31,460.75	3.76	148.90	3.67
Bahrain	2,224.50	27,287.33	2.25	151.72	0.38
Qatar	2,186.75	111,405.57	3.32	76.71	2.96
Sudan	1,182.13	53,043.88	18.00	15.63	4.06
Pakistan	1,280.06	229,865.44	8.09	29.39	89.88
Brunei	684.31	9,575.17	0.20	70.22	1.03
Kuwait	377.13	60,707.82	1.46	69/97	0.16

Source: Authors' compilation. Values are period average for the year 2004-2019.

The Covid-19 pandemic has been an unparalleled public health epidemic that affected every country across the world. The outbreak is predicted to significantly affect the worldwide economy due to the stringent control measures used to suppress the virus. Many countries may have an economic downturn if stringent lockdown measures, travel restrictions, border closures, and economic shutdowns are imposed, and this might occur globally (Barro et al., 2020). According to current reports, the Covid-19 pandemic is expected to become one of the most economically destructive pandemics in the recent past (Boissay and Rungcharoenkitkul, 2020).

Although the Covid-19 pandemic has been one of the most unprecedented pandemics in contemporary history, in the first twenty-first century, there have been several pandemics, including Avian Flu (2002–2003), Swine Flu (2009–2010), Bird Flu (2013–2017), Ebola (2014–2016) and Middle East Respiratory Syndrome (MERS) (2014). According to research, most of these pandemics have extended to regional levels or have had a modest influence on economic indicators. These pandemics, on the other hand, highlight how the Covid-19 pandemic might alter macroeconomic parameters.

Altig et al. (2020) opine that in 2020, the global economy will be more unstable than it was in the year before the Covid-19 pandemic. This is supported by Baker et al. (2020), where there is dramatically an increased economic uncertainty due to the pandemic, which is linked to reduced consumption, employment, and investment levels, and stock market underperformance. Leduc and Liu (2020) further assert that the Covid-19 associated uncertainty is crucial in shaping macroeconomic performance.

4. Findings and Analysis

The decomposition of growth rates in 2015-2019 for the sukuk issuing countries shows that in a situation where oil prices remain below average in multi-years, the consumption component is the one that contributes the most to the changes in GDP. In most cases, consumption and investment are the components that contributed the most to the period average of changes in real GDP. On the other hand, the smallest contributors are the next export and government spending components. Indonesia reported the highest positive percentage of changes in GDP (1.62), while Sudan recorded the highest negative percentage changes of GDP (-1.76).

As for stability, based on the standard deviation measurement, the consumption component is the most stable and also the biggest contributor to national income. Therefore, a policy designed to stabilize the economy during a pandemic situation should focus on the consumption components, followed by the government spending component. The most unstable component is most likely to be the international trade sector. Therefore, maintain a good relationship with traditional trading partners is important during a crisis period. Table 2 lists the percentage contribution of each GDP component to the changes in GDP for the period 2015 until 2019.

Table 2: The Decomposition of Growth Rates, 2015 - 2019

Country	GDP Components Growth Contribution					Highest/ Lowest Growth Contributor
	Changes in GDP	Consumption (C)	Investment (I)	Government Expenditure (G)	Net Export (X_N)	
Malaysia	0.20	1.63	-0.71	-0.26	-0.86	C/ X_N
Saudi Arabia	1.08	1.05	-0.33	-0.80	-1.00	C/ X_N
Indonesia	1.62	0.10	-0.20	-0.45	-1.07	C/ X_N
UAE	-0.54	1.30	0.72	-1.18	-0.30	C/G
Bahrain	0.86	-0.15	0.50	0.46	-1.67	I/ X_N
Qatar	-1.25	0.55	1.31	-0.64	0.02	I/G
Sudan	-1.76	0.18	0.71	0.38	0.48	I/C
Pakistan	-1.54	0.87	0.33	0.76	-0.42	C/ X_N
Brunei	-1.42	0.56	1.24	-0.34	-0.05	I/G
Kuwait	-1.65	0.95	0.19	0.57	-0.06	C/ X_N
Average and Standard Deviation						
Average	-0.44	0.704	0.376	-0.15	-0.493	-0.44
Std dev.	1.28	0.56	0.66	0.65	0.65	1.28
Average and Standard Deviation (absolute values)						
Average	1.192	0.734	0.624	0.584	0.593	1.192
Std. dev.	0.49	0.49	0.38	0.26	0.52	0.49

The Covid-19 pandemic has badly impacted the global economy. The fact that the new coronavirus is more lethal than the virus associated with seasonal flu means that governments have enacted several regulatory measures to help cut down the spread of the virus. Specifically, officials have blocked off or quarantined public locations, including schools, restaurants, shopping malls, or the general population chosen to avoid public locations during the Covid-19 pandemic. Leduc and Liu (2020) claim that a considerable Covid-19 associated uncertainty is the primary factor driving the macroeconomic indicators. Following these papers, this study examines the relationship between the Covid-19 pandemic and the GDP components.

A GDP component lens may be used to examine the effects of coronavirus. Out of the four components of GDP, personal consumption expenditures best reflect the effects of the coronavirus epidemic. Due to disease and government social distancing regulations, the pandemic has resulted in substantial and acute losses in several economies throughout the globe. The effect and duration of the pandemic-related economic crisis on individual families are difficult to estimate since numerous unknowns surround the crisis's duration, such as the length of stay-at-home orders, damaged sectors, and post-crisis consumption and recovery.

Figure 1 shows changes in GDP and its components, namely government expenditure (G), net export (N_x), foreign direct investment (I), and personal consumption expenditure (PCE). The y-axis refers to the contribution to the changes in real GDP from 2015 to 2019 in billion United States dollars (USD), while the x-axis represents the four GDP components mentioned earlier.

Based on Figure 1, it has been observed that household consumption has been significantly increased in Sudan, Brunei, Malaysia, Indonesia, the UAE, Saudi Arabia, Kuwait, Qatar, and Pakistan and significantly reduced during the Covid-19 pandemic in Bahrain (not shown in the diagram). Malaysia's household policies included electricity discount, and temporary paid leave, cash transfers to low-income families, salary subsidies to assist companies in retaining workers. In addition, employees are permitted exceptional withdrawals from their Employment Provident Fund (EPF) and hiring and training subsidies. This strategy encourages families to spend more and contributes to the economy's long-term stability.

As a result, boosting government spending during the pandemic may aid in maintaining economic success. The lockdown and social distance process have also created a dangerous scenario for global commerce in general, particularly the services sector, which are intricately linked and need close contact between the providers and the customers. The findings also indicate that export significantly reduced during the Covid-19 pandemic in all countries, except for Sudan. The trade restrictions implemented by most regions have contributed to this situation. The health crisis has affected many sectors, including the availability of food supplies. In such a circumstance, governments may be compelled to limit their food exports in the near term to ensure sufficient domestic supply.

Offshoring and worldwide dispersion of economic activity, particularly in the manufacturing and services sectors, are driving the surge in to foreign direct investment (FDI) in emerging nations. The decline in global FDI is therefore closely linked to global supply chain disruptions, because of the Covid-19 pandemic. The graph above shows that FDI significantly increases in Brunei, Sudan, Kuwait, Qatar, the UAE, Pakistan, and Bahrain. However, this component is significantly reduced in Indonesia, Malaysia, and Saudi Arabia. FDI could play an essential role in supporting economies during the economic recovery following the pandemic. Evidence from previous crises shows that foreign-owned affiliates, even small and medium-sized businesses, maybe more resilient during times of crisis because of their ties to their parent corporations and access to their financial resources.

In terms of expenditure, the finding shows that the government expenditure significantly increases in Bahrain, Kuwait, Pakistan, and Saudi Arabia. The increase in spending during the coronavirus pandemic fulfils both criteria, which is debt-financed, and central banks have taken unprecedented steps to accommodate, rather than constrain, economic activity (Chodorow-Reich, 2019). However, the government expenditure decreased in Brunei, Indonesia, Malaysia, Qatar, Sudan, and the United Arab Emirates. The data only covers 2015 to 2019, when many nations were still in the early stages of Covid-19 and had yet to implement additional rules and limitations, including new rules for households, government fiscal policy, and trade restrictions. This might explain why the results showed that government spending is decreasing in several nations.

The pandemic has had a significant influence on the government's fiscal policy, both in terms of income and spending, and has compelled most governments to take countercyclical policies to mitigate the crisis's effects. In this sense, the federal government needs to take urgent action by injecting a large amount of money into the economy to boost it. Expansionary fiscal policy measures, such as greater allocation and tax relaxation, are vital to preserving people's lives, assisting businesses, and reducing the consequences of the crisis on economic activity. This situation can, to some extent, affect government spending positively and negatively.

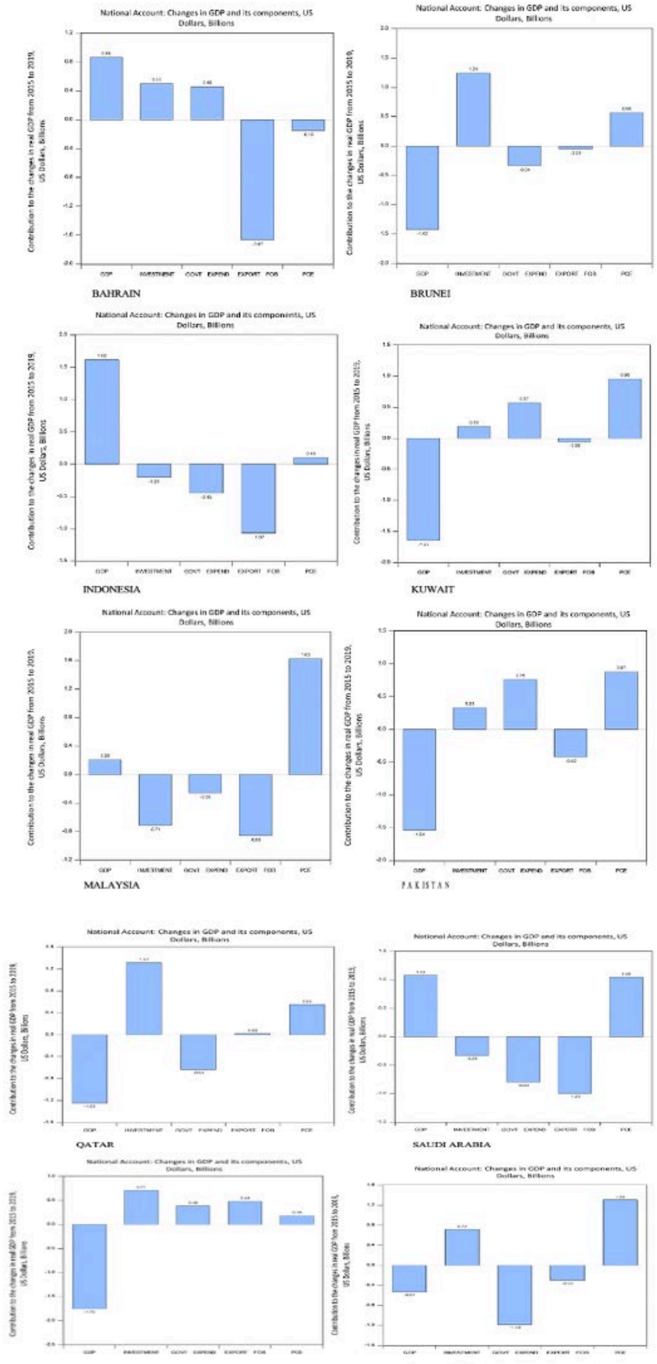

Figure 1: Changes in GDP Components and Contribution to Growth

5. Conclusion

This study examines the growth components of GDP in ten sukuk issuing companies five years before the Covid-19 pandemic outbreak. The countries performance in terms of changes in percentage contribution of consumption, investment, government spending, and net export, towards GDP growth, is measured. The findings indicate that consumption is the important component that would contribute to economic stability. Therefore, the authorities can implement policies that would support productive consumption and design labor policies that would support industries in these areas. Furthermore, other macroeconomic indicators or other factors that specifically affect the issuance of sukuk can be added to these studies, such as exchange rate volatility, bond return rates, or market liquidity. Identifying the causes and consequences arising from the recent pandemic will help the economies swiftly recover once the pandemic has passed.

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