

A Closer Look at the SAR Government Sukuk Market

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Introduction

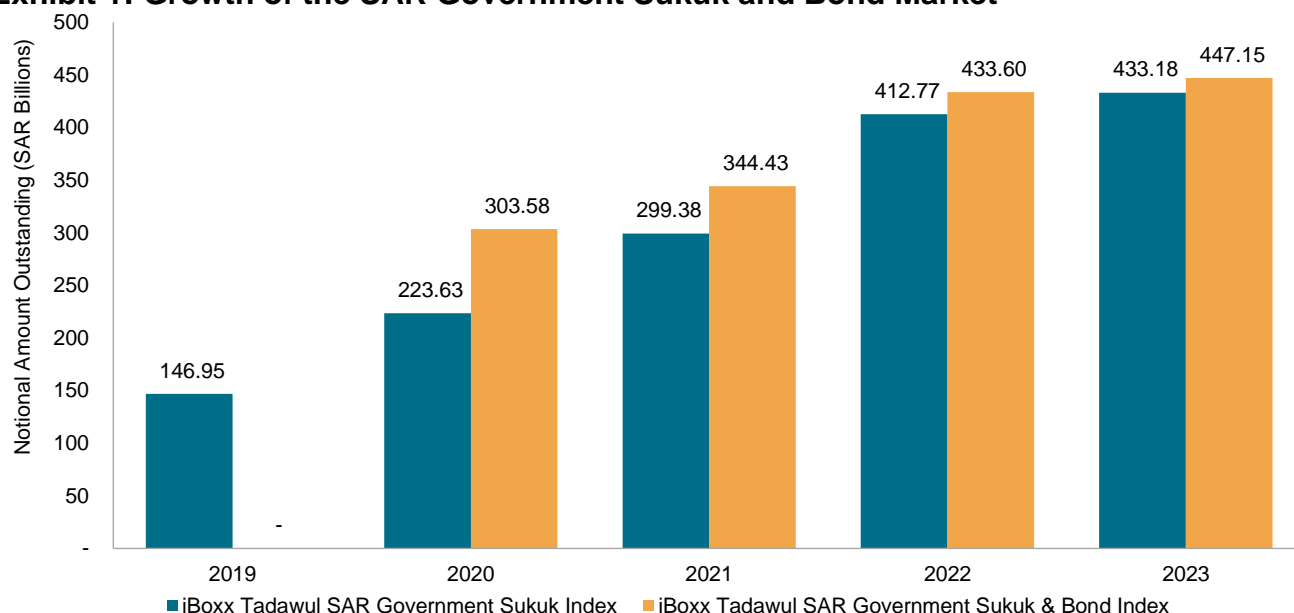
The [iBoxx Tadawul SAR Government Sukuk & Bond Index](#) was launched in 2020 in collaboration with the Saudi Stock Exchange (Tadawul) to track the performance of Saudi Arabian riyal (SAR) denominated domestic government bonds, including sukuk issued by Saudi Arabia. The index seeks to track SAR-denominated fixed coupon bonds that have an amount outstanding of at least SAR 100 million. As the Saudi government continues to enhance the accessibility and infrastructure of its domestic debt market through various initiatives such as the Primary Dealers Program, the index, which combines Tadawul's market data with iBoxx indexing capabilities, provides transparency for the market and could serve as a market benchmark for domestic and international investors.

Evolution of the Market

At launch, the index had a significant portion of conventional debt in addition to sukuk. It started out with 22 bonds (SAR 79.50 billion in amount outstanding, or 35% of the total) and gradually reduced to 7 bonds as of August 2023 (SAR 13.96 billion, or 3% of the total outstanding). The portion of bonds within the iBoxx Tadawul SAR Government Sukuk & Bond Index has shrunk as the demand for Shariah-compliant instruments for domestic Islamic banks' liquidity management purposes has favored sukuk over conventional bond issuances.

The Saudi Arabia domestic government sukuk market, as represented by the [iBoxx Tadawul SAR Government Sukuk Index](#) in Exhibit 1, has been growing steadily over the past few years, with most of the expansion occurring between 2019 and 2022, cementing the Saudi government's position as the largest sovereign sukuk issuer globally. Due to market volatility, interest rate changes and a surge in crude oil prices in 2022, Saudi Arabia, the largest oil exporting country in the world, has reduced its domestic debt issuances since 2022. Since the index's inception (June 30, 2019), the number of sukuk has increased from 29 to 50 and the total notional outstanding has increased from SAR 146.95 billion to SAR 433.18 billion.

Exhibit 1: Growth of the SAR Government Sukuk and Bond Market



Source: IHS Markit, part of S&P Global. Data from Aug. 31, 2019, to Aug. 31, 2023. Notional amount outstanding in SAR. The iBoxx Tadawul SAR Government Sukuk & Bond Index was launched June 2020. The iBoxx Tadawul SAR Government Sukuk Index was launched February 2020. All data prior to index launch date is back-tested hypothetical data. Past performance is no guarantee of future results. Chart is provided for illustrative purposes and reflects hypothetical historical performance. Please see the Performance Disclosure at the end of this document for more information regarding the inherent limitations associated with back-tested performance.

Performance

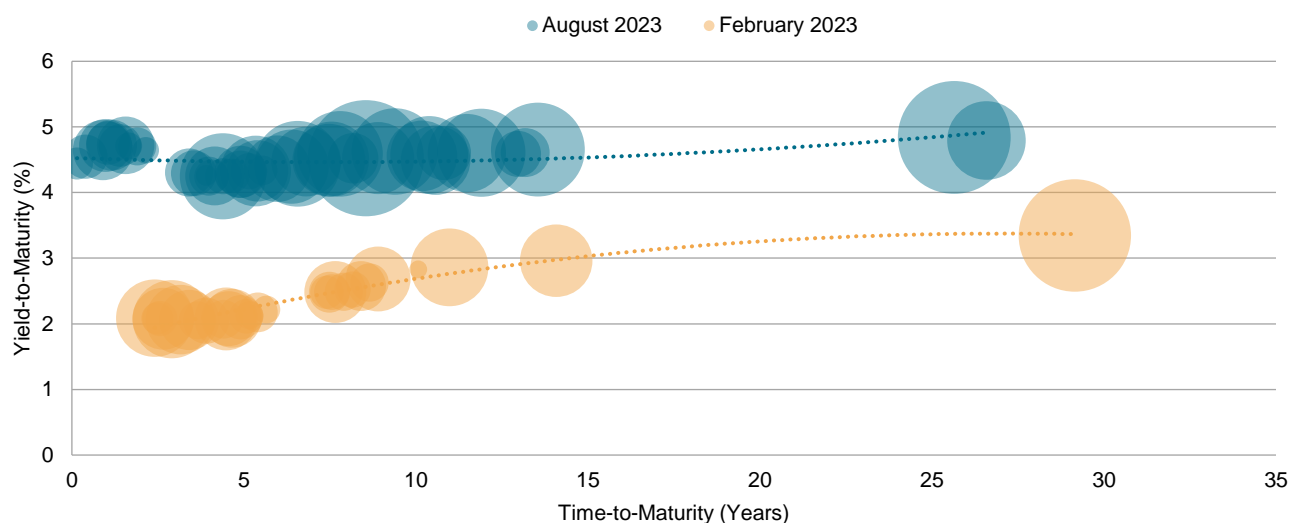
Similar to global government bond markets where long-dated bonds have performed the worst, the performance of long-dated sukuk (10+ years), which comprise approximately 34% of the index, have suffered losses of 8.82% over the past three years. Short-dated sukuk returned 4.61% (0-1 year) and 2.36% (1-3 year), which helped to offset some of the losses in the overall index (-4.68%). With the slowing of interest rate hikes by central banks globally this year, the long-dated sukuk segment was the best-performing segment in 2023, with returns of 4.93% YTD.

Exhibit 2: Performance of the iBoxx Tadawul SAR Government Sukuk & Bond Index and Its Subindices

Index/Maturity	Index Level	Δ YTD (%)	Δ 3 Year (%)	Market Value (SAR Billions)	Yield (%)	Duration (Years)	Number of Instruments
iBoxx Tadawul SAR Government Sukuk Index	103.82	3.10	-4.68	399.99	4.63	6.79	50
0-1 Year	104.61	3.05	4.61	6.12	4.53	0.31	2
1-3 Years	106.17	2.57	2.36	41.64	4.76	1.17	10
3-5 Years	104.77	2.04	-0.83	44.89	4.30	3.71	10
5-7 Years	103.70	1.89	-3.48	78.03	4.43	5.19	10
7-10 Years	102.29	1.98	-6.25	96.24	4.60	7.00	7
10+ Years	105.96	4.93	-8.82	133.08	4.74	10.66	11
iBoxx Tadawul SAR Government Sukuk & Bond Index	99.95	3.05	-4.11	413.21	4.63	6.67	57

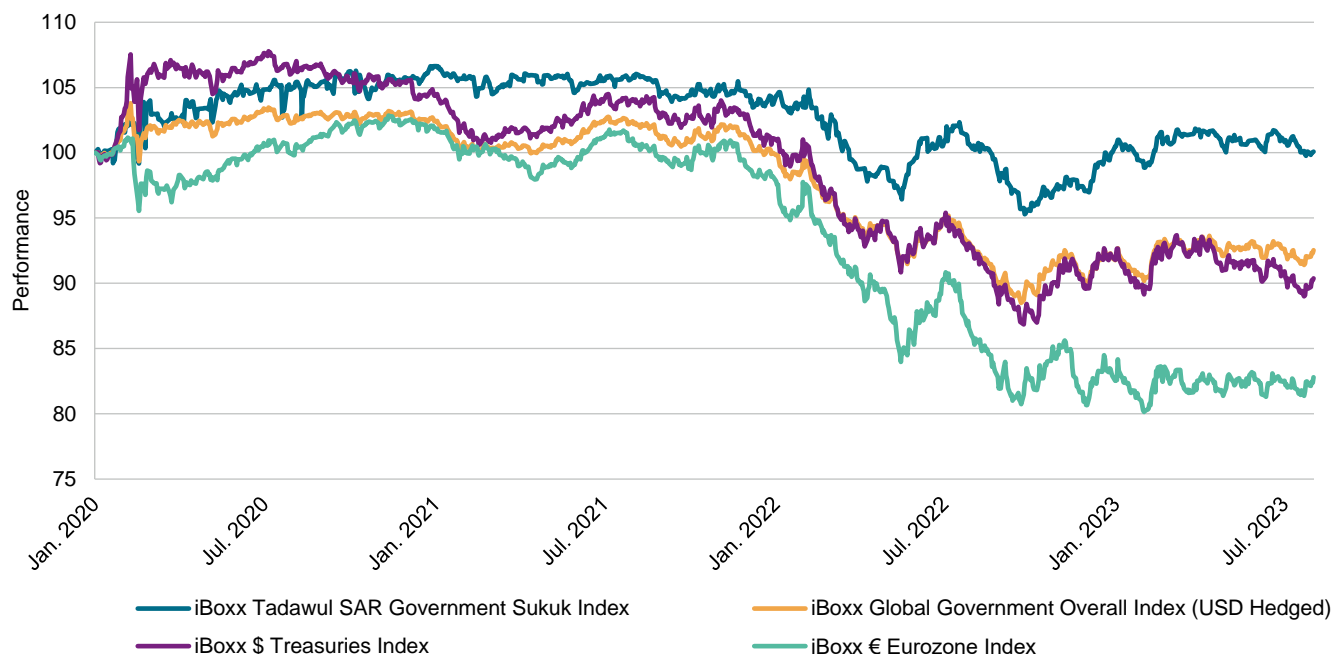
Source: IHS Markit, part of S&P Global. Data as of Aug. 31, 2023. Index performance based on total return in SAR. Yield refers to annual yield in percent. Duration refers to annual modified duration. Past performance is no guarantee of future results. Table is provided for illustrative purposes.

Exhibit 3: Yield Curve of the iBoxx Tadawul SAR Government Sukuk Index by Market Value



(Bubble Scale = Notional Amount Outstanding in SAR)
 Source: IHS Markit, part of S&P Global. Data as of Feb. 29, 2020, and Aug. 31, 2023. Chart is provided for illustrative purposes.

As seen in Exhibit 3, yields have risen from between 2-4% to 4-5% in the past three years, and the yield curve has also changed from upward sloping to almost flat, with a slight inversion on the short end. Most outstanding sukuk have an outstanding time-to-maturity of between 5 to 15 years, with more than one-half of them greater than SAR 10 billion in size. There are not many changes on the long end, the only addition is a 30-year sukuk with SAR 14.9 billion notional issued on the cusp of the COVID-19 lockdown period.

Exhibit 4: Total Return of Selected iBoxx Indices since January 2020

Source: IHS Markit, part of S&P Global. Data from Jan. 31, 2020, to Aug. 31, 2023. Index performance based on total return in SAR for the iBoxx Tadawul SAR Government Sukuk Index, in USD for the iBoxx \$ Treasuries and iBoxx Global Government Overall Indices and in EUR for the iBoxx EUR Eurozone Index. Past performance is no guarantee of future results. The iBoxx Tadawul SAR Government Sukuk Index was launched February 2020. All data prior to index launch date is back-tested hypothetical data. Chart is provided for illustrative purposes and reflects hypothetical historical performance. Please see the Performance Disclosure at the end of this document for more information regarding the inherent limitations associated with back-tested performance.

Since its launch, the iBoxx Tadawul SAR Government Sukuk Index has performed in tandem with other government bond markets, represented by the iBoxx Global Government Overall, iBoxx \$ Treasuries and iBoxx EUR Eurozone Indices, withstanding the stress of the COVID-19 crisis in 2020 and the economic recovery in 2021. Heightened inflation due to the impacts of restarting global economies forced global central banks into action, and they delivered multiple interest rate hikes to tame inflationary pressures. Since 2022, the U.S. Federal Reserve (Fed) and European Central Bank have hiked interest rates by 5.25% and 4.25%, respectively. In order to defend its currency peg to the U.S. dollar, the Saudi Central Bank has matched the Fed's interest rate moves, increasing rates by 5% since 2022.

As shown in Exhibit 4, the drawdowns for the government bonds globally represented by the iBoxx Global Government Overall (USD Hedged), iBoxx \$ Treasuries and iBoxx EUR Eurozone were far more pronounced compared to the shariah-compliant SAR government sukuk represented by the iBoxx Tadawul SAR Government Sukuk Index.

Conclusion

Since the index launch, the Saudi Arabia domestic government sukuk market has expanded in size and diversified its maturity profile, as new issuances are distributed more evenly across different maturity buckets. With Saudi Arabia's status as the world's largest oil exporter, the impact of oil prices do play in its funding needs and corresponding issuance plans.

The Saudi sukuk market faced the same challenges when dealing with the impacts of a pandemic as government bond markets globally—market volatility, monetary policy regime changes, etc. Compared to global sovereign bond markets, the performance of the index has shown the resilience of the SAR government sukuk and the benefits of owning high quality shariah-compliant fixed income securities.

As the Saudi government continues in its endeavor to strengthen the domestic debt market and manage its debt portfolio's refinancing risk, the iBoxx Tadawul SAR Government Sukuk & Bond Indices will continue to serve as a barometer for the government's domestic debt while upholding minimum standards of investability and liquidity.

Performance Disclosure/Back-Tested Data

The iBoxx Tadawul SAR Government Sukuk & Bond Index was launched June 2020. The iBoxx Tadawul SAR Government Sukuk Index was launched February 2020. All information presented prior to an index's Launch Date is hypothetical (back-tested), not actual performance. The back-test calculations are based on the same methodology that was in effect on the index Launch Date. However, when creating back-tested history for periods of market anomalies or other periods that do not reflect the general current market environment, index methodology rules may be relaxed to capture a large enough universe of securities to simulate the target market the index is designed to measure or strategy the index is designed to capture. For example, market capitalization and liquidity thresholds may be reduced. Complete index methodology details are available at www.spglobal.com/spdji. Past performance of the Index is not an indication of future results. Back-tested performance reflects application of an index methodology and selection of index constituents with the benefit of hindsight and knowledge of factors that may have positively affected its performance, cannot account for all financial risk that may affect results and may be considered to reflect survivor/look ahead bias. Actual returns may differ significantly from, and be lower than, back-tested returns. Past performance is not an indication or guarantee of future results. Please refer to the methodology for the Index for more details about the index, including the manner in which it is rebalanced, the timing of such rebalancing, criteria for additions and deletions, as well as all index calculations. Back-tested performance is for use with institutions only; not for use with retail investors.

S&P Dow Jones Indices defines various dates to assist our clients in providing transparency. The First Value Date is the first day for which there is a calculated value (either live or back-tested) for a given index. The Base Date is the date at which the index is set to a fixed value for calculation purposes. The Launch Date designates the date when the values of an index are first considered live: index values provided for any date or time period prior to the index's Launch Date are considered back-tested. S&P Dow Jones Indices defines the Launch Date as the date by which the values of an index are known to have been released to the public, for example via the company's public website or its data feed to external parties. For Dow Jones-branded indices introduced prior to May 31, 2013, the Launch Date (which prior to May 31, 2013, was termed "Date of introduction") is set at a date upon which no further changes were permitted to be made to the index methodology, but that may have been prior to the Index's public release date.

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