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Financial Globalization has the potential to promote and reinforce Islamic Financial Industry: Dr. Akhtar

Dr Shamshad Akhtar, Governor, State Bank of Pakistan has said that the Islamic financial services industry needs to consolidate itself to be able to better compete with global players through achieving scale, efficiency and cost effectiveness in addition to rapidly building its capacities to standardize regulation and supervision and accounting practices, while strengthening the governance of the industry.

Delivering her keynote address as the Chairperson of the Islamic Financial Services Board (IFSB) for 2008 on 'Financial Globalization and Islamic Financial Services Industry' at the 5th Annual Summit of the IFSB held in Amman, Jordan yesterday, Dr Akhtar said that the Islamic Financial (IF) services industry has been transformed from being a peripheral activity to a sizeable industry which is attracting global interest.

She said that financial globalization will foster IF and given the inherent features and richness of Islamic principles, modalities and products' growth in IF, will be beneficial for supporting the process of regional and global financial deepening. Although currently the size of IF is small relative to the global financial system, it has promising growth prospects, she added.

"Well developed and integrated Islamic money, capital, and foreign exchange markets will not only be beneficial for borrowers and institutional investors but can also further enhance the stability of IF institutions, providing them with improved portfolio, liquidity and risk management tools," Dr Akhtar opined.

Referring to Sukuks, she said that the internationalization of the Sukuk structure and its flotation, which is expected to hit the \$100 billion mark soon, is helping to better integrate IF with the world of global finance.. This will not only meet the region's massive infrastructure project financing requirement but will also help diversify financial markets, Dr Akhtar added.

SBP Governor said that financial globalization has grown in size and scale and there is now a broad consensus that an effectively-managed financial globalization has the potential to benefit from and contribute to growing world trade integration, easing of investment and cross-border capital flows as economic liberalization gains momentum, development of interdependent production structures, that have evolved to maximize comparative advantage, and the revolution in information technology and institutional reforms.

However, she said the recent financial market turmoil in the subprime mortgage market has unfolded itself in an unprecedented global liquidity crunch,

triggering huge financial and economic losses and added that the world is now realizing the stress of growing global imbalances that have for several months now manifested themselves in the rising global commodity prices and have fuelled inflationary pressures.

Dr Akhtar said these events have again provoked debates regarding the pros and cons of financial globalization, as its impact becomes incrementally visible resulting in (i) slowdown of world economy and consequently in trade in selected products and markets, (ii) volatility in equity markets which in some cases generated losses, and (iii) easing of liquidity in a number of ways by the affected central banks which is now compounding inflationary pressures otherwise building up because of the international rise in food and oil prices. Corrective actions are underway and lessons are being drawn from the unfolding events, she said.

However, she said the good news is that the IF industry has generally remained insulated from the recent episode and this is because Islamic banks' transactions are backed by real economic transactions and risk management benefiting from the application and compliance with Shariah principles and guidelines, wherein the banks and investors have to share the profit and losses in accordance with the risks taken. While in conventional finance risk-free capital encouraged over-leveraging and over-exposures by transferring transactions to off balance sheet conduits, IF services drive their inherent strengths from the Shariah guidelines and principles. Notwithstanding, IF services, like all businesses, could be impacted if the global slowdown deepens, she added.

SBP Governor said that abstracting from the current scenario which is still unfolding, broad evidence confirms that financial globalization with adequate safeguards promotes economic growth and development. Financial globalization has the potential to promote and reinforce IF by ensuring its conformity with conventional finance by fostering newer and better linkages with the regional and global financial markets. "IF in turn can reinforce and support globalization by bringing to it financial innovation and stability, provided it is properly nurtured and developed in conformity with the internationally well accepted and tested financial sector prudential and regulatory frameworks," she said, and added that in order to achieve deeper and sustainable impact, IF would benefit by aligning and positioning itself in a way that it takes full advantage of financial globalization.

Dr Akhtar said that although the IF industry has the potential to grow by 20-30%, there are concerns that it is fraught with diversity, fragmentation and heterogeneity. To foster IF to integrally benefit from and contribute to financial globalization, there is a need for countries to launch a coherent, coordinated and synchronized development of the IF industry at national levels which feeds into and reinforces the implementation of IF strategy, approved by the Council of Governors of IFSB last year.

She said that in order to support and withstand financial globalization, IF needs to reorient itself to consolidate; promote "globalization" of IF modes and

instruments, promote and adopt Islamic financial architecture that encourages standardization of legal structure and contracts, prudential regulation and supervision supported by appropriate risk management of the special features and structure of the new products, and accounting practices in line with AAOIFI standards; harmonization and convergence of religious views on Islamic laws relating to financial transactions and developing suitable framework and applications of PLS-based products.
