MOODY'S
INVESTORS SERVICE

SECTOR IN-DEPTH
21 September 2022

Send Your Feedback

Analyst Contacts

Mik Kabeya +44.20.7772.8614
VP-Senior Analyst
mik.kabeya@moodys.com

Lynn Merhi +44.20.7772.1983
Associate Analyst
lynn.merhi@moodys.com

Antonello Aquino +44.20.7772.1582
Associate Managing Director
antonello.aquino@moodys.com

Sean Marion +44.20.7772.1056
MD-Financial Institutions
sean.marion@moodys.com

CLIENT SERVICES

Americas	1-212-553-1653
Asia Pacific	852-3551-3077
Japan	81-3-5408-4100
EMEA	44-20-7772-5454

Islamic Finance – Africa

Competitive conventional banking and nascent regulation constrain Islamic finance growth in Africa

Summary

Islamic banking has made little headway in Africa despite the continent's large Muslim populations. Sub-Saharan Africa, for example, has around 15% of the world's Muslim population but its Shariah-law compliant banking assets make up only around 1% of global Islamic banking assets. Ongoing challenges will constrain the growth of Islamic banking in Africa over the next 12 to 18 months, but the longer term growth potential remains significant.

» **Competitive conventional banking sector will hold back the growth of Islamic finance in Africa.** The incumbent conventional banks typically have solid, well entrenched positions, supported by their local expertise and innovative operations. These help them navigate the continent's challenging operating conditions. Limited public awareness is another constraining factor, as is the limited penetration of retail banking across most of the continent; retail banking has been the catalyst for the expansion of Islamic banking services in Asia and the Gulf States. Sudan and Djibouti are exceptions. Sudan has a fully Shariah-compliant banking system in Sudan, while a quarter of banking assets in Djibouti are Islamic.

» **Modest support from authorities results in a nascent legal, regulatory and fiscal framework for the Islamic finance industry.** Governments have in the past paid scant attention to the development of Islamic finance as they address more urgent socioeconomic challenges, or take account of domestic political considerations. Regulations and legal requirements forming a base for the Islamic finance industry across the continent are therefore in their infancy. Nonetheless, gradually increasing attention from authorities is leading to some improvement.

» **Over the longer term, Africa has significant potential for growth in Islamic banking.** We expect Islamic banking assets in Africa to increase noticeably over the next 10 years. There is huge potential for growth in the sector, given Africa's large Muslim populations and the low starting base. The Islamic banking industry could also benefit from some of the drivers fuelling growth in the conventional banking sector, including low banking penetration on the African continent.

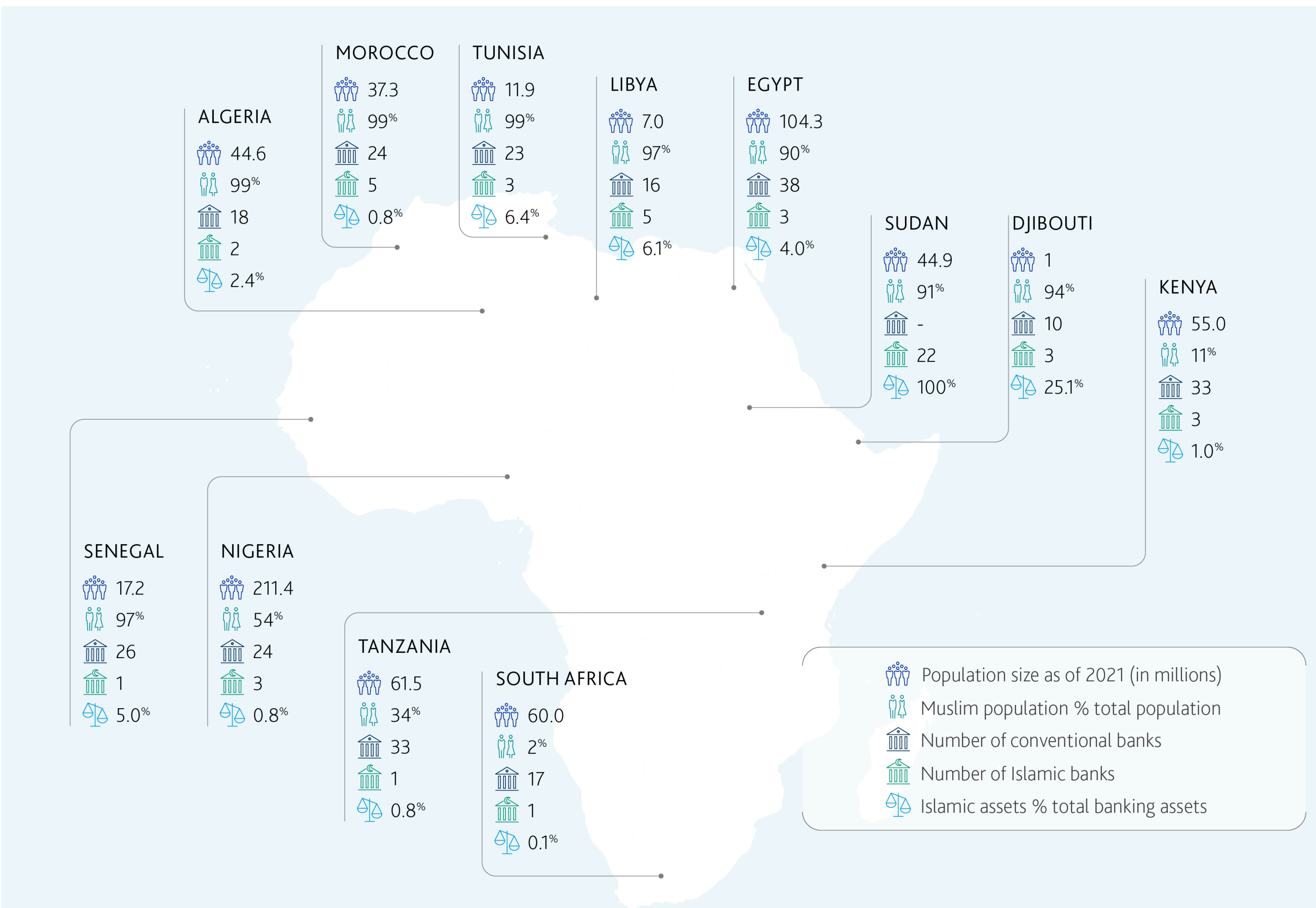
The competitive conventional banking landscape will constrain the growth of Islamic finance in Africa over the next 12 to 18 months

Keen competition among conventional banks in Africa makes for a difficult environment for the development of the Islamic banking industry. Many incumbent conventional banks have established solid market positions, their local expertise helps them navigate challenging operating environments, and innovative, increasingly digital services are improving customer satisfaction. Some conventional banks are introducing dedicated Islamic windows alongside their traditional services, but the majority are focused on strengthening their market share in conventional banking products. As of December 2021, Islamic banking assets in Africa constituted only 2% of global Islamic banking assets, and less than 10% of total domestic banking assets in most African countries[1](see Exhibit 1). This is despite sub-Saharan Africa having around 15% of the world's Muslim population[2]. The exceptions are Sudan whose banking system is fully Shariah compliant and Djibouti, where Islamic banking assets make up around 25% of banking sector assets.

Exhibit 1

Islamic banking penetration is very low in most African countries

African banks and population



Source: World Bank, Central Banks of the respective countries, Islamic Financial Services Board (IFSB)

This publication does not announce a credit rating action. For any credit ratings referenced in this publication, please see the issuer/deal page on https://ratings.moodys.com for the most updated credit rating action information and rating history.

Limited awareness among the population and the banking staff is a further growth constraint. Customers who could potentially be interested in Islamic banking products have little knowledge of such products, which leads them to subscribe to conventional products and services instead. The range of product offerings is also narrow and there is a general lack of familiarity with the complex documentation associated with Islamic financial products among bank staff and corporate clients.

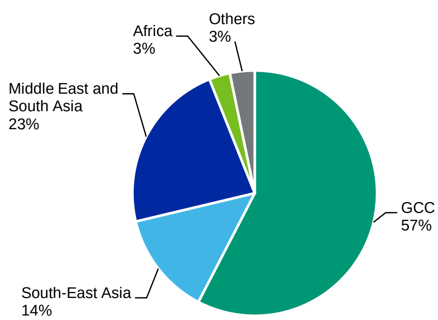
In Asia and in the countries of the Gulf Cooperation Council (GCC) retail banking has been the catalyst for the expansion of Islamic banking services. Households have subscribed to products that are more in line with their religious beliefs and a gradual adoption by corporate clients has then followed. But retail banking penetration is low in Africa and for now most banks focus primarily on catering to large private and state-owned companies with stronger credit profiles. This will slow the pace of adoption of Islamic banking across those populations.

The regulatory framework underpinning Islamic banking services is still in its infancy

Scant government involvement in the development of the Islamic finance industry in the past is another barrier to growth. Extreme poverty in some areas of the continent has meant that many African governments have been more intent on addressing urgent socioeconomic challenges.

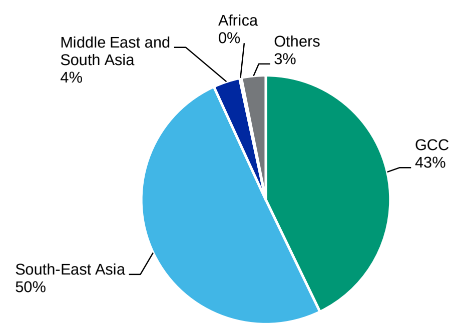
Despite all of this, a willingness to develop Islamic finance has been increasing in recent years, although the push from African authorities remains modest in light of what has been necessary to develop the Islamic banking sector in Asia and the GCC. Issuances of sukuk (Islamic bonds) by African entities are slowly picking up but they still lag Asia and the GCC by a long chalk. Outstanding sukuk securities issued by Africa-based issuers represented less than 1% of global outstanding sukuk issuances at the end of 2021 (exhibit 2).

Exhibit 2
Share of global Islamic banking assets by region
December 2021



Source: Islamic Financial Services Board

Exhibit 3
Share of global sukuk outstanding by region
December 2021



Source: Islamic Financial Services Board

The legal, regulatory and tax regimes for the Islamic finance industry across the continent are, for the most part, in early stages of development. Legal frameworks for the sector are a prerequisite for the establishment of both fully-fledged Islamic lenders and Islamic windows. Specific regulations such as the creation of Shariah Board or Committee are also needed to ensure compliance of marketed Islamic financial products and services with Shariah law. Specific tax laws are essential to help ensure equal treatment of Islamic finance lending products with conventional banking products, for example taking into account the fact that Islamic banking transactions usually involve multiple asset sales and purchases. Such regimes are only partly in place but improvements are under way.

There has been some improvement in the Islamic finance industry's regulatory regimes

» In **Morocco**, the central bank is drawing up a Moroccan legal and regulatory package relating to Islamic finance. Progress in 2021 includes: (a) completion of insurance code's implementation texts relating to Islamic "takaful" insurance, as well as the approval of some "takaful" insurers; (b) the broadening of the regulatory framework governing capital market instruments related to Islamic finance (including sukuk certificates and Shariah-compliant mutual funds); and (c) allowing the financing of agricultural land through Islamic "Murabaha"[3] operations. Morocco passed landmark legislation to lay out a legal framework for the sector in 2015.

- In **Nigeria**, the central bank (CBN) issued revised guidelines for the operation of Islamic institutions earlier this year. In 2020, it had issued draft guidance discussing the non-interest bearing instruments that Islamic banks can use to access the central bank's liquidity windows. In 2018, the central bank issued draft guidance on regulatory capital for Islamic banks. The guidance requires national Islamic banks (similar to conventional banks) to maintain a minimum capital adequacy requirement of 10% of risk-weighted assets, while those with an international licence must maintain a minimum capital ratio of 15%.
- In the **West African Economic and Monetary Union** (WAEMU), the regional central bank (BCEAO) last year continued its diversification of funding sources used by member economies, with a focus on the promotion of Islamic finance by providing support to initiatives for establishing Islamic financial institutions. The central bank has also carried out work to provide the Islamic financial institutions with Shariah-compliant contract templates and governance tools.
- In **Algeria**, large state-owned conventional banks started catering for the demand for Shariah-compliant banking products and services in 2020. Algeria put in place regulatory guidelines allowing banks to open Islamic windows in 2018.
- In **Tunisia**, the central bank last year issued a circular setting out the governance framework of financial institutions, including specific provisions for Islamic financial entities, requesting them to set up a Shariah committee and hire an international Shariah auditor. The central bank published a circular defining Islamic banking products as well as their terms and conditions in 2019.
- In **Egypt**, the House of Representatives last year approved a draft law relating to issuances of sovereign sukuk, which sets out various types of certificates that may be issued. The related regulations became effective earlier this year after receiving Cabinet approval. The country's Financial Regulatory Authority issued a regulation pertaining to sukuk securities issuance in 2019, and the authorities set up a Shariah supervisory committee. Egypt has the longest history of Islamic banking in the North Africa region dating back to the 1960s, but regulatory progress has slowed more recently.
- **South Africa** was the first country in sub-Saharan Africa to launch an Islamic bank In 1989. Over the past decade, regulators have introduced tax laws for the treatment of Islamic financial products such as murabaha and sukuk.

Islamic banking has significant potential for growth in Africa over the next 10 years

We expect Islamic banking assets in Africa to increase markedly over the next decade, as a natural consequence of the continent's large Muslim populations and the low starting base of the Islamic banking industry.

The Muslim population of Africa stands at some 530 million people, [4] around 40% of the African population. In North Africa, the Muslim population is above 90%, close to levels in Gulf countries and some way above Malaysia, where numbers are around 60%. Africa's unbanked populations, in particular those opting out of the conventional system due their religious beliefs, present an untapped pool of potential deposits and investments.

Islamic banking in Africa dates back to the 1960s and 70s when the first Islamic banks were established in countries with large Muslim populations, such as Sudan. However, outside Sudan and Djibouti its development has since languished. The very low penetration rate suggests that once momentum builds, growth could be rapid. Penetration of Islamic financing in Malaysia is around 30%, while it is between 20% and 50% in most Gulf Cooperation Council countries, and 77% in Saudi Arabia.

The Islamic banking industry could also benefit from some of the drivers fuelling the growth of the conventional banking sector, including the low banking penetration on the African continent. In Africa, large numbers of households do not use bank accounts, with a sizeable potion of the sub-Saharan African population being unbanked.

Moody's related publications

» Islamic finance - Cross region: High commodity prices will sustain the recovery of Islamic banks, 8 Sep 2022

» Cross sector - Islamic finance: Islamic finance will continue to grow despite expected lower sukuk issuances, 8 Mar 2022

» Islamic finance - Africa: Rising sovereign sukuk issuance will help develop Islamic banking in Africa, 27 Sep 2021

» Islamic banking - North Africa: Higher government efforts remain key to gear up the sector for growth, 2 Nov 2020

Endnotes

1 Source: Islamic Financial Services Board

2 Latest data available as of 2010; Source:Pew Research Center

3 A Shari'ah compliant contract of sale with an agreed profit mark-up on the cost

4 2020 estimate. Source: International Journal of Environmental Science and Development - Muslim Population in Africa: 1950-2020

© 2022 Moody's Corporation, Moody's Investors Service, Inc., Moody's Analytics, Inc. and/or their licensors and affiliates (collectively, "MOODY'S"). All rights reserved.

CREDIT RATINGS ISSUED BY MOODY'S CREDIT RATINGS AFFILIATES ARE THEIR CURRENT OPINIONS OF THE RELATIVE FUTURE CREDIT RISK OF ENTITIES, CREDIT COMMITMENTS, OR DEBT OR DEBT-LIKE SECURITIES, AND MATERIALS, PRODUCTS, SERVICES AND INFORMATION PUBLISHED BY MOODY'S (COLLECTIVELY, "PUBLICATIONS") MAY INCLUDE SUCH CURRENT OPINIONS. MOODY'S DEFINES CREDIT RISK AS THE RISK THAT AN ENTITY MAY NOT MEET ITS CONTRACTUAL FINANCIAL OBLIGATIONS AS THEY COME DUE AND ANY ESTIMATED FINANCIAL LOSS IN THE EVENT OF DEFAULT OR IMPAIRMENT. SEE APPLICABLE MOODY'S RATING SYMBOLS AND DEFINITIONS PUBLICATION FOR INFORMATION ON THE TYPES OF CONTRACTUAL FINANCIAL OBLIGATIONS ADDRESSED BY MOODY'S CREDIT RATINGS. CREDIT RATINGS DO NOT ADDRESS ANY OTHER RISK, INCLUDING BUT NOT LIMITED TO: LIQUIDITY RISK, MARKET VALUE RISK, OR PRICE VOLATILITY. CREDIT RATINGS, NON-CREDIT ASSESSMENTS ("ASSESSMENTS"), AND OTHER OPINIONS INCLUDED IN MOODY'S PUBLICATIONS ARE NOT STATEMENTS OF CURRENT OR HISTORICAL FACT. MOODY'S PUBLICATIONS MAY ALSO INCLUDE QUANTITATIVE MODEL-BASED ESTIMATES OF CREDIT RISK AND RELATED OPINIONS OR COMMENTARY PUBLISHED BY MOODY'S ANALYTICS, INC. AND/OR ITS AFFILIATES. MOODY'S CREDIT RATINGS, ASSESSMENTS, OTHER OPINIONS AND PUBLICATIONS DO NOT CONSTITUTE OR PROVIDE INVESTMENT OR FINANCIAL ADVICE, AND MOODY'S CREDIT RATINGS, ASSESSMENTS, OTHER OPINIONS AND PUBLICATIONS ARE NOT AND DO NOT PROVIDE RECOMMENDATIONS TO PURCHASE, SELL, OR HOLD PARTICULAR SECURITIES. MOODY'S CREDIT RATINGS, ASSESSMENTS, OTHER OPINIONS AND PUBLICATIONS DO NOT COMMENT ON THE SUITABILITY OF AN INVESTMENT FOR ANY PARTICULAR INVESTOR. MOODY'S ISSUES ITS CREDIT RATINGS, ASSESSMENTS AND OTHER OPINIONS AND PUBLISHES ITS PUBLICATIONS WITH THE EXPECTATION AND UNDERSTANDING THAT EACH INVESTOR WILL, WITH DUE CARE, MAKE ITS OWN STUDY AND EVALUATION OF EACH SECURITY THAT IS UNDER CONSIDERATION FOR PURCHASE, HOLDING, OR SALE.

MOODY'S CREDIT RATINGS, ASSESSMENTS, OTHER OPINIONS, AND PUBLICATIONS ARE NOT INTENDED FOR USE BY RETAIL INVESTORS AND IT WOULD BE RECKLESS AND INAPPROPRIATE FOR RETAIL INVESTORS TO USE MOODY'S CREDIT RATINGS, ASSESSMENTS, OTHER OPINIONS OR PUBLICATIONS WHEN MAKING AN INVESTMENT DECISION. IF IN DOUBT YOU SHOULD CONTACT YOUR FINANCIAL OR OTHER PROFESSIONAL ADVISER.

ALL INFORMATION CONTAINED HEREIN IS PROTECTED BY LAW, INCLUDING BUT NOT LIMITED TO, COPYRIGHT LAW, AND NONE OF SUCH INFORMATION MAY BE COPIED OR OTHERWISE REPRODUCED, REPACKAGED, FURTHER TRANSMITTED, TRANSFERRED, DISSEMINATED, REDISTRIBUTED OR RESOLD, OR STORED FOR SUBSEQUENT USE FOR ANY SUCH PURPOSE, IN WHOLE OR IN PART, IN ANY FORM OR MANNER OR BY ANY MEANS WHATSOEVER, BY ANY PERSON WITHOUT MOODY'S PRIOR WRITTEN CONSENT.

MOODY'S CREDIT RATINGS, ASSESSMENTS, OTHER OPINIONS AND PUBLICATIONS ARE NOT INTENDED FOR USE BY ANY PERSON AS A BENCHMARK AS THAT TERM IS DEFINED FOR REGULATORY PURPOSES AND MUST NOT BE USED IN ANY WAY THAT COULD RESULT IN THEM BEING CONSIDERED A BENCHMARK.

All information contained herein is obtained by MOODY'S from sources believed by it to be accurate and reliable. Because of the possibility of human or mechanical error as well as other factors, however, all information contained herein is provided "AS IS" without warranty of any kind. MOODY'S adopts all necessary measures so that the information it uses in assigning a credit rating is of sufficient quality and from sources MOODY'S considers to be reliable including, when appropriate, independent third-party sources. However, MOODY'S is not an auditor and cannot in every instance independently verify or validate information received in the rating process or in preparing its Publications.

To the extent permitted by law, MOODY'S and its directors, officers, employees, agents, representatives, licensors and suppliers disclaim liability to any person or entity for any indirect, special, consequential, or incidental losses or damages whatsoever arising from or in connection with the information contained herein or the use of or inability to use any such information, even if MOODY'S or any of its directors, officers, employees, agents, representatives, licensors or suppliers is advised in advance of the possibility of such losses or damages, including but not limited to: (a) any loss of present or prospective profits or (b) any loss or damage arising where the relevant financial instrument is not the subject of a particular credit rating assigned by MOODY'S.

To the extent permitted by law, MOODY'S and its directors, officers, employees, agents, representatives, licensors and suppliers disclaim liability for any direct or compensatory losses or damages caused to any person or entity, including but not limited to by any negligence (but excluding fraud, willful misconduct or any other type of liability that, for the avoidance of doubt, by law cannot be excluded) on the part of, or any contingency within or beyond the control of, MOODY'S or any of its directors, officers, employees, agents, representatives, licensors or suppliers, arising from or in connection with the information contained herein or the use of or inability to use any such information.

NO WARRANTY, EXPRESS OR IMPLIED, AS TO THE ACCURACY, TIMELINESS, COMPLETENESS, MERCHANTABILITY OR FITNESS FOR ANY PARTICULAR PURPOSE OF ANY CREDIT RATING, ASSESSMENT, OTHER OPINION OR INFORMATION IS GIVEN OR MADE BY MOODY'S IN ANY FORM OR MANNER WHATSOEVER.

Moody's Investors Service, Inc., a wholly-owned credit rating agency subsidiary of Moody's Corporation ("MCO"), hereby discloses that most issuers of debt securities (including corporate and municipal bonds, debentures, notes and commercial paper) and preferred stock rated by Moody's Investors Service, Inc. have, prior to assignment of any credit rating, agreed to pay to Moody's Investors Service, Inc. for credit ratings opinions and services rendered by it fees ranging from $1,000 to approximately $5,000,000. MCO and Moody's Investors Service also maintain policies and procedures to address the independence of Moody's Investors Service credit ratings and credit rating processes. Information regarding certain affiliations that may exist between directors of MCO and rated entities, and between entities who hold credit ratings from Moody's Investors Service and have also publicly reported to the SEC an ownership interest in MCO of more than 5%, is posted annually at www.moodys.com under the heading "Investor Relations — Corporate Governance — Director and Shareholder Affiliation Policy."

Additional terms for Australia only: Any publication into Australia of this document is pursuant to the Australian Financial Services License of MOODY'S affiliate, Moody's Investors Service Pty Limited ABN 61 003 399 657AFSL 336969 and/or Moody's Analytics Australia Pty Ltd ABN 94 105 136 972 AFSL 383569 (as applicable). This document is intended to be provided only to "wholesale clients" within the meaning of section 761G of the Corporations Act 2001. By continuing to access this document from within Australia, you represent to MOODY'S that you are, or are accessing the document as a representative of, a "wholesale client" and that neither you nor the entity you represent will directly or indirectly disseminate this document or its contents to "retail clients" within the meaning of section 761G of the Corporations Act 2001. MOODY'S credit rating is an opinion as to the creditworthiness of a debt obligation of the issuer, not on the equity securities of the issuer or any form of security that is available to retail investors.

Additional terms for Japan only: Moody's Japan K.K. ("MJKK") is a wholly-owned credit rating agency subsidiary of Moody's Group Japan G.K., which is wholly-owned by Moody's Overseas Holdings Inc., a wholly-owned subsidiary of MCO. Moody's SF Japan K.K. ("MSFJ") is a wholly-owned credit rating agency subsidiary of MJKK. MSFJ is not a Nationally Recognized Statistical Rating Organization ("NRSRO"). Therefore, credit ratings assigned by MSFJ are Non-NRSRO Credit Ratings. Non-NRSRO Credit Ratings are assigned by an entity that is not a NRSRO and, consequently, the rated obligation will not qualify for certain types of treatment under U.S. laws. MJKK and MSFJ are credit rating agencies registered with the Japan Financial Services Agency and their registration numbers are FSA Commissioner (Ratings) No. 2 and 3 respectively.

MJKK or MSFJ (as applicable) hereby disclose that most issuers of debt securities (including corporate and municipal bonds, debentures, notes and commercial paper) and preferred stock rated by MJKK or MSFJ (as applicable) have, prior to assignment of any credit rating, agreed to pay to MJKK or MSFJ (as applicable) for credit ratings opinions and services rendered by it fees ranging from JPY100,000 to approximately JPY550,000,000.

MJKK and MSFJ also maintain policies and procedures to address Japanese regulatory requirements.

REPORT NUMBER 1341020

CLIENT SERVICES

Americas	1-212-553-1653
Asia Pacific	852-3551-3077
Japan	81-3-5408-4100
EMEA	44-20-7772-5454

MOODY'S INVESTORS SERVICE