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The role of Islamic sukuku in light of the sovereign debt crisis in pushing the state's general budget deficit

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Abstract---Islamic sukuku, in their various forms, make significant contributions that foster both economic and social development, driving the economy forward. They also offer a range of benefits to individuals, institutions, investors, and issuers, creating a positive impact that serves both the issuer and society. Therefore, a primary objective of this research paper is to explore Islamic sukuku as an Islamic financing mechanism, which has recently garnered global attention. This includes examining their definition, types, and issuance regulations, as well as highlighting the crucial role Islamic instruments can play in addressing budget deficit challenges. The key findings indicate that sukuku are an effective tool for accumulating liquidity, thereby providing essential financing for both institutions and governments. By mobilizing financial resources and channeling them into real, productive investments, sukuku have the potential to bridge the gap between the real economy and the financial sector, as their issuance requires underlying assets prior to securitization.

Keywords---debt crisis budge, deficit, Islamic sukuk, sovereign debt.

Introduction

Approximately 15% of all Islamic financial assets globally are Islamic sukuk, making them one of the cornerstones of the Islamic financial system. In recent years, the global financial system has faced one of its worst crises in history: the mortgage crisis. This crisis began in the American markets and subsequently spread to Europe, Asia, the Gulf, and developing nations. The financial system

continues to emerge from one crisis only to face another, with the most recent being the severe Greek sovereign debt crisis, which nearly dismantled the nation's political and economic structures.

Sovereign debt has become one of the most frequently discussed terms in economic literature, especially as many industrialized nations are now grappling with it. In general, the term debt refers to the total amount a country owes at a given time. This can be due to borrowing from domestic sources (referred to as internal debt) or from foreign lenders, which is known as sovereign debt. Countries resort to borrowing when they are unable to meet their expenditures through domestic resources, to repay existing foreign debts and interest, to fund future projects, or when their consumption exceeds production, among other reasons. Such debts have a negative impact on the national economy, burdening it with debt service payments and cumulative interest, thus increasing the state's financial obligations and contributing to a general budget deficit. Governments employ various methods to eliminate budget deficits, such as internal and external borrowing, encouraging central banks to increase monetary issuance, inflationary financing, and taxation. However, none of these methods is without negative consequences, as evidenced by the numerous debt crises faced by countries, including the European sovereign debt crisis of 2010. This situation has led many major economic nations to search for alternative financing solutions.

A significant body of research has examined Islamic securitization, particularly in the wake of the 2008 financial crisis, as these instruments have proven effective in helping governments address budget deficits. Islamic sukuk have emerged as the most prominent of these tools, offering a modern solution to contemporary economic challenges.

The central question posed in this study is: What role do Islamic sukuk play in mitigating sovereign debt crises and addressing public budget deficits?

This research adopts a descriptive and analytical methodology to study Islamic sukuk as a financial tool, offering a new alternative to the traditional instruments used in conventional financial systems. The research utilizes the following approaches:

Descriptive approach: To examine the theoretical framework of Islamic sukuk, including their types, issuance controls, and associated risks. Analytical approach: To assess the role of Islamic sukuk as an alternative tool for resolving sovereign debt crises, specifically in supporting the Greek state's budget deficit.

The structure of the paper is organized as follows:

First Section: An overview of Islamic sukuk, including key concepts and definitions.

Second Section: An analysis of the role of Islamic sukuk in addressing the sovereign debt crisis and supporting the general budget.

1. Consists of broad ideas regarding Islamic sukuk

The great importance of the Islamic bond's product, which is considered a qualitative leap in the development of Islamic financial instruments, came in response to developments in the international financial environment, in light of

the increasing global interest in Islamic finance, especially in the wake of the recent global financial crisis. If Islamic sukuk have received international recognition as an Islamic financial product that responds to mobilizing resources and financing projects, especially what are known as government Islamic sukuk, dealing with these sukuk has created many risks associated with them, which require mechanisms to manage these risks in accordance with Sharia controls.

1.1 Definition of Islamic sukuk:

The concept of Islamic sukuk is rooted in the principle of participation in financing medium- or long-term investment projects or operations, based on the rule of *ghannam bi al-ghuram* (sharing in profit and loss). Sukuk are issued to secure the necessary funding, with the offering made available for public subscription to investors who wish to participate.

1.1.1 Terminological Definition:

In return for the money the subscriber gave the project owner, they are bonds, certificates, or papers issued in his name. They are negotiable, equal in value, and represent common shares in the capital. Their owner is subject to additional obligations under Islamic investment and trading regulationsⁱ. Investment sukuk are defined as documents of equal value that represent common shares in the ownership of assets, benefits, services, or in the assets of a particular project or private investment activity by the Accounting and Auditing Organization for Islamic Financial Institutions' Sharia standards. This comes after the sukuk value has been gathered, the subscription period has ended, and the sukuk have begun to be used for the intended purposesⁱⁱ.

It is described as an investment instrument by the International Islamic Fiqh Academy as follows: financial sukuk with capital divided into equal shares are issued, with the capital divided into units of equal value and registered in the names of the owners as common shares in the capital and as what is transferred to it in proportion to each owner's ownership in itⁱⁱⁱ.

They are securities of equal value that represent assets, benefits, and services together - or both, based on an investment project that generates income^{iv}.

As a result, Islamic Sukuk are defined as "equivalent-value documents representing common ownership interests or Sharia-permissible investment activities, issued in compliance with Islamic financing formulas that follow Sharia controls."

1.2 Types of Islamic investment sukuk:

Islamic sukuk offer a variety of investment options based on different considerations. Below, the types of investment sukuk will be reviewed according to the Sharia-compliant structure upon which they are based, as well as the nature of the relationship between the various parties involved in the sukuk.

1.2.1 Sukuk al Musharaka: These are equal-value documents issued with the intention of using the revenues to launch a new project, advance an ongoing one, or provide funding for an endeavor based on a *al Musharaka* contract. Within the

parameters of their shares, the sukuk holders own the project. The basis of Sukuk al Musharaka is participation strategies in its several manifestations. Allocating a portion of the company's profits to risks is a form of solidarity and cooperation. By sharing money, the shareholders waive any real share in profits or losses. Alternatively, sharing money on the one hand and work and experience on the other, this basis of participation guarantees a reduction in the risk of exposure to loss.

1.2.2 Sukuk al-mudaraba: Documents of equal value that are issued to finance the purchase of al-mudaraba commodity, and the latter becomes owned by the sukuk holders. The issuer of these Sukuk is the seller of al-mudaraba commodity, and the subscribers to it are its buyers, and the subscription proceeds are the cost of purchasing it, and the sukuk holder owns this commodity once buy them, and they are worth the selling price^v.

The profit generated from sukuk arises from the margin between the initial cost of acquiring a commodity and the cash payments associated with its related expenses. Trading of these sukuk is permitted after the subscription phase is completed and the goods have been purchased, continuing until the point of delivery to the buyer. Payment may be deferred or made in installments. However, there are restrictions on trading debts once the goods have been delivered, and trading is limited until the deferred payments are fully received and the transaction is finalized.

1.2.3 Sukuk al Salam: are financial certificates of equal value issued to raise capital for a Salam transaction, where the holders of these sukuk gain ownership of the underlying commodity. The funds collected are given to a supplier in exchange for a future delivery of a specified commodity. The sukuk holders' rights are deferred until the commodity is delivered and sold, at which point they receive their initial investment along with any profit from the sale. However, trading these sukuk is not allowed because Islamic principles prohibit the sale of a commodity before it is physically received. Additionally, since Sukuk al-Salam involves the sale of a commodity with deferred delivery at an immediate price, it represents a form of debt, with the commodity still in the seller's possession, making it non-tradable.

1.2.4 Sukuk al-Istisna: They are documents of equal value that are issued to use the proceeds of subscription in the manufacture of a commodity. The manufactured product becomes owned by the holders of the sukuk and its source is the manufacturer (seller). Those who subscribe to it are the buyers of the item to be manufactured, and the proceeds of subscription are the cost of the manufactured item. The holder of the sukuk owns the manufactured item, and they are entitled to its sale price or the price of selling the manufactured item in parallel istisna', if any. Istisna' applies to the construction of buildings, the construction of ships, airplanes, bridges, roads, electric power and water generation stations, etc., where the project's specifications, construction costs, selling price and method of payment are specified in the prospectus. The sukuk suit is worth the price of selling the project, and this price includes the cost of the project represented by issuing the sukuk in addition to A certain profit margin. The terms of Sukuk al-Istisna are determined by the period necessary to

manufacture the item sold in Istisna' and collect the price and distribute it to the Sukuk. Sukuk al-Istisna represents the sale of a commodity. Deferred delivery at an immediate price, and the commodity is a type of debt in kind because it is described and recorded in the debt. However, its price may be postponed, and the sold item is still under the responsibility of the manufacturer. Therefore, these sukuk are considered unsaleable or negotiable in the event that the instrument is issued by one of the two parties, the seller or the buyer^{vi}.

1.2.5 Sukuk Al-Ijara: They are documents of equal value that represent a common share in the ownership of objects, benefits, or services in an investment project that generates income. These Sukuk are offered for the purpose of collecting an amount to purchase an asset and lease it as an operational lease or ending with ownership to a party, and the return of Al-Ijara installments is distributed to sukuk holders, with a return of part of the value of the property if it is a lease ending with ownership^{vii}. Sukuk Al-Ijara are considered common ownership deeds in leased assets owned by sukuk owners. The rental return is distributed to the owners according to their ownership shares. They are negotiable and their value is estimated according to their market value. One of the advantages of Sukuk Al-Ijara is that they provide their holder with a fixed return, which is his share in Al-Ijara installments, which has made investors dispense with bonds with usurious interest, which are characterized by a fixed, pre-determined return.

The Accounting and Auditing Organization for Islamic Financial Institutions classified Sukuk Al-Ijara in to sukuk of ownership of leased assets and sukuk of ownership of usufructs (including sukuk of ownership of the benefits of existing assets, sukuk of ownership of the usufructs of assets described in the liability, sukuk of ownership of services from a specific party, and sukuk of ownership of services from a party described in the liability).

1.2.6 Sukuk al-Muzara'ah: These documents of equal value are issued by the owner of agricultural land to raise funds for covering farming expenses under an al-Muzara'ah contract. The community involved shares in the harvest according to the terms outlined in the contract. The issuer of the sukuk can be the landowner, the person entitled to its benefits, or even the owner of the land's rights, while the subscribers are the farmers engaged in the farming contract, either directly or through other means. The proceeds from the subscription cover agricultural costs. Alternatively, the issuer could be the farmer, with subscribers being investors who purchased land using the subscription funds. Sukuk holders, in this case, are entitled to a predetermined share of the crops produced by the land^{viii}.

1.2.7 Sukuk al-Musaqah: Documents of equal value that are issued to use their proceeds to water, spend on, and care for fruit trees on the basis of al-Musaqah contract. The sukuk holders have a share of the crop in accordance with what the contract specifies. These sukuk are issued by the owner of the trees subject to the contract in order to finance the watering operations, care and its community shares in the crops produced under al-Musaqah contract, the issuer of these sukuk is the owner of the land (its owner or the owner of its benefits) that contains the trees, and the subscribers to it are al-Musaqah contract

participants, and the proceeds of the subscription are the costs of caring for the trees, and the issuer may be al-Musaqi (employer). The subscribers are the owners of the land (the investors who irrigated the land with the proceeds of their subscription), and the sukuk suit is entitled to the agreed upon share of what the trees produce^{ix}.

1.2.8 Sukuk al-Mugharasa: Documents of equal value that are issued to use their proceeds for planting trees and for the work and expenses required for this planting on the basis of al-Mugharasa contract. The sukuk holders have a share in the land and the planting. These sukuk may be issued by either the owner of a land suitable for planting trees, and the subscribers are the planters in the planting contract, and the proceeds of the subscription are the costs of planting the trees, or the issuer may be the planter (the employer) and the subscribers are the owners of the land^x.

2. Islamic Sukuks are an alternative to sovereign debt in supporting the general budget

Islamic sukuk provide Egypt with a pathway toward comprehensive popular participation, enabling citizens to actively contribute to meeting the country's economic development needs. By allowing individuals to feel a sense of ownership and responsibility for their nation's progress, sukuk facilitate public engagement in supporting the economy. These financial instruments help meet the necessary funding requirements to support the national budget, addressing both economic and non-economic programs that require significant capital. In addition, sukuk play a crucial role in helping to close the existing budget deficit.

2.1 The role of Islamic sukuk in collecting and mobilizing local savings:

Islamic sukuk are distinguished by their ability to mobilize and accumulate financial resources, since they meet the desires of all groups. They vary in terms of their value, as well as in terms of their terms, from short, medium and long. They also vary in terms of the method of obtaining the return, and in terms of their liquidity derived from the possibility of trading them in the secondary market or not. Islamic sukuk also have the characteristic of not being exposed to interest rate risks, because they do not deal with it at all, just as sukuk Islamic securities are not exposed to inflation risks, but rather are affected by inflation positively, because these sukuk represent real assets in the form of objects and services whose prices rise with the rise in the general price level, which leads to an increase in the returns on the sukuk representing those assets^{xi}.

2.2 The role of Islamic sukuk in the return of capital invested abroad: In light of the deteriorating economic situation of Arab and Islamic countries, and in addition to the economic reforms that are hoped to be undertaken in the Islamic world, the role of Islamic sukuk emerges as one of the most important factors attracting migrating capital. It has proven its effectiveness in attracting savings and capital in a short period, as the volume of sukuk issuances quadrupled between 2004 and 2006, and experts expect the volume of Islamic sukuk issuances to reach 3 trillion US dollars by 2015^{xii}.

Islamic Sukuk have been able to attract large numbers of investors from various countries of the world, not just the Islamic world, as they have become available to all individuals, companies and governments in countries of Europe, Europe, Asia and America, and if the outstanding performance continues With the risks surrounding Western investments as obstacles in light of the current crises, the sukuk will play the main role in the return of immigrant Islamic funds to their places of origin to contribute to the development process in all its fields^{xiii}.

2.3 The role of Islamic Sukuk in financing development projects: Islamic sukuk can be adopted to enable infrastructure projects and vital projects instead of relying on treasury bonds and internal and external public debt. Governments can issue leasing sukuk to enable the establishment of projects of public benefit, which the government does not wish to establish. On the basis of profit, for a public interest it deems necessary, such as financing the construction of bridges, airports, roads, dams, and other major infrastructure projects, and in this case the government is the tenant of the sukuk holders who They are the owners of these properties leased to the state. Then the government (in its capacity as a lessee) makes the road available for cars to travel, and the bridge for those crossing it, and uses the dam to reserve the water, store it, and distribute it to farmers and the rest of the population^{xiv}. It is also possible, for example, to issue government bonds. In order to finance agricultural and industrial activity, especially financing the previous stages of production and export of popular goods and products, by purchasing them peacefully and re-marketing them at remunerative prices^{xv}.

2.4 Addressing the general budget deficit and solving the problem of debt: The emergence of a deficit in the state budget highlights the need to address this deficit given the impossibility of reducing expenses or increasing revenues in the short term in order to remove this deficit by any means. The latter has many drawbacks, which is why sukuk can replace them. There are several types of Sharia sukuk that transfer resources to the state on a temporary basis. They can be divided into four main types^{xvi}:

A- Financing in the form of al-mudaraba or al Musharaka: It is suitable for income- or revenue-generating projects, such as: electric power stations, ports, and others. The state can purchase the share of sukuk al-mudaraba or al Musharaka gradually according to a specific program and over a specific period of time through decreasing Musharakah.

In 1984, a type of participation bond was issued in Turkey to finance the construction of a bridge over the Bosphorus Strait in the amount of \$200 million. The issuance was widely accepted by the public, especially among Turkish citizen's expatriates outside the country. The proceeds of the issuance were used to finance the construction of the bridge, which helped facilitate traffic movement across both parts of Istanbul and provided a good income.

B- Financing in one of the forms of Ijara: where the state uses, in exchange for a specific fee, fixed assets owned by others, and may buy them from them at the end of the contract. Sukuk Al-Ijara and leased assets can be used to mobilize the necessary resources to finance many government projects and expenditures.

These sukuk can be used to mobilize the financial resources necessary to finance the purchase of machinery, equipment, devices, and similar long-lived objects.

C- Financing through the form of Salam: by paying the price of the commodity immediately and receiving this commodity at a later agreed-upon date. According to these sukuk, the state sells a commodity that it produces in peace with specific descriptions, so that the buyer pays the price to the state immediately, provided that the state delivers the commodity to him at a later date. This method is suitable for countries that have natural resources to sell, such as oil, phosphate, and electrical energy.

D- Financing in the form of al-Istisna: to manufacture specific products, build urban projects, extend bridges and roads, or establish an electric power plant, water desalination, etc., so that the other party pays the amount specified in the contract immediately after the production of the goods or the completion of the project, or on the date of Later, it is agreed upon, and usually the second party contracts on one side with factories or specialized contracting companies to implement the project according to the specifications specified by the other party.

2.5 Eliminating the problem of unemployment and idle funds: Islamic investment sukuk contribute to eliminating the problem of unemployment, increasing the level of employment and putting idle funds to work, as these sukuk fulfill the desires of both investors and savers alike, and the method of al-mudharaba represents an important motivation towards motivating the unemployed (due to his lack of capital) to work hard, and this will contribute to financing economic development and its success, and it represents a method of participation that encourages those with money to each other in investment work, especially those who have money that is not sufficient to cover the expenses of their investments. Also, the owner of the agricultural land can agree with the one who cultivates and irrigate it, in exchange for this farmer receiving a portion of the fruit, and this is what is provided by Sukuk al-Muzara'ah and Sukuk al-Musaqah. As for the Murabaha and Salam method, it contributes to financing capital goods for artisans and small agricultural producers and new industrialists who lack sufficient experience and financial solvency^{xvii}. Also, Sukuk Al-Ijara ending with ownership, work to encourage the worker to work hard to advance his work from the tenant to the original owner, and the Qard Al-Hassan Sukuk also plays a role in raising the volume of employment and the continuity of the development process through Lending to investors and providing them with the necessary liquidity.

2.6 New trends directions dealing in Islamic sukuk: Over the past six years, Islamic Sukuk has emerged as one of the leading products in the Islamic finance sector, experiencing remarkable expansion. By the end of 2007, Sukuk became the fastest-growing segment in the Islamic finance industry, with global issuances reaching \$97.3 billion. The majority of these issuances were from Malaysia and the Arabian Gulf. In Europe, the Middle East, Africa, and Asia, the total volume of Sukuk issuances rose by 71% to \$32.65 billion in 2007, compared to 2006. The number of issuances increased from 109 in 2006 to 119 in 2007, and the average transaction size grew from \$175 million in 2006 to \$269.8 million in 2007. The financial services sector accounted for 31% of total issuances, followed by real estate at 25%, and energy and services at 12%. Sukuk al-Musharaka led in terms

of issuance volume, with \$12.9 billion, while Sukuk al-Ijara followed closely with \$10.13 billion in issuance. Notably, 54 Sukuk al-Ijara were issued compared to 22 Sukuk al-Musharaka. The global Sukuk market is expected to continue its robust growth, with an estimated annual increase of 30 to 35% in 2008, and sovereign Sukuk issuances are anticipated from countries like Japan, Thailand, and the United Kingdom^{xviii}.

Conclusion

Following the 2008 global financial crisis, interest in Islamic finance surged, with Islamic sukuk emerging as a key tool for attracting a wide range of investors, including individuals, corporations, and governments from diverse regions. Sukuk has proven to be an effective method for securing financing for both public and private projects, contributing to its rapid growth in recent years. By 2012, sukuk became the fastest-growing segment within the Islamic finance industry, with the primary issuance market expanding by 44.3% between the beginning of the year and November. The total value of sukuk issuances reached approximately \$140 billion by the end of 2012, marking a 64.8% increase compared to 2011, with an average monthly issuance rate of \$11.2 billion. From 2000 to 2011, the sukuk industry experienced remarkable growth, increasing by 246%, solidifying its position as the most prominent instrument in Islamic capital markets.

Among the key findings of the study are the following:

- Sukuk is an effective tool for accumulating liquidity, providing essential financing for institutions and governments alike.
- It helps governments address chronic public budget deficits, which have become a significant concern for policymakers and often obstruct the development of countries.
- Sukuk contributes to market depth and efficiency by promoting balanced interest between primary and secondary markets. Its growth in both quantity and quality significantly enhances market breadth and overall efficiency.
- Sukuk creates a balance between the real and financial economies, as its issuance requires the existence of tangible assets before securitization. Additionally, sukuk is free from usury and relies on profit-sharing, making it a more equitable alternative to interest-based financing instruments.
- Through Sharia-compliant regulations, Islamic sukuk can help strengthen ethical oversight within financial markets. For instance, the French Supreme Supervision Authority has prohibited fictitious deals and symbolic sales, which are hallmarks of the capitalist system.

Based on these findings, the following recommendations can be made:

- Efforts must be made to continuously promote Islamic financial literacy to dispel any ambiguities surrounding investment in Islamic financial instruments, particularly sukuk.
- It is essential to complete the legislative framework for Islamic sukuk to encompass all aspects of their issuance and trading in both primary and secondary markets, ensuring compliance with Sharia principles.

Evaluative research studies should be conducted on pioneering Islamic finance experiences to assess their value and leverage them for the development of sukuk products that better address risk distribution. The global financial crisis presents

an opportunity to spread awareness about the Islamic finance industry, particularly sukuk. Institutes and training centers should be established to qualify professionals to work in the Islamic financial markets, with a focus on both legal and economic perspectives. Islamic financial instruments serve as an alternative to traditional, interest-based instruments, but to fully meet the financing needs of national economies, they must not merely offer an alternative. Instead, they should proactively develop strategies for innovation and improvement. Greater emphasis must be placed on specialized scientific research to enhance the efficiency and effectiveness of existing Islamic financial instruments.

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