Islamic Banking Acceleration in Malaysia and Indonesia: Panel VAR Approach

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ABSTRACT

Islamic banking acceleration has been the major theme discussed for years, indicating the importance of such topic to be reexamined comprehensively. This study is aimed to empirically examine several aspects and condition which may play a leading role in accelerating (preventing) the growth of Islamic bank in two countries, namely Malaysia and Indonesia. To that end, this study attempts to incorporate selected internal bank condition and macroeconomic situation in a single model to exhibit the dynamics relationship between both and the total asset of Islamic banking. In terms of methodology, this study employs the dynamic panel model that is expected to be able to address the research questions. The result of this study demonstrates that both third party fund and financing-to-deposit ratio are proven to be effective in accelerating the Islamic banking asset, as opposed by the non-performing financing ratio that has a negative impact on it. Moreover, it becomes apparent the acceleration of Islamic bank share is heavily dependent upon the real sector growth represented by GDP yet the monetary variables (interest rate and exchange rate) remains the serious problem for Islamic bank to foster the growth. This implies that the real sector is valuable contributor to the share of Islamic bank compare to monetary condition.

1. Introduction

The annually published report, named World Islamic Banking Competitiveness Report, highlighted there has been a considerable growth in the market share of Islamic banking from 2013 to 2014 in six countries, including Qatar, Indonesia, Saudi Arabia, Malaysia, Uni Emirates Arab
and Turkey well known as QISMUT, which stands for each of those six countries being reported. Moreover, such annual report that was also delivered in Global Islamic Banking Conference in Manama, Bahrain asserted that the total asset of Islamic banking operated in six countries accounts for 78 percent of the whole Islamic banking asset in the world, reaching 1.72 trillion US dollars. This number however had increased, if compared with that in 2012 amounted to 1.54 trillion US dollars (World Islamic Banking Competitiveness Report, 2013 and 2014).

Of those six countries, Indonesia has been a country that contributed to the world market share of Islamic banking. It may be due to the fact that there are 240 million people living in this country, known also as the largest Moslem countries in the world since Islam is the religion embraced by, more or less, 80 percent of its population. It is in line with the growth of Islamic banks in Indonesia which has risen dramatically as reported in Statistics of Islamic Banking (2014) which was a monthly report published by Bank Indonesia and later on by Financial Service Authority (OJK). Based on this report, there have been 11 sharia commercial banks, 23 Sharia business unit of conventional banks, 163 sharia rural banks functioning in this country along with 2997 offices; 38.4 percent of asset growth and 95 percent for financing.

Supporting the acceleration of Islamic banking, Bank Indonesia has a grand strategy to increase the market share with six phases of development. Yet the main focus is on the first stage: implementing new vision of Islamic banking development in 2008 which extended understanding about Islamic banks as beyond banking which had targeted asset 50 billion rupiahs and 40 percent growth in asset. Subsequently, the second phase in 2009 has more impressive target than the previous one, making Indonesia Islamic banking as the most attractive in ASEAN by setting the target of its asset up to 87 billion rupiahs and will be increased to 124 billion rupiahs in the third phase with the growth of industry by 81 percent.

Another policy issued by Bank Indonesia was acceleration policy on developing Islamic banking 2007-2008 [Program Akselerasi Pengembangan Bank Syariah (PAPBS)]—seventh of eight phases written in the stage of banking policy 2007. The aim is for achieving the market share of Islamic banking, at the end of 2008, by 5 percent relative to all asset of Indonesian banking. In stark contrast however, the total asset of Islamic banks in Indonesia until 2013 was US$ 20 billion with 4.6 percent share. Hence, the target of Islamic banking growth had not yet be attained.
Table 1.1 Islamic Banking Acceleration

<table>
<thead>
<tr>
<th>No</th>
<th>Country</th>
<th>Times (compared to conventional)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Qatar</td>
<td>1.8 times faster than conventional</td>
</tr>
<tr>
<td>2</td>
<td>Indonesia</td>
<td>3.1</td>
</tr>
<tr>
<td>3</td>
<td>Saudi Arabia</td>
<td>3.6</td>
</tr>
<tr>
<td>4</td>
<td>Malaysia</td>
<td>2.1</td>
</tr>
<tr>
<td>5</td>
<td>Uni Emirate Arab</td>
<td>3</td>
</tr>
<tr>
<td>6</td>
<td>Turkey</td>
<td>1.6</td>
</tr>
</tbody>
</table>


despite the tremendous growth of its asset which was triple that of conventional counterpart, as depicted in table 1.1.

Contrast to Indonesia case, Malaysia has experienced a significant rise in its Islamic banking market share by about 20 percent according to World Islamic Banking Competitiveness Report (2013 and 2014). In terms of growth of market share, Malaysia Islamic bank has doubled if compared with that of conventional side. It is worth noting that Islamic banking in Malaysia has been running since 1983 while Indonesia was left nine years behind. Bank Islam Malaysia Berhard was the first Islamic bank established in Malaysia, which was also the first Islamic bank in Southeast Asia. Until 2014, Malaysia has had 16 banks either national or foreign ownership which will probably be increasing as the ambitious target of Malaysia is to be the centre of global Islamic banking.

Financial system in Malaysia has been rapidly growing to such an extent that may likely boost the real sectors and thus stimulate economic growth. Furqani (2009) argued such a condition can be seen from the infrastructure of Islamic finance in Malaysia, beside the establishment of Islamic bank in 1983 there were institutions of Islamic finance which existed including Islamic insurance (1984), Islamic capital market (1993), Kuala Lumpur Stock Exchange (KLSE) Shaira Index (1999). In 2012, asset of Islamic banks in Malaysia had hit 129 billion US dollars and been expected to rise in 2018 up to 390 billion US dollars with 21 percent compound annual growth rate (CAGR).
If further analyzed by looking again at the data shown in figure 1.1, the development of Indonesia Islamic banking is still far from what has been expected since it contributed 1 percent only to the whole asset of Islamic banking in the world. It was left behind by its neighboring country, Malaysia, which has greater share (8%) of the global Islamic banking. Notwithstanding, both countries are now generally considered by many to be the hub of Islamic finance industry in Southeast Asia region under the dual financial system wherein conventional and Islamic banking system have been run together. The scope of the research on this issue needs to be broadened as financial liberalization, outlined by Sharia Competitiveness Report (2013-2014), is now able to provide Islamic banks around the globe ample opportunity to strengthen close and mutual cooperation to deal with trade as well as to expand the size of strong Islamic finance industry. As a result, the cross-country analysis cannot be ignored when conducting new research on the Islamic banking acceleration. This paper seeks to do so by examining the acceleration of Islamic banking in Malaysia and Indonesia.

It can be argued that Islamic banking acceleration remains an important issue to discuss as the fact explains there have been numbers of literature written to address system implemented, namely dual financial
such an issue by using different variables as a proxy of Islamic banking acceleration. More importantly, those studies had been undertaken not only for Malaysia and Indonesia case but also for other countries such as Jordan and Iran.

As explained extensively by Cleopatra (2008), third party fund has been one of the key factors that may play a key role in supporting the growth of Islamic banking share, represented by total asset. Since third party fund is the essential component of Islamic commercial bank to keep the business lucrative by extending the large amount of money as a financing to the entrepreneurs who are in need of fund. Also, such fund is the essential part of the capital structure of the bank, so that it is very likely that third party fund will be calculated to manage its budget that will be allocated and redistributed by bank to generate targeted profit. The third party fund thus might have positive and significant effect on total asset of Islamic banking as stated also by Abduh, Omar & Duasa (2011) who found the positive relation between third party fund and total asset of Islamic bank in the case of Malaysia.

Other internal bank performance to be assessed in this issue, as has repeatedly been researched, is financing to deposit ratio (FDR). That is defined as a ratio between financing distributed by bank and the deposit collected from the customers. Such a ratio therefore is substantial to see how much the bank allocated its fund for financing; the higher this ratio increases the more likely the bank finances businesses, thereby having a high profit to accumulate its asset. The research by Palupi (2014); Furqani and Mulyany (2009) and Abduh, Omar & Duasa (2011) confirmed this statement highlighting that when financing to deposit ratio rose and that resulted in marked increase in Islamic banking asset. This is in line with the theory stating that financing has become primary activity of bank that may increase the profit and thus acquiring more valuable asset.

Another factor that accounted for total asset of Islamic bank is non performing financing (NPF), defined as a ratio between total non performing financing and total financing. A high NPF will certainly affect the structure capital of the bank because it has to fulfill minimum level required by authority; if such a bad condition happened it might reduce the capital held by bank as it should deal with the authority regulation by, among others, paying extra money. Hence, the bank must keep this ratio low to yield maximum profit. Many previous studies that had been conducted support this hypothesis including Setiadi dan Putri (2011), Palupi (2014), Ahmad dan Noor (2011), and Izhar dan Ausaty (2007).
Nonetheless, macroeconomics condition of the country where the Islamic bank is operated is deemed essential in explaining the growing Islamic banking asset. Some researches argued that inflation (Cleopatra, 2008; Haron, 1996; Mukhtar, 2013; and Abduh, Omar & Duasa, 2011), Gross Domestic Product (Ahmad & Noor, 2014; Al-Oqool, Okab & Bashayreh, 2014; Farahani, Yazdan, Sadr & Hossein, 2012; Azizah & Rizal, 2014; and Anto & Wibowo, 2012), exchange rate (Syakuro, 2014; Abdelloa, Yusoff & Dahalan, 2011), interest rate (Kasri, 2010; Kassim, Majid & Yusof, 2009) served a meaningful role in explaining the Islamic banking acceleration. To begin with, when inflation is high and thus general price soared it is likely that customers will withdraw their money from the bank to fulfill their needs that become more expensive than before. This condition may lead to a adverse consequence that is the profit generated by bank for years will eventually decline, resulting in a substantial decrease in total asset. Such an adverse implication may be experienced also in the case of exchange rate.

Moreover, gross domestic product (GDP) as a common measurement for society welfare has also a tremendous impact on accelerating Islamic banking asset as found by Kasri (2010) in Indonesia and Al-Oqool, Okab & Bashayreh (2014) in Jordan. They threw some light on considerable contribution of GDP towards total asset of Islamic banking. It might be said when GDP increases to a significant extent that can improve the public welfare, the people tend to increase savings by putting more money in bank. As a result there will be additional money to be distributed to acquire profit, to the same extent, asset. Yet, when discussing another macroeconomic variable—which is interest rate, many presumably assumed that there was a negative correlation between interest rate and total asset. Kassim, Majid & Yusof (2009) who undertook the study on Malaysia case stated Islamic bank seemed to be more sensitive to the monetary shock coming from policy rate. This implies that Islamic bank’s depositors seem quite rational regarding the profit they will gain after depositing their money in Islamic bank, therefore depositors tend to withdraw their money and allocate it to conventional one due to an increase in interest rate that may likely offer them higher profit in the near future, as revealed by Kasri (2010).

This research however is designed to fill the gaps of the previous literatures related to: (1) methodology adopted in many studies which has not yet considered the dynamic panel model that may help researcher grasp more comprehensive information about the dynamic
relationships between variables across the countries; and (2) implement that panel model in the case of Malaysia and Indonesia.

Table 2.1 List of Islamic banks

<table>
<thead>
<tr>
<th>Country</th>
<th>Bank</th>
</tr>
</thead>
<tbody>
<tr>
<td>Malaysia</td>
<td>Malaysia CIMB Islamic Bank Berhard</td>
</tr>
<tr>
<td></td>
<td>Maybank Islamic Berhard</td>
</tr>
<tr>
<td></td>
<td>Alliance Islamic Bank Berhard</td>
</tr>
<tr>
<td></td>
<td>RHB Islamic Bank Berhard</td>
</tr>
<tr>
<td>Indonesia</td>
<td>Bank Muamalat Indonesia</td>
</tr>
<tr>
<td></td>
<td>Bank Rakyat Indonesia Syariah</td>
</tr>
<tr>
<td></td>
<td>Bank Nasional Indonesia Syariah</td>
</tr>
<tr>
<td></td>
<td>Bank Mega Syariah</td>
</tr>
</tbody>
</table>

2. Research Methods
2.1 Data characteristics
As this study is aimed at examining the dynamics relationships between macroeconomics and internal performance of many Islamic banks operated in two different countries—Malaysia and Indonesia, bank-level data from Islamic banks in both countries are employed. The Islamic banks whose data are included in the model are as follows:

The data available are compiled from many official publications of Bank Indonesia and Bank Negara Malaysia, besides the financial and progress reports which have regularly been published by all Islamic banks listed in table 2.1. The data on internal condition of Islamic banks and macroeconomic performance of both countries in quarterly basis spanning from 2007Q1 to 2014Q2 are used. This paper therefore uses a strongly balanced panel data which are modeled in panel VAR system based on GMM estimation.

2.2 Panel Vector Autoregressive (PVAR) Model
As said earlier that this study will deploy the dynamic panel, so-called Panel Vector Autoregressive model which basically the extended version of VAR model. While the VAR model can only be used in time series data, PVAR was introduced to deal with the cross-section data given the increasing importance of cross sectional data to be used in analyzing more complex condition of the economy, including banking. Panel VAR model adopted in this study is based on what has extensively been explained by Abrigo & Love (2016) who provided such statistical package to be employed in wider users. This model however is relied heavily on GMM estimation style which was proposed, among others, by Arellano and Bover (1995) to estimate the coefficient of
panel VAR model. The general model of PVAR can be written by the following equation (Abrigo and Love, 2016):

\[ y_{it} = y_{it-1}\alpha_1 + y_{it-2}\alpha_2 \ldots y_{it-p+1}\alpha_{p-1} + y_{it-p}\alpha_p + x_{it}\beta + \mu_i + e_{it} \]

\( i = 1, \ldots, N, t = 1, \ldots T \)

where the dependent variables are denoted by \( y_{it} \) and that is in the form of vector \((1 \times k)\); \( x_{it} \) is \((1 \times l)\) vector of exogenous covariate; both \( \mu_i \) and \( e_{it} \) are \((1 \times k)\) vectors of specific dependent variable panel fixed-effects and errors, respectively. In this study, \( y_{it} \) incorporates many variables encompassing total asset of Islamic banks, non-performing financing, financing-to-deposit ratio as well as macroeconomic condition as represented by GDP, policy rate, exchange rate and inflation. It is expected, by incorporating both internal performance of each bank and macroeconomics into a single model, there will be in-depth information to be elicited regarding the dynamics relation between those variables. Table 3.2 below provides more information about all variables employed in this study.

<table>
<thead>
<tr>
<th>Data</th>
<th>Symbol</th>
<th>Unit</th>
<th>Source</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Macro condition</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>• Gross Domestic Product</td>
<td>( g )</td>
<td>Log scale</td>
<td>Bank Indonesia</td>
</tr>
<tr>
<td>• Exchange rate</td>
<td>( ex )</td>
<td>Log scale</td>
<td>Bank Negara Malaysia</td>
</tr>
<tr>
<td>• Policy rate</td>
<td>( r )</td>
<td>Percentage</td>
<td></td>
</tr>
<tr>
<td><strong>Bank performance</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>• Total Asset</td>
<td>( ast )</td>
<td>Log scale</td>
<td>Annual Report of Islamic Banks</td>
</tr>
<tr>
<td>• Financing-to-deposit ratio</td>
<td>( fdr )</td>
<td>Percentage</td>
<td></td>
</tr>
<tr>
<td>• Non-performing financing</td>
<td>( npf )</td>
<td>Percentage</td>
<td></td>
</tr>
<tr>
<td>• Third party fund</td>
<td>( dpk )</td>
<td>Log scale</td>
<td></td>
</tr>
</tbody>
</table>

3. **Results and Analysis**

3.1 **Preliminary Test**

Before discussing empirical result of this study, several initial tests have to be undertaken so as to assess the robustness of both data and PVAR model: the first test is unit root test aimed to decide whether all data used are stationary. This test is based on panel ADF-Fisher test. **Second**, following Andrews and Lu (2001) as suggested by Abrigo and Love (2016), the lag selection is conducted to obtain the selected lag to be applied in the model by looking at the smallest number of moment and model selection criteria (MMSC) for GMM estimation as well as MBIC (Bayesian) and
MQIC. Third, after lag-order is selected which is also be utilized to examine whether the panel VAR model is stable. Table 3.1 below provides the information about the unit root test based on ADF Fisher test. The result demonstrate that all variables that will be used in the model are stationary, indicating the eligibility of data to be proceeded to the dynamic panel model.

Table 3.1 Panel Unit Root test

<table>
<thead>
<tr>
<th>Variable</th>
<th>ADF-Fisher Chi Square</th>
<th>Prob.</th>
</tr>
</thead>
<tbody>
<tr>
<td>GDP</td>
<td>250.877</td>
<td>0.0000</td>
</tr>
<tr>
<td>Exchange rate</td>
<td>135.6507</td>
<td>0.0000</td>
</tr>
<tr>
<td>Policy rate</td>
<td>30.6317</td>
<td>0.0150</td>
</tr>
<tr>
<td>Asset</td>
<td>102.1844</td>
<td>0.0000</td>
</tr>
<tr>
<td>NPF</td>
<td>49.5999</td>
<td>0.0000</td>
</tr>
<tr>
<td>FDR</td>
<td>69.3993</td>
<td>0.0000</td>
</tr>
<tr>
<td>DPK</td>
<td>130.908</td>
<td>0.0000</td>
</tr>
</tbody>
</table>

Beside panel unit root test, it is also necessary to examine whether panel VAR model is stable, as commonly applied in its time-series model. The model is considered stable when all Eigenvalues lie inside the unit circle, otherwise it seems that the does not satisfy the stability condition. By looking at the figure 3.1 below, it is apparent that the model used in this study is proven to be in required condition, the estimation results thus can be interpreted.

Figure 3.1 PVAR Stability
3.2 PVAR Analysis

This section provides the main results of this study, demonstrating several dynamics relationship between macroeconomic condition and Islamic bank performance. Hence, the explanation will be divided into two sections; it first addresses about likely relation between bank condition and Islamic banking asset in two biggest countries which have had so far thriving Islamic finance industry, namely Malaysia and Indonesia. Secondly, it highlights whether macroeconomic performance of each country has noticeable impact on the Islamic banking acceleration, as seen from its total asset.

From the result of internal bank condition, it is apparent that third party fund has significantly positive impact on total asset of Islamic bank as can be viewed from PVAR based on GMM estimation (see Appendix 2). This indicates there is a profound relation between Islamic bank asset (logast) and third party fund (logdpk), implying that the Islamic bank acceleration can effectively be boosted by collecting more and more funding from society, in the context of Malaysia and Indonesia this can be done by encouraging every community in both nations—not restricted to Moslem—to save their money in Islamic bank. This is also in line with Impulse Response Function which demonstrates clearly that the shock from Islamic bank third party fund is responded positively by total asset (see figure 3.2). IRF presents the similar result compared to estimation model counterpart, indicating the robust model.

Based on such a result, it appears likely that the asset of Islamic bank is very dependent on third party fund therefore if there is a marked increase in third party fund it will subsequently be followed by a rise in total asset. Third party fund, beside the capital invested by investors, lending and other asset structure, is one of structures necessary in Islamic bank. As a consequence, it can be the main determinant for bank to maintain its liquidity to fulfill the short term liability, in accordance with the rule imposed by Bank Indonesia relating to this matter. The good liquidity condition therefore must be maintained and achieved since one of main sources of crisis is liquidity. The result of this study supports the previous researches by Cleopatra (2008) and Mukhtar and Setiadi (2013) which stated there was a close and positive relation between third party fund and total asset.
The next research question to be answered is whether the relation between finance-to-deposit ratio \((fdr)\) and total asset \((log_{ast})\) is positive and significant as the effect which exists in third party fund. The estimation model demonstrates that the positive impact of finance-to-deposit ratio on acceleration of Islamic bank total asset (represented by total asset \(log_{ast}\)), while in fact impact of \(fdr\) is less strong compared to that of third party fund as revealed in the estimation result of panel VAR model with the coefficient 0.287 and 0.00034, respectively. IRF also presents the consistent pattern as the PVAR estimation has regarding the effect of \(fdr\); the response of financing-to-deposit ratio is positive towards the shocks emanating from this ratio and is increasing substantially in the beginning of fifth quarter (see figure 3.2).

Based on aforementioned effect of \(fdr\), it can be argued that as \(fdr\) is the ratio between the financing extended by Islamic bank and total deposit—it should be noted also that the majority of banking fund was generated from deposit including third party fund—this ratio is likely to have a positive and significant effect on total bank asset. Such a ratio is highly prominent to measure the intermediary function performed by bank; the more the ratio increases the bigger the
total asset will be. This may due to the enormous profit gained from extending financing to the society both individual or corporation that can probably be spent to have more total asset. Conversely, it may be terrible for Islamic bank to have low fdr because the primary income of the bank generates from the bank’s financing. This result is in line with the previous studies by Khoiriyah (2011), Setiawan dan Putri (2013), Paluppi (2014) Furqani and Mulyany (2009) and Abduh, Omar & Duasa (2011) who found a similar result in the case of financing-to-deposit ratio.

Another internal bank performance to be tested is non performing financing ratio (npf) which is assumed to be negative since the adverse effect of npf for the bank may certainly reduce the total income as determined before, thereby affecting the structure of modal. The result of this study demonstrates the similar pattern, showing the negative and significant effect of non performing financing ratio on total asset as can be seen from both estimation model (see Appendix 2) and Impulse Response Function (see figure 3.2). From the estimation result, it is shown that negative and significant relation between non-performing financing and total asset of Islamic bank actually exist with the coefficient -0.00493, while IRF appears to support the estimation result. The response of total asset is negative towards npf shocks, attaining its lowest level at the third quarter and tending to stabilize after seventh period. This implies that the rise in non-performing ratio may result in a sharp decrease in total asset as revealed in figure 3.2 above.

This result is basically in line with the previous studies by Mukhtar (2013) dan Cleopatra (2008) who explained npf may bring about the bad effect on total asset of Islamic bank in Indonesia. In practice however this is the case for banking system including Islamic bank due to contagious effect of npf on modal structure that make bank fulfill provision for loan losses [Penyisihan Penghapusan Aktiva Produktif] set by the regulator, which in fact such fund can be extended again to yield more profit.

Turning to dynamics relationship between macroeconomic shocks as represented here by GDP (real sector), interest rate and exchange rate (monetary sector) and Islamic bank total asset. It is evident that GDP shocks is responded positively by the total asset reaching a peak in the third quarter, and followed by slight decline (but still positive) (see figure 3.3). This implies that the GDP contributes enormously to total asset. A similar result occurs also in estimation model which has positive coefficient (0.497).
This result is confirmed by many previous literatures that have discussed the positive effect of GDP as society welfare indicator on total asset of Islamic bank, among others, Ahmad & Noor, 2014; Al-Oqool, Okab & Bashayreh, 2014; Farahani, Yazdan, Sadr & Hossein, 2012; Azizah & Rizal, 2014; and Anto & Wibowo, 2012. Such positive relation may be explained as follows: when the people have more money than before (reflected from GDP), it will rise the probability of the people to save their money in bank account thereby inducing an increasing in total asset. In this context, bank can perform a substantial role to distribute the fund to more productive investment, for instance, in the form of financing (Farahani, Yazdan, Sadr & Hossein, 2012). This financing will probably bring about an increase in Islamic bank profitability both in the short and long run (Al-Oqool, Okab & Bashayreh, 2014).

In stark contrast however, there is a negative and significant relation between monetary instruments—both policy rate (Central Bank) and exchange rate—and total asset. The estimation result proves such relation among both as it has a negative coefficient (-0.0277). Also, IRF
reveals the similar output: the response of total bank asset is negative to the shocks from the interest rate, as illustrated by the gradual decline of total asset from the first quarter to 10th period owing to the interest rate shock. This indicates that the policy rate may affect the total asset of Islamic bank, implying when policy rate is increasing the total asset seems to be decreasing. This can be happening because, as suggested by Kasri (2010), Islamic bank customers were rational regarding the profit they may gain from putting their money in Islamic bank, hence they tend to withdraw their money from Islamic bank when the interest rate in conventional counterpart, which is based on policy rate, is rising expecting to earn more profit by doing so. This strengthens the previous fact about the negative effect of interest rate in the case of Malaysia as extensively explained by Kassim, Majid & Yusof (2009) who argued that Islamic bank in Malaysia appeared to have great sensitivity to the interest rate.

As for exchange rate impact on total bank asset, it is apparent from the result of both estimation model and IRF that the response of total bank asset towards the exchange rate fluctuation is very similar compared to what was illustrated in the impact of interest rate yet the magnitude of that response is somewhat different: the response of total asset is higher when dealing with exchange rate shock ($\Delta e$) than interest rate shock ($r$) as proven from the coefficient (-0.223) and the degree of total asset response (see figure 3.3). This condition can probably persist as the financial liberalization has enabled financial institution—including Islamic bank—to engage more with international activities encompassing, as explained by Widodo and Agustiyani (2017), foreign currency financing significantly extended by several Islamic banks such as Bank Syariah Mandiri (47.83% contribution), Bank Mumalat Indonesia (47.08%) dan BNI Syariah (5.09%). Given such a financial environment, the total asset of Islamic bank therefore can be affected by the exchange rate; when exchange rate (IDR rupiah against US dollar) depreciates it seems to be followed by a decrease in total asset of Islamic bank.

4. Conclusion

Employing the dynamic panel model to capture the recent development of Islamic bank, this study is able to grasp more dynamic information by addressing the research question. First, it deals with the relation between the internal bank performance and total asset. Both third party fund and financing-to-deposit ratio are proven to be effective in accelerating the Islamic banking asset, as opposed by the non-performing financing ratio that has
a negative impact on it. Based on this result, it is worth noting that Islamic bank should pay special attention to third party fund collected from the society and at the same time to hamper non-performing financing ratio so as to spur the growth of Islamic bank asset.

Second, it focuses on the dynamic relation between macroeconomic condition (real and monetary aspect) and total asset. The result suggests that the acceleration of Islamic bank share is heavily dependent upon the real sector growth represented by GDP yet the monetary variables (interest rate and exchange rate) remains the serious problem for Islamic bank to foster the growth. This implies that the real sector is valuable contributor to the share of Islamic bank compare to monetary condition. However, Islamic bank should consider seriously the recent monetary condition to maintain total asset since when interest rate and exchange rate are in bad performance it may certainly prevent bank asset to grow rapidly.

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