The Effect of Monetary Instrument of Islamic Banking Financing Channel

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Submission date: 18-Nov-2021 07:35PM (UTC+0700)
Submission ID: 1706525998
File name: Paper_JESP_UMY.docx (67.04K)
Word count: 5137
Character count: 28522

The Effect of Monetary Instrument of Islamic Banking Financing Channel Towards The Economic Growth In Indonesia

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ABSTRACT

Monetary policy is closely related to economic activities in its effort for the achievement of economic growth which eventually give welfare for the community. In order to transmit the monetary policy in the real sector, Bank Indonesia as the monetary authority establishes Islamic Certificate of Bank Indonesia / Sertifikat Bank Indonesia Syariah (SBIS) as an instrument through Islamic open market operation. One of the channels for monetary transmission is through financial channel by transmitting fund from Islamic banking through finance. The aims of this study are to analyze the description of transmission flow of financing channel, the effect of monetary policy instrument as well as its effectivity to achieve the final target. The variables used in this study are Islamic Banking Finance (FIN), return of SBIS, return of PUAS and Industrial Production Index (IPI) as the proxy of economic growth. This study used quantitative associative method using Vector Error Correction Model (VECM) analysis instrument. The result of the study showed that, first, based on Granger Causality test, the transmission flow could not be identified clearly, because the flow stopped in FIN and it could not effect IPI. Second, the result of VECM estimation showed that all variables only affected on long term period and did not affect the short-term period. Third, monetary policy transmission of Islamic banking financing channel was not effective enough, which was proven with the result of IRF simulation which showed that the effect of shock on financing channel variable (FIN) towards IPI was subsided and stable on period 10. Meanwhile, the result of FEVD simulation showed that

financing channel variable (FIN) only gave contribution as much as 0.14 percent towards IPI.

Key Word: Islamic Monetary Instrument, Islamic Banking Financing Channel, Economic Growth, Vector Error Correction Model (VECM).

Introduction

The role of the Government in achieving public welfare in a country is illustrated by the rate of economic growth, one of which is through the Central Bank. Bank Indonesia (BI) as the central bank in Indonesia, always tries to maintain exchange rate stability as the ultimate goal by regulating the money supply (Johari, 2014). Since the enactment of the Central Bank Act in Indonesia No. 23 of 1999, Indonesia became one of the countries that implemented a dual banking system, namely conventional banks and Islamic banks (Islamic Banks), with the aim of increasing financing capacity for the national economic sector. To achieve this goal, it is necessary to have a central bank policy that regulates the economy in the aggregate, one of which is through monetary policy.

As stated in the Law in Indonesia No. 3 of 2004 article 7 on monetary policy. In this context, the monetary sector must be linked to the real sector. Where the purpose of monetary control in Islam is able to achieve Full Employment conditions, a condition where property is disinfected between the financial sector and the real sector to achieve public welfare (Biancone & Radwan, 2018).

Monetary policy in Indonesia aims to achieve and maintain rupiah exchange rate stability. "The stability of the value of the rupiah is closely related to the amount of money circulating in the community" (Hapsari, 2013). To that end, the government through the Central Bank created several sharia monetary instruments, one of which was the Bank Indonesia Wadiah Certificate (SWBI) in 2000. It was later replaced with a Sharia Bank Indonesia Certificate (SBIS) since 2008. The steps taken by BI to achieve this goal are: by transforming it through six channels, such as interest rates, credit, asset prices, balance of payments, exchange rates, and inflation expectations. The closest transmission line and strong linkage with the real sector is through credit or bank financing. (Bernanke, 1995).

The illustration above shows the magnitude of the influence of monetary policy on various economic and financial activities. This is not surprising because the monetary policy adopted by BI is to influence and direct various economic and financial activities to the goal to be achieved, namely price stability while taking into account economic growth.

The problem of the monetary policy transmission mechanism is increasing, from time lag to alternative solutions using the Dual Monetary System, such as the sharia banking financing line as a complement to the banking credit line. Since the implementation of the Dual Monetary System in Indonesia as regulated in Bank Indonesia Law Number 3 of 2004, it is stated that Bank Indonesia is obliged to carry out double monetary operations using fees based on Bank Indonesia Syariah certificates (SBIS) as instruments for the sharia system.

Bank Indonesia (BI) has dual authority, therefore the transmission of monetary policy does not only have an impact on conventional banking, but also has an impact on Islamic banking. Banking is expected to be the main instrument in achieving economic goals. The role of Islamic banking in moving the real sector can be seen from the financing side.

In line with the results of research by Ayuniyyah (2010), Wulandari (2014) and Rifky and Karsinah (2016), explaining that increasing Islamic banking financing is expected to encourage growth in the real sector. This is reinforced by the results of Ascarya's research (2012) which states that the contract of respect and sharing of losses (Mudharabah and Musyarakah) in Islamic banking has a positive effect on the output of the real sector. Because the purpose of Islamic economic activity is to support productive activities, assist the community in accumulating capital, and distributing wealth to achieve prosperity for all. Therefore, the transmission of dual monetary policy through the Islamic banking financing channel is important to study.

This study will analyze the flow of the transmission mechanism of Islamic monetary policy through the financing channel in influencing economic growth, the influence of the monetary instrument of the Islamic banking financing channel on economic growth in Indonesia and analyze the effectiveness of the monetary instrument of the Islamic banking financing channel affect economic growth in Indonesia.

2. Theoretical Framework

2.1. Monetary policy transmission mechanism

The monetary policy transmission mechanism (MTKM) is the path that a monetary policy passes through to influence the final goal of national monetary policy and inflation. According to LAW No. 23 year 1999 about Bank Indonesia, “monetary policy is: policies established and implemented by Bank Indonesia to achieve and maintain stability in the

value of the rupiah, which are carried out among others through controlling the money supply and/or interest rates."

While in the Islamic Monetary management policy is the stability of demand for money and directs it to an important objective that is productive activities. Therefore, any instrument that leads to instability and allocating unproductive sources of funds will be abandoned. The goal is to ensure the appropriate monetary expansion, but is sufficiently capable of producing adequate growth and can result in equitable welfare for the community. The target growth rate must be continuity, realistic, and long term. Tahapan Transmisi Moneter.

The process of transmitting monetary policy is not separated from the interaction between the monetary authorities which is the central bank with the national banking and other financial institutions as well as economic actors in the real sector. This interaction is conducted through two stages, first, the interaction between the central bank and the banking and other financial institutions in various financial transactions. Second, interaction relating to the function of intermediation, namely the interaction between banking and other financial institutions with the economic actors in the activities in the real economic sector.

2.2. **Indicators of the Effectiveness of the Monetary Policy Transmission Mechanism**

The effectiveness of the Monetary Policy Transmission Mechanism (MTKM) can be measured by two indicators,

a. What is the speed in the grace period (time lag); The speed indicator is measured by the amount of time lag required by the variables in a path to respond to the shock of policy instruments until the intermediate and final targets are achieved.
b. The strength of the variables in the monetary transmission line in response to the BI rate shock until the final target is realized.

2.3. **Sharia Interbank Money Market and Bank Indonesia Sharia Certificate**

Sharia Interbank Money Market, hereinafter abbreviated as PUAS, is an interbank short-term (less than one year) financial transaction activity based on sharia principles, both in rupiah and foreign currency. In order to support the task of establishing and implementing monetary policy, Bank Indonesia as the central bank conducts monetary control through the open market operations based on Sharia principles (OPTS). BI has the authority in establishing the OPT-in instruments used. Therefore, BI needs to issue Bank Indonesia Sharia certificate (SBIS) as one of open market operating instruments conducted based on

sharia principles. SBIS is a Bank certificate in rupiah currency issued by Bank Indonesia Short term based on sharia principles.

2.4. Economic Growth

Economic growth is the process of increasing the real national income in the long term. According to Schumpeter, stating that the main source of output of a country is not sourced from its economic growth alone, but rather the increase in output sourced from economic development (Boediono, 1982). One variable that can be used as a proxy to measure the economic growth of a country, namely Industrial Production Index (IPI). IPI is the name of an economic indicator that calculates the real production output of the manufacturing, mining and other manufacturing sectors such as oil and gas and electricity.

2.5. Sharia Banking Financing

Financing (Financing) is one of the main tasks of the bank, which is to provide a provision of funds to meet the needs of the parties who are the deficit unit. Sharia bank financing has a very important role in the economic pace. In general, financing has the function to increase the usability of money, the use of goods, the circulation of money, generate excitement in trying, economic stability and as a bridge to increase national income(Biancone & Radwan, 2018).

Hypothesis

H1: Monetary transmission of Sharia banking financing line has a clear flow.

H2: Monetary instrument of Sharia banking financing line has long-term influence on economic growth in Indonesia.

H3: Islamic banking Financing Line's monetary instrument promotes economic growth in Indonesia.

3. Method

This type of research uses quantitative methods using statistical methods. This research is an associative research that aims to determine the influence or relationship between two or more variables. In this study, the technique used in data collection is documentation technique. Documentation is research that is sourced from papers, such as books, magazines, documents, regulations, research journals, websites and so on related to the object of research.

The data used in this study is secondary data, in the form of time series data with a monthly scale, namely the period January 2012 to December 2019 or as many as 96 samples. Data were obtained from the Financial Services Authority (OJK), Bank Indonesia Economic and Banking Statistics (SEKI-BI), Bank Indonesia Sharia Banking Statistics (SPS-BI) and the Central Bureau of Statistics (BPS).

3.1. Operational Definition of Research Variables

The variables used in this study are as follows:

a. SBIS is a short term SBIS return in rupiah currency issued by Bank Indonesia. The data used is SBIS return rate data for the monthly period from January 2012 to December 2019 obtained from BI Sharia Banking Statistics (SPS-BI)
b. PUAS is the monthly rate of return on the Islamic Interbank Money Market (PUAS) from January 2012 to December 2019 obtained from Bank Indonesia's Economic and Banking Statistics (SEKI BI).
c. FIN is the total financing provided to third parties by the Islamic banking industry for the monthly period from January 2013 to December 2020 obtained from Bank Indonesia's Economic and Banking Statistics (SEKI BI).
d. IPI is a monthly production index of Large and Medium Industries as a proxy for economic growth in Indonesia for the monthly period from January 2012 to December 2019 obtained from the Central Statistics Agency (BPS).

3.2 Research Model

To determine the effect of Islamic monetary instruments on financing in Islamic banking in Indonesia, this study will use the variables of Islamic banking financing data (FIN), SBIS data, PUAS data and Industrial Production Index (IPI) data. All variables involved in this study were formulated in the VECM model. Vector Error Correction Model (VECM) is carried out if there are variables that are stationary at first different, contain unit roots and are cointegrated (Rosadi, 2011). By using the VECM method, long-term and short-term impacts are obtained. In addition, VECM is used to see a certain level of change with the analysis of Impulse Respond Function and Variance Decomposition.

The model can be described as follows:

$x_t = \mu_i + \sum_{i=1}^{k} A_i + X_{t-1} + \varepsilon_i$ ..... (1)

$\Delta x_{t-1} = \mu_i + \prod x_{t-1} + \sum_{i=1}^{k-1} \Gamma_i \Delta x_{t-1} + \varepsilon_i$ ..... (2)

$IPI_t = \beta_0 + \alpha_{1i} + \sum_{n-1} SBIS_{t-k} + a_{1i} + \sum_{n-1} PUAS_{t-k} + a_{1i} + \sum_{n-1} FIN_{t-k} + a_{1i} + \varepsilon_i$

..... (3)

IPI_t = Endogenous Variables

β_0 = Constant

α_{1i} = Variable lag coefficient for the i-th equation

$SBIS_{t-k}$, $PUAS_{t-k}$, dan FIN_{t-k} = Variable equation

ε_i = Vektor *error term*

4. Result and Analysis

Before estimating VAR/VECM, this study went through several stages of pre-estimation tests:

Stationary Test

Table 2. Stationary Test

Variabel	Level		First Difference	
	ADF-Statistik	Critical Values (5%)	ADF-Statistik	Critical Values (5%)
LIPI	-2.288544	-2.892200	-11.24047*	-2.892536
LFIN	-1.487506	-2.892879	-3.310538*	-2.892879
PUAS	-1.661708	-2.892536	-13.66648*	-2.892536
SBIS	-3.631214*	-2.892536	-7.007628*	-2.892879

* Stationary on a real level 5 percent

Test to find out time series data has a unit root (not stationary) or not. Non-stationary data will also produce spurious regression, namely a regression that describes the relationship between two or more variables that looks statistically significant, when in fact it is not. This stationary test was carried out using the Augmented Dickey Fuller (ADF) root test using a 5 percent significance level (Widarjono, 2013).

From Table 2 above, it is found that of the four variables, only the SBIS variable is stationary at the level, while the IPI, FIN and PUAS variables are not stationary. So the VAR model needs to be checked for stationarity at the first difference level. At the first difference level, it is found that all variables are stationary, meaning that these variables already have a consistent mean and variance.

Optimum Lag Test

In VAR, determining the optimal lag is very important because determining the optimal lag is useful for eliminating autocorrelation problems in a VAR system. If the optimal lag is entered too short, it is feared that it cannot explain the overall dynamics of the model. However, a lag that is too long will also result in an inefficient estimation due to the reduced degree of freedom (Basuki, 2015). Determination of optimal lag is also useful to show how long the reaction of a variable to other variables. Order or lag was selected based on the Akaike Information Criterion (AIC), Schwarz Information Criterion (SC) and Hannan Quinnon (HQ) criteria. The selected lag is the model with the smallest value of AIC and SC, and the largest value of HQ (Gujarati, 2010).

Table 3
Optimum Lag Test Results

Lag	LogL	LR	FPE	AIC	SC	HQ
0	-197.6655	NA	0.001038	4.481456	4.592559	4.526259
1	343.7739	1022.719	8.82e-09	-7.194975	-6.639462*	-6.970960
2	370.1166	47.41696*	7.03e-09*	-7.424814*	-6.424890	-7.021586*
3	382.1814	20.64415	7.71e-09	-7.337364	-5.893030	-6.754924
4	394.5734	20.10263	8.44e-09	-7.257187	-5.368442	-6.495534
5	401.5255	10.65989	1.05e-08	-7.056123	-4.722967	-6.115258
6	419.6223	26.13976	1.03e-08	-7.102718	-4.325151	-5.982640

* Smallest value (indicates selected lag)

Determination of the optimal lag used in this study is based on the smallest lag using the Akaike Information Criterion (AIC). Based on the results of the optimum lag test contained in Table 4.2 that the optimum equation model is in the second lag (2).

VAR Stability Test:

Table 4
VAR Stability Test Results

Root	Modulus
0.981387	0.981387
0.949178	0.949178
0.754538	0.754538
0.419807 - 0.255069i	0.491221
0.419807 + 0.255069i	0.491221
-0.311356	0.311356
-0.061034 - 0.074160i	0.096047
-0.061034 + 0.074160i	0.096047

Source: Output Data

The stability of VAR can be seen from the value of the inverse roots characteristic of the AR polynomial. The VAR system is said to be stable if all the roots in the AR roots table have a modulus less than one (1) and all of them lie within the unit circle

Based on the results of the VAR stability test above, it can be concluded that the estimated VAR to be used for IRF and FEVD analysis is stable at its optimal lag, because the tested unit has a modulus range of less than one, which ranges from 0.096047-0.981387.

Granger Causality Test

Causality test is conducted to determine whether an endogenous variable can be treated as an exogenous variable. This stems from ignorance of the influence between variables. If there are two variables y and z, then whether y causes z or z causes y or applies both or not both (Basuki, 2015). The causality test in this study was carried out using Granger causality and error correction of the causality model. In this study, the Granger causality method was used to test the causal relationship between two variables. Impulse Respond Function (IRF).

Estimation of the Impulse Response Function (IRF) was carried out to see the shock response of the innovation variable to other variables. In addition, this method aims to see how long the shock of one variable affects other variables (Rusydiana, 2009).

Table 5.
Results of a Granger Causality Test

Hipotesis	Probability	Kesimpulan
IPI does not *Granger* Cause FIN	0.0015	IPI → FIN
SBIS does not *Granger* Cause FIN	0.0002	SBIS →FIN
PUAS does not *Granger* Cause FIN	1.E-05	PUAS →FIN
PUAS does not *Granger* Cause SBIS	7.E-05*	PUAS → SBIS
SBIS does not *Granger* Cause PUAS	0.0391*	SBIS → PUAS

* Have causal relationship between variables
Source: Data Output

Based on the results of the Granger causality test in this research model, it can be seen that a one-way relationship occurs in the variables SBIS with FIN, PUAS with FIN and IPI with FIN. While a two-way relationship (cause and effect) occurs between the SBIS variable and PUAS.

Johansen Cointegration Test

If the data that has been observed in the unit root test is not stationary, then the next step is to perform a cointegration test. Cointegration is a long-term relationship between non-stationary variables that will become stationary if the variables are combined linearly. If there is cointegration in the variables, it can be ascertained that there is a long-term relationship between the variables. Cointegration test was carried out using the Johansen's Cointegration Test method.

Table 6
Johansen Cointegration Test Results

Unrestricted Cointegration Rank Test (Trace)				
Hypothesized No. of CE (s)	**Eigenvalue**	**Trace Statistic**	**0.05 Critical Value**	**Prob.****
None *	0.571669	118.2101	47.85613	0.0000
At most 1 *	0.207146	39.35925	29.79707	0.0030
At most 2*	0.152321	17.77243	15.49471	0.0223
At most 3	0.025517	2.403929	3.841466	0.1210

* Cointegrated

Source: Data Output

Cointegration test results based on the trace statistics above show that the model has 3 (three) cointegrated ranks at a five percent significance level. Thus, the results of the integration test indicate that the IPI, FIN, SBIS and PUAS movements have a relationship of stability or balance and similarity of movements in the long term.

Uji Estimasi VECM

Table 7
VECM Short Term Estimates Results

Jangka Pendek		
Variabel	**Koefisien**	**t-Statistik**
CointEq1	0.000428	0.53769
D(LIPI(-1))	-0.158889	-1.45739
D(LIPI(-2))	-0.170790	-1.56294
D(SBIS(-1))	0.007840	1.01590
D(SBIS(-2))	0.003587	0.47771
D(PUAS(-1))	-0.006719	-0.66646
D(PUAS(-2))	-0.017371	-1.94410
D(LFIN(-1))	-0.251611	-0.74038
D(LFIN(-2))	0.306392	0.84528
C	-0. 001391	-0.16058

* Significant real-level five percent
source: data Output

From the results of the short-term VECM estimation test in table 4.6, it does not explain the relationship in the short term, because there are no variables that significantly affect economic growth. This happens because the model in this study is a monetary transmission model, so that a variable takes time or lag to react to other variables so that generally the reaction of a variable to other variables occurs in the long run.

Table 8
Long-term VECM consensus estimates

Jangka Panjang		
Variabel	**Koefisien**	**t-Statistik**
SBIS(-1)	-0.970091	-10.1676*
PUAS(-1)	1.110815	8.38526*
LFIN(-1)	0.372269	2.46028*

* Significantly on real levels five percent
Source: Data Output

Based on the table above, the only variable that has a negative effect on economic growth is SBIS, while the PUAS and FIN variables have a positive effect.

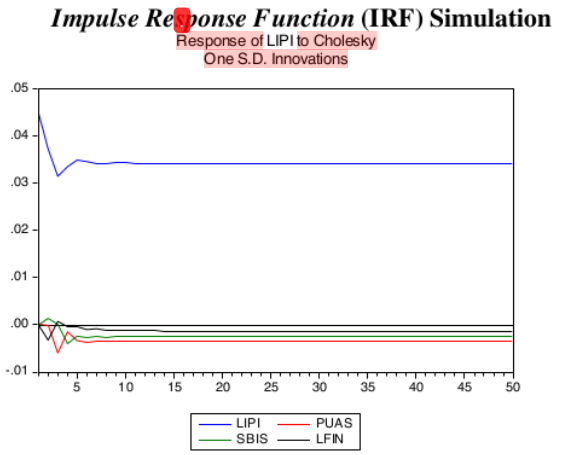


Figure 2
Impulse IPI response to other variables

In this case the author uses a period of up to a period of 50 or equal to the next 50 months. While the vertical axis shows changes in IPI due to shock of certain variables, where this change is expressed in standard deviation units (SD). Overall, IPI's response to the shock of monetary instruments, namely SBIS and PUAS, stabilized more quickly than the shock of the FIN variable. Where the fastest stability point occurs when there is a shock

to the SBIS variable in period 7 and the longest response is given when there is a shock to the FIN variable, which is period 10.

Simulasi *Forecast Error Variance Decomposition* (FEVD)

Forecast Error Variance Decomposition is a method used to see how changes in a variable indicated by changes in error variance are affected by other variables. This analysis is used to calculate how big the influence of random shocks from certain variables to endogenous variables. With this method we can see the strengths and advantages of each variable in influencing other variables over a long period of time (Basuki, 2015).

Table 9

FEVD test result for IPI

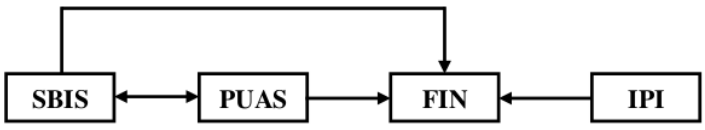
Variance Decomposition of LIPI					
Periode	S.E.	LIPI	SBIS	PUAS	FIN
1	0.044975	100.0000	0.000000	0.000000	0.000000
5	0.082701	98.78877	0.679637	0.370092	0.161498
10	0.113321	98.58467	1.049785	0.239560	0.125987
15	0.137200	98.51710	1.165718	0.190523	0.126663
20	0.157497	98.48058	1.223649	0.164843	0.130927
25	0.175460	98.45783	1.258558	0.149080	0.134528
30	0.191747	98.44238	1.281980	0.138430	0.137212
35	0.206755	98.43122	1.298815	0.130755	0.139213
40	0.220745	98.42279	1.311508	0.124964	0.140740
45	0.233900	98.41620	1.321423	0.120438	0.141938
50	**0.246354**	**98.41091**	**1.329384**	**0.116804**	**0.142901**

Source: Data Output

Overall, the variables SBIS, PUAS and FIN only have a very small contribution to the variability of economic growth, which is only 1.59 percent. The contribution of Islamic monetary instruments in influencing output growth is still small, so changes in SBIS returns have not been able to have a real impact on changes in output.

5. Discussions

Transmissive Monetary Policy Transmission of Sharia Banking Financing Line



(Source: Results of Granger Causality Test, Processed)

Figure 3
The Transmission Mechanism of Sharia Monetary Policy Financing Line

From the results of the Granger Causality test, overall it can be seen that the transmission path of Islamic monetary policy cannot be clearly identified. This shows that changes in the rate of return on the monetary controlling variable (SBIS) have an effect on PUAS returns. This is in accordance with the theory that if there is an increase in yields on SBIS, in general it will also be followed by an increase in PUAS yields. Then the level of return on PUAS also affects changes in the volume of financing disbursed by Islamic banking (FIN), but FIN has not been able to influence the final destination, namely output or IPI. This is in accordance with the behavior of banks that look first at the condition of the domestic economy before distributing financing for entrepreneurs or the public, namely adverse selection, as one of the banking efforts to reduce financing risk by being more careful in distributing financing.

The results of this study are in line with Daniar (2016) and Ascarya (2010 and 2012), which state that the flow of the transmission mechanism of Islamic monetary policy is not able to influence economic growth. The results of Daniar's research show that the flow stops at financing while the results of Ascarya's research show that the transmission line stops at PUAS.

Influence of monetary variable Sharia banking financing line on Indonesian economic growth

Based on the results of the VECM estimation test, the estimation results do not explain the existence of a relationship in the short term. So that there are no variables that significantly affect economic growth in Indonesia. This happens because the model in this study is a monetary transmission model. However, the VECM estimation results show that all variables have a long-term effect on economic growth.

Effectiveness of Sharia Transmission Mechanism Through Sharia Banking Financing Line

From the results of this research can be concluded that the mechanism of transmission of monetary policy through financing lines is less effective. It can be analyzed based on IPI response rate against FIN variable shock and FIN contribution to IPI. The time span required by the IPI variable to respond to the presence of FIN variable changes to achieve a balanced condition is 10 months. However, FIN has a relatively small contribution of only 0.14 percent. Thus, the Sharia banking financing line has not yet contributed to economic growth. In addition, Islamic monetary policy objectives are the benchmark of the effective monetary policy transmission line in achieving the final target, one of which is economic growth, but apparently this goal cannot be achieved due to the transmission flow Just stop until financing.

6. Conclusions

Based on the results of the analysis and discussion of the research above, the following conclusions can be drawn:

a. Based on the Granger causality test, the transmission path of monetary policy in the Islamic banking financing channel has not been clearly identified and is interrupted in the FIN. However, monetary transmission through the financing channel has a positive effect on real sector output.

b. From the VECM estimation results, it shows that the SBIS, PUAS and FIN variables only affect the long term and have no effect on the short term. This is because the variables used are monetary variables that require a grace period or time lag to be able to influence the final target.

c. Based on the IRF and FEVD simulations, the transmission mechanism in the Islamic banking financing channel has proven to be less effective. Shocks in the financing channel variable (FIN) to IPI, subsided and stabilized in a period of less than one year, namely period 10. Meanwhile, in terms of the amount of its contribution, the financing variable (FIN) only had a very small contribution in encouraging economic growth, which was 0.14 percent.

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