Research Article

Islamic Bank and Economic Growth in the World

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Abstract: This research has purpose to analyze (i) the influence of oil prices, profitability and banks deposit on Islamic banks growth. (ii) the influence of Islamic banks growth on economic growth. The data for this study were collected from secondary data of the 105 Islamic banks from 24 countries. This research was conducted with the period of 10 years from 2007 to 2016, therefore this method using panel data regression. The result of panel data regression with fixed effect model consisted of the variable of oil prices, profitability, bank deposit have a significant positive effect on Islamic banks growth. The other results of panel data regression with fixed effect model consisted of the variable of islamic banks growth have a significant positive effect on economic growth. The results of this study consistent with the results of previous research. This means that the high growth of Islamic banking can increase a country's economic growth. This study gives results that can be used as reinforcement from previous studies. This research is the first research that study on the effect of the Islamic banking growth while affecting economic growth in thr World. Therefore, government intervention is needed to maintain the stability of Islamic banking and good international relations are needed to keep oil price stable.

Keywords: oil prices, banks-specifics, Islamic bank growth, economic growth

1. Introduction

Islamic banking has now become part of the capital investment sector by offering interest-free funding which provides a special attraction in various countries (Kaleem et al. (2016). Another attraction of Islamic banking is that there are features that share profits more equitably (distribution of profits and losses according to role), lower reliance on loans (because it uses the principle of partnership) and provides a clear boundary between short-term and long-term financing, without forgetting the strengthening of its asset base that even when the Islamic banking recession remains stable and has performance better (Khattak, 2010 and Rogoff, 2011).

Islamic banking growth in the World continues to increase, the average growth of assets in Islamic banking is 12%. According to the Islamic Financial Services Board - IFSB (2018) in 2017, asset growth has returned to the trajectory of positive growth after previously negative (in 2015). As well as gaining domestic market share in the Islamic banking sector in 19 countries. Even so, the growth of Islamic banking is still relatively slow. When seen in table 1.1 below, the percentage of asset growth in Islamic banking in 2008 - 2009 increased by 39%, while the percentage for 2016 - 2017 only increased by 7%.

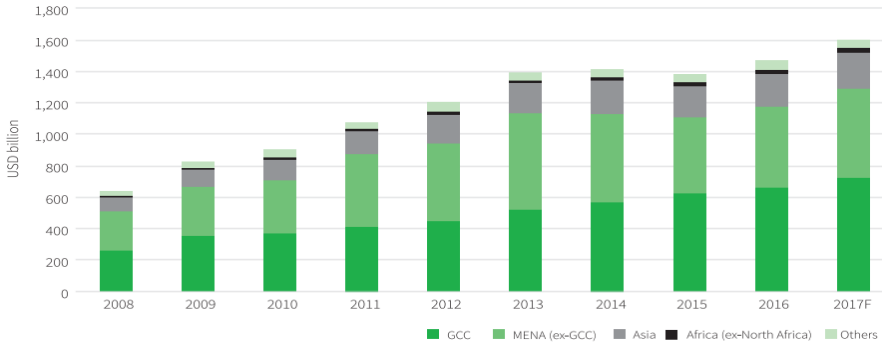


Figure 1. Islamic Banking Assets (2008 – 2017)

Source: IFSI – IFSB report, 2018

The above explanation provides information that growth in Islamic banking can affect a country's economic growth. With better performance and stability in times of crisis (Khattak, 2010 and Rogoff, 2011; Freire, 2019). Research on the growth of Islamic banking and economic growth was first examined by Scharf (1983). The results

of his research found that Islamic banking has a high contribution to economic growth, especially when a recession situation arises. This is because the Islamic banking business is associated with real and productive investments, it also uses an interest-free system that can reduce shocks during a recession. Furqani and Mulyani (2009) revealed that, Islamic banking provides positive changes in economic growth, and Islamic banking can restore customer confidence in banks, especially after the global financial crisis. The tremendous increase in assets and deposits in Islamic banking makes a high contribution in the financial sector and economic growth (Ali et al. 2011).

Abduh & Omar (2012) target the Indonesian economy for causal relations from the dynamics of growth and development in the Islamic banking sector. The results of this study confirm a significant relationship in the short and long term between Islamic banking and economic growth. However, the relationship is not in the same direction as Schumpeter stated based on supply-leading and Robinson based on the demand-following theory. This finding is similar to the research work of Abduh and Chowdhury (2012) which focuses on the Bangladesh economy to examine the relationship between economic growth and Islamic banking. The results of this study reveal a positive relationship in the long term and also in a two-way direction.

Imam and Kpodar (2013), in the Middle East, continued Imam and Kpodar (2016) in 52 countries and Kaleem et al. (2016) in Pakistan which also conducted research on the growth of Islamic banking with economic growth. The results obtained are the growth of Islamic banking can significantly affect economic growth. As well, it is expected that countries that experience growth in Islamic banking are slow to develop banks through investment in the infrastructure sector and reform of regulations and policies.

Boukhatem and Moussa (2018) found strong evidence to show that the development of the Islamic banking system stimulated economic growth in MENA countries. Then, other evidence was found that although the development of Islamic banking could encourage economic growth, this positive effect was hampered by a less developed institutional framework. In addition, clean oil exporting MENA countries do not seem to benefit from large oil-fueled deposits which tend to increase the scale of loans. The findings indicate that the government must consider implementing proactive and profitable economic and institutional policies directed at Islamic banking.

In contrast to the studies found above, Goaied & Saifallah (2010) in his study found an insignificant relationship between growth and the Islamic banking system, which in turn strengthened the concept of zero bank contributions in economic growth. Furthermore, the results reveal a negative relationship from bank indicators with growth factors below certain conditions. It was also told that Islamic banks were not extraordinary in the financial markets and were weakly correlated with economic growth but somehow these banks acted positively when demonstrated theoretically.

The difference in the findings above can be caused by many factors that can affect the rate of asset growth in Islamic banking. One reason for the slow growth of Islamic banking assets is due to unstable oil prices (Cham, 2018). Cham (2018) conducted research on the growth of Islamic banking tested the effect on oil prices, carried out specifically only in MENA countries. The results of the tests found that oil prices had a positive effect on the growth of Islamic banking. The influence of these oil prices can affect asset growth in Islamic banking in the world because most of the oil exporting countries are the biggest asset contributors to Islamic banking - such as GCC and MENA (Effendi, 2019).

In addition to oil prices, interest rates can also affect growth in Islamic banking (Imam and Kpodar, 2013). Research conducted in the Middle Eastern states found that interest rates also had a significant negative effect on the growth of Islamic banking. Furthermore, Shaikh (2014) conducted research on the growth of Islamic banking in Pakistan. Finding results that, asset growth is positively related to profitability ratios and also influenced by the growth of deposits. The negative relationship between asset growth and financial ratios to deposits is consistent with the observed data.

In general, an increase in the financial ratio of deposits is a good signal when financing assets are generated through careful financial provision. However, during the study period, depositors who led the growth of assets in banks have interpreted the decline in the financial ratio of deposits as a positive sign amid high costs of doing business, inflation driven by costs, and a high discount rate maintained by the central bank. Therefore, depositors have invested more in Islamic banking by considering more liquid, solvent and wise in providing finance.

Extensive research has been carried out in determining the factors that influence the growth of Islamic banking (Imam and Kpodar, 2013; Shaikh, 2014 and Cham, 2018). Extensive research has been carried out in determining external factors (oil prices) and internal (profitability, deposits) separately, then in this study continued by determining the two factors. Other extensive research has also been carried out in assessing the relationship

between the financial sector and economic growth (Patrick, 1966; Levine, 1997; Ahmed & Ansari, 1998; Alfero et al., 2004; Khan et al., 2005; Shahbaz, Ahmed & Ali, 2008), but limited research has been found within the framework of the Islamic banking sector (which has also been done by Scharf, 1983; Furqani and Mulyani, 2009; Ali et al, 2011; Abduh and Omar, 2012; Abduh and Chowdhury, 2012; Imam and Kpodar , 2013 & 2016; Kaleem et al.2016; Boukhatem and Moussa, 2018). This research was conducted to explore the causal relationship between growth in Islamic banking and economic growth.

Based on the explanation above, the purpose of this study is twofold, namely (i) determining the effect of oil prices, profitability, deposits on the growth of Islamic banking, (ii) seeing the influence of the growth of Islamic banking on economic growth in a country.

2. Data and Method

The object of this study is Profitability (X1), Deposito (X2), Oil Price (X3), Islamic Bank Growth (Y1), and Economic Growth (X2). The analysis with regression analysis of data panel. The data for this study were collected from secondary sources via financial statements of the 105 from 395 Islamic bank in the world and from 24 countries. The data used are annual ones from 2007 to 2019. This study can represent the state of Islamic banking because the 105 banks account for more than half of the existing population of 395 Islamic banks.

The Formula

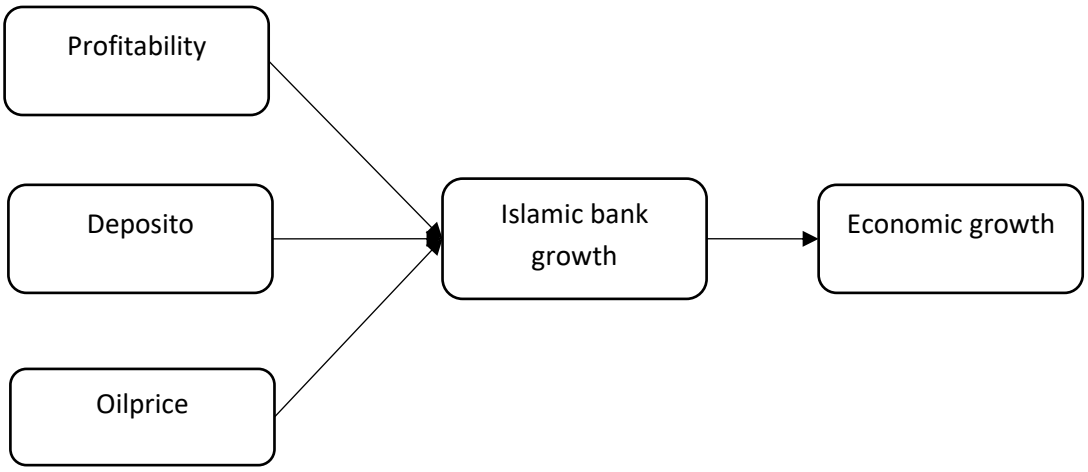
- The bank performance variable represented by Islamic bank growth calculated using the formula *ln total assets*.
- The profitability is calculated using the formula *net income / net operating income*.
- The deposito variable is calculated using the formula *total deposito*.
- The Economic growth from *GDP*
- The oil price from *average oil price per year*.

The model specified in equation 1 and equation 2 is used to express the relationship between variables:

$$Islamicbank\_growth = \beta_0 + \beta_1 Profitability + \beta_2 Deposito + \beta_3 Oilprice + \varepsilon_1 \quad (1)$$

$$Economic\_growth = \beta_0 + \beta_1 Islamicbank\_growth + \varepsilon_2 \quad (2)$$

The Model Analysis



The Regression

This research uses an explanatory analysis. In the panel data regression testing requires 3 steps, namely: Correlation test, Model Test and Regression. In the correlation test, the value between variables should be <0.8 to be free from multicollinearity. Next is the model test, this is done to determine the best regression model. There are four regression model of panel data namely: Common effect, fixed effect, fixed effect with cross section weight and random effect. There are three test models named chow test, hausman test and lagrange multiplier test. The next step is to read the results of the panel data regression which is the best model, whether it is common effect, fixed effect, fixed effect with cross section weight and random effect.

3. Results and Discussion

a. Correlation Analysis

Table 1 summarizes the correlation values for all the variables used. This test is performed to identify some variables that have high correlation with correlation value above 0.8. If there is a correlation value above 0.8, then inter variables occur multicollinearity.

Table 1. Correlation Matrix of Study Variables

	Profitability	Deposito	Oilprice	Islamicbank_growth	Economic_growth
Profitability	1				
Deposito	0.112921	1			
Oilprice	-0.085763	0.015346	1		
Islamicbank_growth	0.175142	0.596714	-0.007918	1	
Economic_growth	0.083743	-0.047325	-0.064860	0.028670	1

Test results in table 1 show that all variables have a correlation value below 0.8. This means that all variables are independent of multicolinearity. If all variables are freed from multicollinearity, then the research can be proceed.

b. Model Testing

Testing the first model is a test using Chow and Hausman test. The result for the model testing is a fixed effect model better than the common effect model or random effect model,because profitabily chow and hausman test lower than 0,05.

c. Regression Analysis

The estimation result in table 2 is the estimated profitability, deposito, oilprice on Islamic bank growth. Table 2 below is a summary fixed effect cross section weight.

Table 2. Regression Analysis Dependent Variable Islamic Bank Growth

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	3.924085	0.021923	178.9904	0.0000
PROFITABILITY	0.002376	0.027687	0.085830	0.9316
DEPOSITO	1.01E-05	1.03E-06	9.868186	0.0000
OILPRICE	0.109144	0.023722	4.601006	0.0000
Effects Specification				
Cross-section fixed (dummy variables)				
Weighted Statistics				
R-squared	0.986431	Mean dependent var		8.320429
Adjusted R-squared	0.984887	S.D. dependent var		9.445545
S.E. of regression	0.947615	Sum squared resid		844.0961
F-statistic	638.6732	Durbin-Watson stat		0.611086
Prob(F-statistic)	0.000000			

Table 2 above is the result of testing of panel data regression with the whole model. After passing the testing phase of the model is fixed effect model was chosen as the best model in this panel data regression test. Goodness of fit in this model is 0.986432 or 98,64%. This means that the three independent variables such as profitability, deposito and oil price affects Islamic bank growth in Islamic bank in the world by 98,64% while the other 1,36% is influenced by other factors. R-square is very important in every research, but only limited to the informer how much influence the independent variable to the dependent variable.

The results of the analysis above show that the variable deposits and oil prices have a positive and significant effect on growth in Islamic banking in the World. These results indicate that high rates of deposits and oil prices could increase growth in Islamic banking in the world. This positive signal illustrates that growth in Islamic banking is strongly influenced by the level of deposits and world oil prices.

The results of this study are consistent with previous studies which revealed that high deposit rates (Shaikh, 2014) can increase growth in Islamic banking and rising world oil prices can also increase growth in Islamic banking (Cham, 2018) and Effendi, 2019) because of the Islamic banking business most of them are in countries located in the Middle East that have a main business in the oil sector.

The results of the analysis above show that if the profitability variable does not have a significant influence on the growth of Islamic banking in the World. Although the variable used is the measure that best describes the profitability of Islamic banking, and the most appropriate variable is used to measure profitability in Islamic banking (Wiryono & Rahmayuni, 2010).

However, the results show that profitability does not affect the growth of Islamic banking in the world as opposed to the results of research conducted by Shaikh (2014). This can illustrate that the high or low level of profitability of Islamic banking does not affect its growth. So that Islamic banking does not need to be oriented only to profit, but rather to increase social value so that the real function of Islamic banking for the benefit of the people is realized. This can attract the attention of Muslim depositors who are obedient to save their funds in Islamic banks which will actually increase the growth of Islamic banking in the World.

Table 3. Regression Analysis Dependent Variable Economic Growth

Variable	Coefficient	Std. Error	t-Statistic	Prob.
ISLAMICBANK_GROWTH	0.314756	0.058766	5.356086	0.0000
C	5.652465	0.243589	23.20494	0.0000
Effects Specification				
Cross-section fixed (dummy variables)				
Weighted Statistics				
R-squared	0.363929	Mean dependent var		8.713677
Adjusted R-squared	0.293030	S.D. dependent var		9.879055
S.E. of regression	3.635631	Sum squared resid		12451.18
F-statistic	5.133020	Durbin-Watson stat		1.586218
Prob(F-statistic)	0.000000			

Table 3 above is the result of testing of panel data regression with the whole model. After passing the testing phase of the model is fixed effect model was chosen as the best model in this panel data regression test. Goodness of fit in this model is 0.363929 or 36,39%. This means that the independent variables affects economic growth by 36,39%% while the other 63,61% is influenced by other factors. R-square is very important in every research, but only limited to the informer how much influence the independent variable to the dependent variable.

The results of the analysis in table 3 find that the growth of Islamic banking has a significant positive effect on a country's economic growth. The results of this study are consistent with the research of Furqani & Mulyani (2009) Abduh & Omar (2012), Abduh & Chowdhury (2012), Imam & Kpodar (2013), Imam & Kpodar (2016) Kaleem et al. (2016), Boukhatem & Moussa (2018). These results illustrate that the increasing growth of Islamic banking can affect a country's economic growth. So from that Islamic banking is considered to influence the economic growth of a country.

4. Conclusion

This study aims is twofold, namely (i) determining the effect of oil prices, profitability, deposits on the growth of Islamic banking, (ii) seeing the influence of the growth of Islamic banking on economic growth in a country. The data for this study were collected from secondary sources via financial statements of the 105 Islamic bank in 24 countries. The data used are annual ones from 2007 to 2016, therefore this study was analyzed using panel data regression. The results of this study are in accordance with previous studies which found results that the level of deposits and oil prices had a large influence on the growth of Islamic banking in the World, while profitability did not affect the growth of Islamic banking. Furthermore, the growth of Islamic banking has a significant positive effect on a country's economic growth. This can illustrate that the high or low level of profitability of Islamic banking does not affect its growth. So that Islamic banking does not need to be oriented only to profit, but rather to increase social value so that the real function of Islamic banking for the benefit of the people is realized. This can attract the attention of Muslim depositors who are obedient to save their funds in Islamic banks which will actually increase the growth of Islamic banking in the World. Furthermore Islamic banking also has a major influence on a country's economic growth.

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