

CHAPTER I

INTRODUCTION

1.1 Background of the Study

The development of Islamic Banking in Indonesia is getting better from year to year. After the enactment of act 21 of 2008 about Islamic Banking, the development of national Islamic Banking Industry were starting to have more appropriate law basis that push the development even more. In the last five years, the average growth of financing is 38.5% per year (Financial Services Authority, The Islamic Indonesia Banking Statistic, 2015).

It is in line with the high rate of economic growth of Indonesia from year to year, which constantly increase. Unlike other countries, which have lower and unstable gross domestic product (GDP) as the measurement of economic growth. It showed the extensive transformation in many aspects, including the rapid development of Islamic banking which has provided a more resilience formation into the Indonesia economic development today (Abduh and Omar, 2012).

Moreover, Abduh and Omar (2012) found that it is not just the Islamic banking development that has influenced the economic growth but vice versa. The economic growth has influenced the Islamic banking development by stimulating the demand for external capital to expand business and to follow the economic growth itself.

Some recent articles and theoretical papers have discussed about the link between Islamic banking financial and economic growth globally. Generally, they

concluded that in the short run and long run, Islamic banking financial has influence on the economic growth. However, the empirical studies that have been conducted in this field still lack on the sufficient works particularly in the case of Indonesia. Not like other Islamic countries, based on the classification, Indonesia is classified in the second group which does not forbid interest rate-based banking-system. The journal of Abduh and Azmi Omar (2012) is used as the main reference in this research that has similarities in the case of Indonesia. Meanwhile the period is lengthened from Q1:2003-Q4:2014 due to the availability of the data. The method and variable are modified in reference to another journal by Al-Oqooli, Okab, and Bashayreh (2012) using two models within the context of VECM framework (financing and deposit).

The objective of paper is to narrow the gap of literature by examining the short run and the long run causality between Islamic banking and economic growth, particularly in the context of Indonesia, using unit root test, co-integration test, and granger causality test.

1.2 Problem Formulation

1. Is there significant causality between Islamic banking development and economic growth in the short-run and long-run?
2. How is the direction of causality between Islamic banking development and economic growth?

1.3 Problem Limitation

There are several limitations through this research:

1. This research focuses on Indonesia in the period of 2003 until 2014.
2. The proxies of Islamic bank are financing (FINC) and deposits (DEPT).
3. The proxies of economic growth are gross domestic product (GDP) and gross fixed capital formation (GFCF).

1.4 Research Objectives

1. This research aims to examine the causality between Islamic banking development and economic growth in the short run and in the long-run.
2. This research aims to examine the direction of causality between Islamic banking development and economic growth.

1.5 Research Contributions

This research will examine the relationship between Islamic financial development and economic growth in Indonesia. Therefore, this research will give advantages as follows:

1. For the advancement of Knowledge

This research is expected to develop the new knowledge about relationship between Islamic banking development and economic growth in Indonesia

2. For Islamic banking management

This research hopefully could make the Islamic banking management realize the relationship between Islamic banking development and economic growth in Indonesia. Thus, the Islamic banking management should ensure that Islamic banking support the national economic growth better day by day.

3. For Government

Hopefully, this paper could make the government have more understanding about the importance of Islamic banking development in supporting the national economic growth. So that, the government would make a good policy which more supporting the Islamic banking in running the financial process.

4. For Writer

This research is expected to give the advantages related to science and knowledge that relates to the theories that the writer has already learnt while studying in International Program Universitas Islam Indonesia.

5. For Future Writer

Hopefully, by completing this research, the future writer could be inspired to make research with the same topic, especially about Islamic banking and economic growth. Thus, this paper could be considered as a guidance and reference for future writer

1.6 Systematic of Writing

The systematic of writing in this research are as follows:

Chapter I: INTRODUCTION

This chapter contains background, problem formulation, problem limitation, research objectives, research contributions, and the systematic of writing,

Chapter II: LITERATURE REVIEW

This chapter contains theoretical review based on literature and previous research related to the topic. This chapter also contains theoretical framework and hypotheses formulation.

Chapter III: RESEARCH METHOD

This chapter contains the description about how the research will be conducted operationally, which explain the research variables, operational definition, type and resource of data, the data collection method, and analysis technique.

Chapter IV: DATA ANALYSIS AND DISCUSSIONS

This chapter contains the analysis process of data, the result explanation, and result discussion.

Chapter V: CONCLUSIONS AND RECOMMENDATIONS

This chapter contains the conclusions of the research and the recommendation for related parties.