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Investment, Deposit Interest Rates, and Real Sector Performance: A Case Study of Islamic Finance in Malaysia

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Abstract
This study aims to examine the influence of interest rates, GDP, consumption, and investment on Islamic finance in Malaysia. Also, it focuses on the causal relationship between the macroeconomic and humanistic approach in understanding the role of Muslim economics. Data were analyzed using the Vector Error Correction Model and the results showed that interest rates negatively affect the real sector. Therefore, the Islamic financial system with a zero or no interest-based interest rate tends to promote a social economy.

Keywords: Islamic finance, deposit interest rate, vector analysis, Malaysia

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INTRODUCTION

The modern revival of Islamic finance began in the 1960s to respond to the unmet needs of their citizens and conform to moral and ethical principles. This economics is not only applicable to Muslims but also non-Muslim countries. Also, Islamic finance enables legal contracts to serve a socially beneficial purpose (Voll, 2019).

Malaysia is one of the countries with Muslim teaching because it is mostly occupied by the Arabian. The study of Kassim (2016) indicated that Islamic banking contributes to organizational economics. However, Muslim education become the basis for resolving societal problems (Oseni, Adewale, & Zain, 2016).

Islamic finance is also spread in various parts of the world including Europe. This economics become a global study because it is not only related to Muslim countries including Malaysia (Khan, Rizvi, Ali, & Haroon, 2021).

However, innovation is inherently formed through Islamic finance that crystallizes contract exchanges. The principle of association with the legal systems helps in shaping this process because it implies that whatever is not prohibited is permissible. Therefore, several contracts in Islamic finance have the same characteristics as that of Western society. For instance, the medieval pledge was in the form of a commercial partnership because it include trust and profit-sharing. According to Aziz, Ashraf, and El-Khatib (2021) and Mutuku (2018), *sukuk* is adapted to modern forms in different ways despite being considered archaic.

Prohibit usury, gharar, and gambling are the three pillars of Sharia that have shaped people's understanding of Islamic finance. Meanwhile, interest implies that economic returns need to be closely linked to risk. This brings about deep concerns on the negative effects of the debt burden among individuals and society. Recently, these concerns greatly affect families associated with the latest reckoning in a crisis-hit economic system (Smaoui, Mimouni, Miniaoui & Temimi, 2020; Sasongko & Bawono, 2020).

The prohibition of excess uncertainty focuses on limiting disinformation because Islamic fiqh puts forward a productive work ethic that improves societal welfare. Therefore, the idea of sharing risk and return is based on Muslim economics. The above principles help in protecting Islamic finance from exposure to mismanagement and toxic assets that have contributed to the global crisis (Salman & Nawaz, 2018).

Recently, Muslim economics become a promising industry in Malaysia because the rapid expansion of the *sukuk* market that is reflected on the supply and demand side is remarkable. The demand leads to an urgent need for infrastructure, while the supply help to remove constraints on bonds. Therefore, the *Sukuk* market brings about structural and sustained changes in the country. According to Kassim (2016), Malaysia integrates Muslim economics into spending programs through social development.

Meanwhile, the growth of Islamic finance reflects the recognition and empowerment of a new consumer group because its values and ethics constitute social and moral capital. These values need to be complemented by other measures to increase economic resilience and stability (Juhro, Narayan, Iyke, & Trisnanto, 2020).

The global financial crisis leads to excess uncertainty and financial imbalances including high leverage and asset prices. Therefore, it is important to strengthen the legal and regulatory framework to keep up with international developments (Alexakis, Izzeldin, Johnes, & Pappas, 2019).

Malaysia is one of the countries with a strong agenda for green and climate-friendly investment because their Islamic Finance Ecosystem is growing rapidly with total Sharia-compliant assets. According to Oseni et al (2016), sustainable Muslim economics has great potential by providing a wide range of investors.

The development of a solid foundation is one of the most important steps in creating a strong system. Therefore, Malaysia's Islamic finance benefits from a comprehensive set of guidelines including the Sustainable and Responsible Investment *Sukuk* Framework as well as the Sustainable and Responsible Investment Funds issued by the securities commission. These guidelines help in facilitating the path to a greener to become more social. According to Bhuiyan, Rahman, Saiti, and Ghani (2019), the Malaysia Stock Exchange is one of the regulatory frameworks that set requirements for large organizations to prepare sustainability reports. Also, Central Bank assists in issuing guidance documents that facilitate value-based intermediation to redirect the Islamic finance towards the Sharia method (Bhuiyan, Rahman, Saiti, & Ghani, 2019).

In Malaysia, innovation thrives in an expert's environment because it is supported by regulators who are enthusiastically driving the development of new products. This is reinforced through the local Islamic finance sector which continues to increase in terms of quality and quantity. However, jurists that specialize in economic transactions have to work diligently to meet the needs imposes by contemporary reality. This is because Islamic investment is more directed at investing in the real sector. Several people and institutions use Muslim economics because of this characteristics. Therefore, Islamic finance is the study of resources to earn money and invest them to make a profit or achieve individual, societal and terrestrial development (Qoyum, Sakti, Thaker, & AlHashfi, 2021). Meanwhile, the products of Islamic financing offered are as follows:

The *Murabaha* contract is a situation where financial institutions sell the commodity in exchange for a debt to the customer based on their promise. The *Murabaha* process has three parties including the seller, buyer, and bank. Bank uses *Musawama* if it did not wish to disclose the cost of the products (Hare & Neo, 2021; Gundogdu, 2016).

Islam recognizes a lease contract called *Ijarah* that allows the customer to pay money monthly for using the product within a specific time. However, the customer has the right to return the commodity, or pay its market value after the expiration of this agreed term. The two

parties involved in the lease include the lessor and the lessee. Therefore, expired ownership leases are a mixture of Sharia contracts consisting of purchase pledges and deferred sales from customers and banks. In expired *Ijarah* properties, the client promises the financial institution to rent a car for a fixed monthly fee in a certain period. The bank buys this item from the owner and rents it out to their customer who pledges. According to Billah (2019), the financial institution makes promises and fulfills them if payments are made to transfer ownership to their clients at the end of the lease.

Parallel *Istisna* is a financing product that meets urgent needs in the construction sector. Therefore, *Istisna* is a contract made by a bank to construct a building for their customer due to certain specifications and time. The contractor and the client are not the same because their relationship ends after receiving an offer that is submitted to the bank. Furthermore, the contract value is not regarded as prepaid due to the construction specifications that need to be determined with complete accuracy (Salem, 2013).

According to Islamic law, it is permissible to invest in stocks with the same terms. Meanwhile, depositors and bonds are Muslim prohibits interest-based investment, while *sukuk* is not an interest-based instrument. *Sukuk* are certificates that prove equal ownership of certain assets because it is a legal alternative to financial bonds. Also, it is a loan that enables the holder to receive economic benefits. *Sukuk* is periodic returns from an invested project or property rented or leased (Elhaj, Muhamed, & Ramli, 2015). Therefore, a *sukuk* issuer is an agent that guarantees capital and the profit limit while agreeing to two parties (Uddin, Kabir, Hossain, Wahab, & Liu, 2020).

Sharia mutual funds are allowed by Islam because they are investment vehicles consisting of a financial pool to invest in shares, *Sukuk*, and other market tools (Sandwick, Hassan, & Collazzo, 2021). Generally, these funds are divided into three including Equity, *Sukuk,* and *Ijarah* Mutual Funds. In Equity mutual funds, all shares are limited to stock investments due to the provisions of Sharia law. Meanwhile, *Sukuk* mutual funds are meant for investors with low-risk funds to generate stable returns. *Ijarah* mutual funds such as Aircraft Leasing Fund invest customers' money in assets that are leased to generate returns. The MALC does buy aircraft and rent them to interested parties including Airways. This asset is usually sold out at the end of the lease term (Guzhva, Raghavan, & D'Agostino, 2019; Morrell, 2021).

Therefore, this study serves as a complement between variables and a macroeconomic indicator in understanding the influence of Islamic finance on the real economy in Malaysia. Attention is mostly directed to interest rates because Muslims forbid the practice of Riba. Sasongko, Bawono, and Prabowo (2021) showed that the real sector and the capital significantly affect an organization's economy. However, the source of capital is not only from debt. The results are in line with the concept of this study that Islamic finance is an investment .

source where banks act as investors to promote the real sector through a working capital with a profit-sharing system.

According to Widarni and Bawono (2021), human factors including confidence and workability greatly affect the societal economy. The results are in line with the study of Sinclair-Desgagné (2021) that human factors are the main drivers in the finance of a country.

Chen and Hungerman (2014) showed that culture and religion affect the societal economy. Also, Kumar, Sahoo, Lim, and Dana (2021) indicated religious factors influence business decisions and the economy.

According to Ren (2021), beliefs and culture significantly affect Malaysia's business relations and cooperation with China. The results are in line with the study of Sasongko, Bawono, and Prabowo (2021) that the human factor is the main driver to real economic growth in China and the USA. This is not consistent with Amin and Alam's (2008) that religion in Malaysia affects the city and the village.

Voll (2019), Kassim (2016), and Oseni et al (2016) emphasized more on the model and conceptual of Islamic finance. Therefore, this study focuses on the neutral causality connection of macroeconomic and Muslim economics using the Vector Error Correction Model. Islamic finance in Malaysia was examined to deeply understand the causal relationship between individuals because the country is occupied by Muslims.

METHOD

The following autoregressive vector model were used to examine the influence between variables.

$$\Delta CO = \beta_0 + \beta_1 CO_{t1} + \beta_2 GDP_{t2} + \beta_3 I_{t3} + \beta_4 IR_{t4} + e_t$$

$$\Delta GDP = \beta_0 + \beta_1 CO_{t1} + \beta_2 GDP_{t2} + \beta_3 I_{t3} + \beta_4 IR_{t4} + e_t$$

$$\Delta I = \beta_0 + \beta_1 CO_{t1} + \beta_2 GDP_{t2} + \beta_3 I_{t3} + \beta_4 IR_{t4} + e_t$$

$$\Delta IR = \beta_0 + \beta_1 CO_{t1} + \beta_2 GDP_{t2} + \beta_3 I_{t3} + \beta_4 IR_{t4} + e_t$$

Where GDP is Gross Domestic Product, C is consumption, I is an investment, and IR is the interest rate.

A stationarity test was performed using the ADF which enables data to be collected through an autoregressive vector model.

This study uses secondary data sourced from the world bank. The IR, GDP, C, and I were calculated using the deposit interest rate, the real gross domestic product indicator, final consumption expenditure, and the net investment in non-financial assets respectively.

RESULT AND DISCUSSION

Data were first tested before being estimated and a stationarity test was performed using the ADF. Table 1 shows the results of the stationarity test.

Table 1. Stationarity test results

Method			Statistic	Prob.**
ADF - Fisher Chi-square			11.0015	0.2016
ADF - Choi Z-stat			0.56865	0.7152
Series	Prob.	Lag	Max Lag	Obs
CO	0.9905	0	4	20
GDP	0.9362	0	4	20
I	0.0156	0	4	20
IR	0.2823	0	4	20

** Probabilities for Fisher tests are computed using an asymptotic Chi-square distribution. All other tests assume asymptotic normality.

Based on the test results, autoregressive vector estimation was performed because all the data are stationary. Table 2 shows the estimation results.

Table 2. Estimation Results

	CO	GDP	I	IR
CO	0.203135	-0.93604	0.01438	-0.000000000554
	-0.65462	-2.05342	-0.53176	-0.000000000150
	[0.31031]	[-0.45584]	[0.02704]	[-0.36133]
GDP	0.065991	0.155332	0.197327	-0.000000000000459
	-0.2385	-0.74815	-0.16207	-0.000000000560
	[0.27669]	[0.20762]	[1.21751]	[-0.82181]
I	1.63	4.24	0.0218	0.000000000001.92
	-0.4.29	-1.34	-0.348	-0.000000000001
	[3.79606]	[3.15160]	[0.06267]	[1.91601]
IR	-0.000000000752	-0.000000000024	-0.00000000022	-0.464
	-0.000000000019	-0.000000006	-0.0000000015	-0.445
	[-0.39560]	[-0.41475]	[-1.47574]	[-1.04311]
C	-0.000000000436	-0.000000000297	0.000000000683	0.438

	CO	GDP	I	IR
	-0.000000000098	-0.000000000031	-0.00000000008	-2.31
	[-0.44283]	[-0.96003]	[0.85351]	[0.18987]
R-squared	0.89	0.89	0.29	0.516
Adj. R-squared	0.89	0.89	0.278	0.13

The estimation results showed the relationship between variables by comparing the t-statistic with the coefficient for the negative and positive direction. This indicated that previous consumption positively affects the future one with a t-statistic value of 0.31031 and a coefficient value of 0.203135. Therefore, current expenditure influences the potential one by 10% with a coefficient of 0.203135. This means that future consumption tends to increase by 2%. Table 2 shows that expenditure is a predictor of itself.

Consumption negatively affects the GDP with a t-statistic value of -0.45584 and a coefficient value of -0.93604. Table 2 shows that expenditure does not significantly influence Malaysia's economic growth because the direction of the relationship is negative. The results are not consistent with the study of Sasongko, Bawono, and Prabowo (2021), Widarni and Bawono (2021), and Sinclair-Desgagné (2021). This shows that consumption is not a predictor of economic growth.

Furthermore, expenditure positively affects investment with a t-statistic value of 0.02704 and a coefficient value of 0.01438. This indicates that consumption in Malaysia tends to become a predictor of investment potential in the future.

The result showed that expenditure negatively affects interest rates with a t-statistic value of -0.36133 and a coefficient of -0.0000000000554. Therefore, there is an inverse relationship between consumption and interest rates. This indicates that the increase in expenditure tends to reduce profits and vice versa. The inverse relationship indicates interest rates suppress public consumption that is positively connected with investment. Therefore, economic growth and assets are depressed while the Islamic economy in Malaysia produces an inverse relationship. This shows that the real sector fills foreign markets. In the economy, the domestic and external market is indicated by consumption and exports respectively.

GDP positively affects consumption with a t-statistic value of 0.27669 and a coefficient value of 0.065991. The results indicated that economic growth is significantly related to expenditure. Vector analysis simulates the relationship by testing each variable. Therefore, there is an inverse connection while consumption and GDP become the independent and dependent variables respectively. The increase in expenditure does not necessarily develop domestic production due to imported goods. Meanwhile, there is an economic scale that makes production more efficient while GDP and consumption become the independent and dependent variables respectively.

Table 2 shows that GDP positively affects itself with a t-statistic value of 0.20762 and a coefficient of 0.155332. This indicates that the archaic Gross Domestic Product influence the current GDP.

GDP positively affects investment with a t-statistic value of 1.21751 and a coefficient of 0.197327. Also, Gross Domestic Product negative influence interest rates with a t-statistic value of -0.82181 and a coefficient of -0.0000000000459. The difference in the above results indicated that GDP encourages investment. This is quite rational because good economic growth tends to increase investors' expectations. However, this is affected by corporate actions that retained earnings increase business growth rather than using debt. This causes interest rates to be depressed.

Table 2 shows that investment positively affects consumption with a t-statistic value of 3.79606 and a coefficient value of 1.63. Also, assets insignificantly influence economic growth with a t-statistic value of 3.15160 and a coefficient of 4.24. Investment positively affects itself with a t-statistic value of 0.06267 and a coefficient of 0.0218. Also, assets significantly influence interest rates with a t-statistic value of 1.91601 and a coefficient of 0.000000000192. Investment is positively related to consumption because it tends to create new job opportunities which increase work participation and workers with new income. Assets promote economic growth but it is not significant due to the use of retained earnings. Furthermore, an archaic investment affects the current one that serves as a predictor of the future. The most surprising result is the positive influence of investment on interest rates. This indicates that in Malaysia not all people are anti-Riba. There is an increment in the amount of money circulating and owned by individuals or communities if there is a high investment. This motivates people to invest and get their funds from debt to drives interest rates.

The interest rate negatively affects consumption with a t-statistic value of -0.39560 and a coefficient of -752000000. Also, dividends insignificantly influence GDP with a t-statistic value of -0.41475 and a coefficient of -247000000. The interest rate negatively affects investment with a t-statistic value of -1.47574 and a coefficient of -22800000000. Furthermore, dividends significantly influence themselves with a t-statistic value of -1.04311 and a coefficient of -0.464. The interest rate becomes the burden of economics while indicated as an independent variable. Therefore, the increase in interest rates tends to put pressure on both the investors and the customers. Investors become depressed because they have to pay a huge amount of funds. In addition, the customers who buy goods including houses and vehicles need a large capital to obtain them. This indicates that the domestic market is experiencing a decrease in product absorption but it is not necessarily that the foreign one needs to support the decline in consumption. This causes economic growth (GDP) to be depressed.

The estimation results showed that the interest rate has a negative direction on all variables. This indicates that the expenditure can be an economic burden in the real sector despite being insignificant. Therefore, the lower the interest rate, the better for the economy.

CONCLUSION

In conclusion, the Islamic financial system prohibits interest or usury. Malaysia is one of the countries that use this economic system because it is mostly occupied by the Arabian who always follow their teachings. This is indicated through the influence of interest rates on the real sector. The results showed that dividends negatively affect the societal economy. Therefore, the Islamic financial system with zero or no interest-based interest rate in Malaysia tends to promote the real sector to be better than the conventional financial system.

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