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Performance of Islamic Banks and Economies of Selected Muslim Countries

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Abstract: This study is a strict attempt to determine the relationship between economic growth and performance of Islamic banks in few selected Muslim countries from 2014 to 2016. The macroeconomic components that were taken into consideration as indicators to economic growth were gross domestic product -GDP, foreign direct investment-FDI, inflation and unemployment in three selected countries; Malaysia, Indonesia and Maldives. Three banks from these three countries were taken into account as representatives for Islamic banks. Comprehensive income and net cash inflows have been considered as measures of performance of each bank. The empirical results show that performance of Islamic banks vary in linear relationship with indicators of economic growth in selected countries. Of the macroeconomic components that were empirically analysed against growth of Islamic banks, FDI net inflows displayed the strongest positive linear relationship with banks' performances followed by GDP. It is thus concluded, that the performance of Islamic banks have connection, but to varying extents with different indicators of economic growth in their respective countries of operations.

Keywords: Islamic Banks, Malaysia, Indonesia, Maldives, Economic growth, GDP, FDI. Inflation, Unemployment.
JEL Classifications: G21

1. Introduction

According to the theory of Schumpeter, financial sector development is a key driver of economic growth. In order to spur economic growth, financial intermediaries perform the essential role in mobilizing savings for potential investments in an economy. It has been found that financial sector development has a positive impact on economic growth, when it comes to low-income countries (Uddin et al, 2013). As Islamic banking and finance has taken over as parallel and alternative system finance for last few decades. Islamic banking has proven better and stable than its conventional counterpart during the recent global financial crises (Venardos, 2010; Imam and Kpaodar, 2010). The rapid and seemingly nonchalant global growth of Islamic banks during the past few decades has left intellects dreaming of a future financial world that is completely Islam-centric, desiring to achieve stability and sustainability in the economic system, driven by a reliable code of ethics. Establishment of Islamic banks is not completely concentrated in a single region of the world but scattered around the globe (Mansoor and Ishfaq 2008). Despite of stability and global presence of Islamic banks, it is being argued that their performance has very week connection with growth indicators of their respective countries (Goaied. M and Sassi S, 2010).

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Plan of this study is to analyse the relation between performances of few selected Islamic banks and economic growth in Malaysia, Indonesia and Maldives. Population, culture and financial system are the most important components considered during selection of countries. Majority of the residents in these three countries are Muslims with Malaysia at 61.4%, Maldives at 98.4% and Indonesia at 88.1% as per estimates in 2010 (ChartsBin, 2011). The three countries chosen for the study have unique qualities when it comes to their culture and financial system. These countries pioneered Islamic banking, while accommodating multiple cultures ranging from Indian to Chinese, and several religions, amongst which Islam is dominant. Three Islamic banks have been selected for this study, namely; Bank Islam Malaysia Berhad in Malaysia, Maldives Islamic Bank in the Republic of Maldives and Bank Muamalat Indonesia in Indonesia. All the three selected banks operate side by side in conventional banking with windows to provide Sharia compliant services. Also the banks are comparable, with respect to their services, operations and environment. Relationships are drawn between the performances of each selected bank with growth of their respective economies using few common macroeconomic variables.

2. Literature Review

Although scholars vary in opinions on relation between financial sectors of a country and its economic growth, but a good number of studies have revealed about the connection of Islamic banking and finance to economic growth. Presence of Islamic banks in world economy has made economic growth to pick up at a faster pace, despite its smaller share in the market, assets of worth $580 billion in 2008 (Imam and Kpodar, 2015). Features of Islamic banks such as; stability, innovation and risk sharing are proven indicators that aid in economic growth and have greater potential in developing infrastructure through both private and public sector projects, hence paving the way to a higher standard of living (Johnson, 2013). A study conducted for the period from the year 2004 to 2013 has found that there is positive relationship between GDP growth rate and inflation, and the advancement of Islamic financing (Nahar and Sarker, 2016). Findings of a UAE based study for the period from year 1990 to 2010, reveal the evidences of attracting foreign direct investments through Islamic banking (Tabash and Dhankar, 2014). An eight years long study from 2005 to 2012, focussed on Bahrain, Kuwait, Qatar, Saudi Arabia and UAE has shown positive relation between favourable macroeconomic condition and performance of Islamic banks (Almanaseer, 2014). Impact of financial sector on economic growth vastly differ between oil exporting and non-oil exporting countries. Impact of economic growth on the former is significantly smaller than the impact on the latter (Goaied and Sassi, 2010).

Despite of wide acceptance and success of Islamic banking, attempts to decipher a causal relationship between Islamic banks and economic growth is somewhat overthrown by researchers showing that Islamic banks do not hold enough savings to have a positive impact on economic growth. (Ajija, Setiano and Hudaifah, 2010; Kesumo and Arshad, 2015). Islamic banks exist only in a theoretical sense and essence of actual Shariah rulings is lost in transmission due to lack of strict implementation of the Word of God (Johnson, 2013). Research by Furqani and Mulyany (2009), revealed that Islamic banking does not boost economic growth of the country in the short run but in the long run. Sanwari and Zakaria (2013), argue that macroeconomic factors have little or no effect on the performance of Islamic banks.

While we focus to individual countries, Islamic banks in most of the countries, including Malaysia, have their own Sharia boards in order to supervise and control their products. Indonesia, on the other hand, has a centralized system governing products not only in Islamic banks, but also in the country's Sharia based capital market (K&L Gates, 2014). Malaysia, being the country with the highest rates in the growth of Islamic banking with its Islamic financing assets at RM783 billion (Global Islamic Economy Gateway. 2017) which is approximately US$184.8 billion, has recorded a sustained and stable economic growth for in the past three decades. As per Gudarzi and Dastan (2013), the relationship between Islamic banks and economic growth follows a bidirectional model. Financial development drives economic growth, and the notion of economic growth backs the financial sector to develop further. Their empirical studies made it evident that financing as per Sharia had proven to be beneficial for the economic growth of both Indonesia and Iran in the short run, as well as the long run. Kesumo and Arshad (2015), found that the contribution of Islamic banks in Indonesia to the country's economic growth remains substantially insignificant.

3. Methodology

Annual reports of the three selected banks were thoroughly reviewed and special attention was paid to their financial statements of three consecutive years; 2014, 2015 and 2016. In order to minimise bias, the items chosen from in the financial statements were common for all the selected banks. All the items were expressed in the respective currencies of each country and the macroeconomic figures were also converted to overcome variations occurring due to differences in exchange rate.

Comprehensive income and net cash flows were the items chosen from each bank. Gross domestic product (GDP), Foreign Direct Investment (FDI), Inflation and Unemployment Rate of each country were used to as macroeconomic variables for comparison in study. Rate of inflation used is in terms of percentage of GDP and rate of unemployment used is in terms percentage of labour force. Year to year changes in chosen macro-economic variables of each country were compared with the performance of their respective banks. Relationships between the macroeconomic variable and performance of Islamic banks in the selected countries were also cross compared. Tools used for the study are data description, percentage comparison and linear relationship.

4. Analysis and Findings

Year to year performance of each bank was compared with GDPs, FDIs, inflation rates and unemployment rates of their respective countries of operation. Results obtained are as follows:

Table 1: Performance of Islamic Banks with respect to GDP of the Country

	Malaysia		
	Comprehensive Income	**Net Cash Flows**	**GDP**
	in billions of MYR ($1 = MYR4.09)		
2014	0.463	3.27	1,382.67
2015	0.432	2.98	1,212.42
2016	0.483	4.06	1212.83
	Maldives		
	Comprehensive Income	**Net Cash Flows**	**GDP**
	in billions of MVR ($1 = MVR15.42)		
2014	0.014	0.44	57.01
2015	0.025	0.72	61.77
2016	0.045	0.84	65.13

	Indonesia		
	Comprehensive Income	Net Cash Flows	GDP
	in billions of IDR ($1 = IDR13,558.83)		
2014	0.672	10.53	12,078,395.59
2015	0.150	7.90	11,677,623.69
2016	0.100	7.51	12,640,341.30

Source: Annual Reports, The World Bank | Data. (2017)

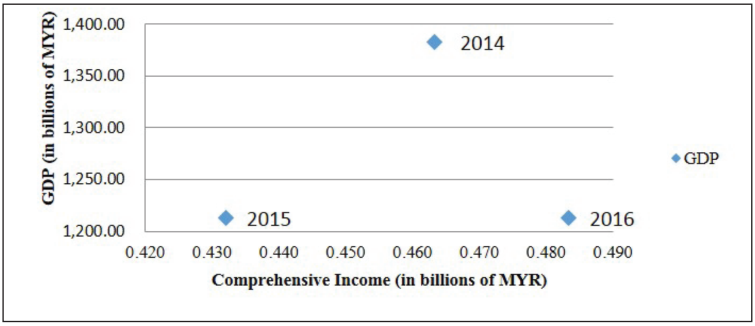

Fig 1: Bank Islam Malaysia Berhad Comprehensive Income against GDP of Malaysia (2014-2016)

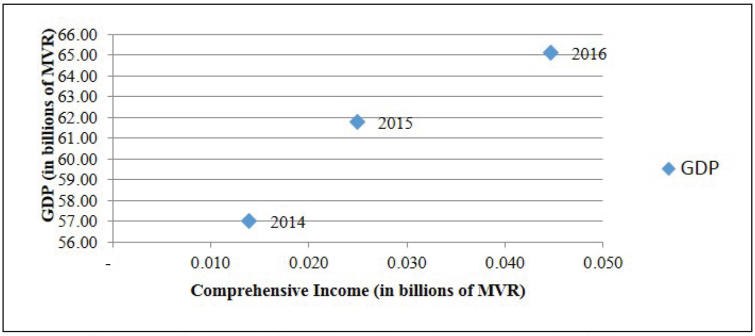

Fig 2: Maldives Islamic Bank Comprehensive Income against GDP of Maldives (2014-2016)

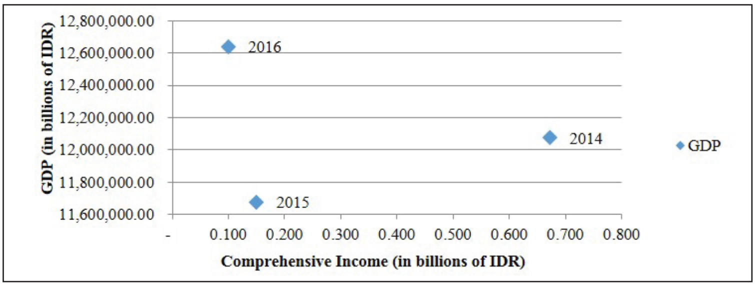

Fig 3: Bank Muamalat Indonesia Comprehensive Income against GDP of Indonesia (2014-2016)

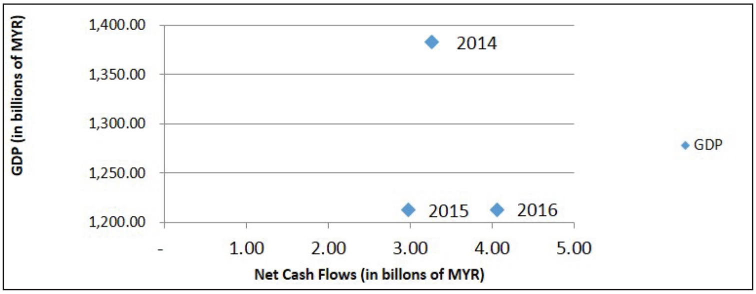

Fig 4: Bank Islam Malaysia Berhad Net Cash Flows against GDP of Malaysia (2014-2016)

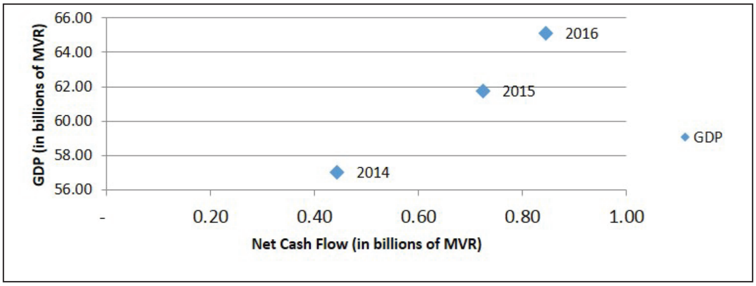

Fig 5 : Maldives Islamic Bank Net Cash Flows against GDP of Maldives (2014-2016)

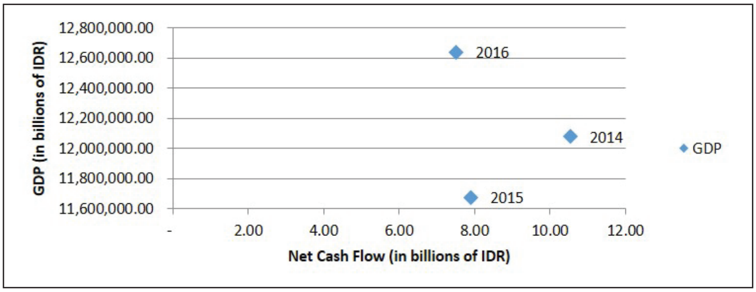

Fig 6: Bank Muamalat Indonesia Net Cash Flows Against GDP of Indonesia (2014-2016)

Above table (Table 1) and figures (Fig 1 to Fig 6) reveal that in Malaysia, GDP has slightly fluctuated during the period, where the figure in 2014 downed by 12.31% in 2015 and then again rose by a mere 0.034% in 2016. GDP appeared to be at its lowest in the year 2015, where both comprehensive income and net cash flows of BIMB were also at their lowest, this relationship does not conform for the years 2014 and 2016.

In the case of Maldives, GDP experienced a constant increase from 2014 through 2016. There was a growth of 8.36% from 2014 to 2015. It further rose by 5.44% in 2016. Similarly, performance of Maldives Islamic Bank also appeared to be on a constant rise in terms of comprehensive income and net cash flows. Thus, these two components and GDP displayed a direct and a positive relationship.

A slightly different scenario could be detected in the case of Indonesia. It is observed that GDP appears to be the highest in the year 2016, which was a rise of 8.24% from the previous year. GDP in the year 2014 fared 3.32% better than 2015. There appears to be no relation between GDP and comprehensive income and net cash flows of Bank Muamalat. In fact, these two components experienced a constant decrease during the three years, hitting their lowest in the year 2016 when GDP was at its highest.

Table 2: Performance of Islamic Banks with respect to FDI of the Country

Malaysia			
	Comprehensive Income	**Net Cash Flows**	**FDI**
	In Billions of MYR ($1 = MYR4.09)		
2014	0.463197	3.269353	43.43
2015	0.431987	2.982246	40.32
2016	0.483335	4.063417	55.28
Maldives			
	Comprehensive Income	**Net Cash Flows**	**FDI**
	In Billions of MVR ($1 = MVR15.42)		
2014	0.013927	0.443120925	5.14
2015	0.024891	0.723665965	4.75
2016	0.044614	0.844708336	6.91
Indonesia			
	Comprehensive Income	**Net Cash Flows**	**FDI**
	In Billions of IDR ($1 = IDR13,558.83)		
2014	0.672169966	10.53402853	340,607.74
2015	0.150376076	7.898658216	268,181.83
2016	0.100153926	7.512605668	56,163.43

Source: Annual Reports, the World Bank | Data. (2017)

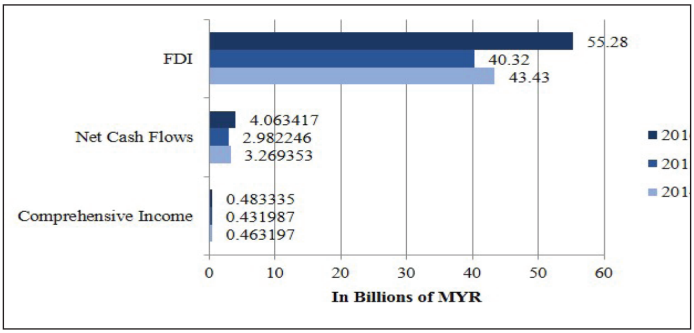

Fig 7: Bank Islam Malaysia Berhad Comprehensive Income, Net Cash Flows and FDI of Malaysia (2014-2016)

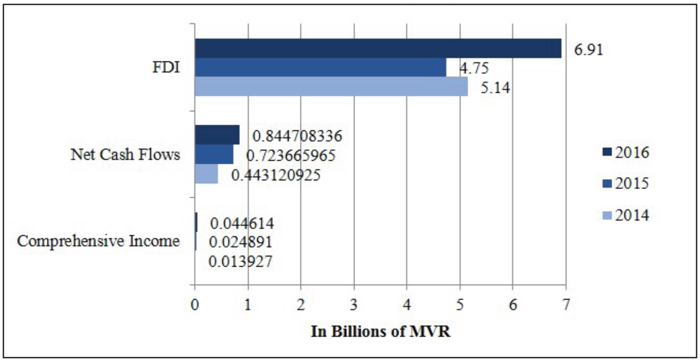

Fig 8: Maldives Islamic Bank Comprehensive Income, Net Cash Flows and FDI of Maldives (2014-2016)

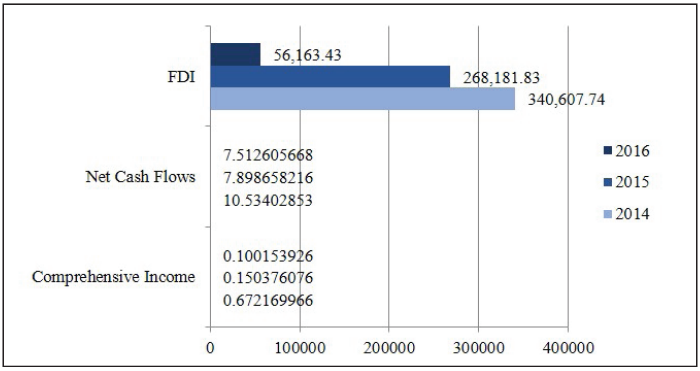

Fig 9: Bank Muamlat Indonesia Comprehensive Income, Net Cash Flows and FDI of Indonesia (2014-2016)

Above analysis (Table 2 and Fig 7 to Fig 9), reveal that FDI appears to have a positive linear relationship with the performance of Bank Islam Malaysia Berhad, using comprehensive income and net cash flows. The highest amount of comprehensive income and net cash flows were MYR0.48 billion and MYR4.06 billion respectively, in the year 2016. FDI also turned out to be the highest in this year at MYR55.28 billion. The figures also followed suit for the years 2014 and 2015. FDI appeared to be the lowest in the year 2015 and so was the performance of BIMB with comprehensive income at MYR0.43 billion and net cash flows at MYR2.98 billion.

Maldives saw a steady rise in FDI even though the figure slightly slumped from MVR5.14 billion in 2014 to MVR4.75. This was a fall of as low as 8%, which rose by an impressive 45.6% in the year 2016 to MVR6.91 billion. This was the year during which Maldives Islamic Bank performed the best among the three years under review, earning a comprehensive income of MVR0.044 billion, wherein net cash flows stood at MVR0.84 billion.

Indonesia also experienced similar trends when it came to FDI and performance of Bank Muamalat Indonesia. The performance of BMI steadily fell from 2014 through 2016 where the bank earned the lowest income in the year 2016 at IDR0.10 billion. This was also the year during which Indonesia attracted the least FDI in comparison to the remaining two years being studied, with FDI at IDR56, 163.43 billion.

Table 3: Performance of Islamic Banks with respect to Inflation

	Malaysia		
	Comprehensive Income	Net Cash Flows	Inflation (% of GDP)
in billions of MYR			
2014	0.463197	3.269353	3.17
2015	0.431987	2.982246	2.08
2016	0.483335	4.063417	2.13
	Maldives		
	Comprehensive Income	**Net Cash Flows**	**Inflation (% of GDP)**
in billions of MVR			
2014	0.013927	0.443120925	2.12
2015	0.024891	0.723665965	0.95
2016	0.044614	0.844708336	0.5
	Indonesia		
	Comprehensive Income	**Net Cash Flows**	**Inflation (% of GDP)**
in billions of IDR			
2014	0.672169966	10.53402853	6.39
2015	0.150376076	7.898658216	6.36
2016	0.100153926	7.512605668	3.53

Source: Annual Reports, The World Bank | Data. (2017)

Results in Table 3 reveal that no relationship could be established with regard to the changes in rate of inflation and performance of BIMB in Malaysia. In Maldives, however, the rate of inflation experienced a constant fall while the performance of MIB was consistently on the rise during the three year period. The scenario is contrary in case of Indonesia, where the rate of inflation steadily reduced and the performance of BMI also went down together with it. Therefore the short run association of inflation to the performance of Islamic banks could not be established.

Table 4: Performance of Islamic Banks with respect to Unemployment

	Malaysia		
	Comprehensive Income	Net Cash Flows	Unemployment rate (% of Labour Force)
	in billions of MYR		
2014	0.463197	3.269353	2.9
2015	0.431987	2.982246	3.1
2016	0.483335	4.063417	3.4

	Maldives		
	Comprehensive Income	Net Cash Flows	Unemployment rate (% of Labour Force)
	in billions of MVR		
2014	0.013927	0.443120925	5.2
2015	0.024891	0.723665965	3.9
2016	0.044614	0.844708336	3.2
	Indonesia		
	Comprehensive Income	**Net Cash Flows**	**Unemployment rate (% of Labour Force)**
	in billions of IDR		
2014	0.672169966	10.53402853	4
2015	0.150376076	7.898658216	4.5
2016	0.100153926	7.512605668	4.1

Source: Annual Reports, The World Bank | Data. (2017)

Results in table 4 reveal that no relationship could be established between the performance of Islamic banks and the rate of unemployment prevailing in the economies of Malaysia and Indonesia. Maldives is the only country having a linear relationship with the rate of unemployment and performance of the bank, where the bank performance improved overtime and the rate of unemployment reduced. Since this is not indicated by the remaining two countries, there is no conclusive evidence that the better performance of Islamic banks leads to a reduction in the rate of unemployment prevailing in economy.

5. Discussion and Conclusions

The empirical outcome of this study showed that Islamic banks are unable to overturn the impact of external factors on the macroeconomic components in the short run, particularly GDP, which is the single most important indicator of economic growth of a country. Even in the case of Malaysia, where total Islamic banking assets accounted for over RM 8 trillion as seen in 2015 (Staff, E. 2015), sharia compliant banking was unable to reverse the damage caused to the country's GDP by the dramatic fall in oil prices and the economic slowdown in China, that caused its exports to diminish substantially (The Malaysian Reserve, 2017). Malaysia was not able to tackle the decelerated consumption, which accounts for up to 52% of the country's GDP, due to growth in inflation attributed to the introduction of Goods and Services Tax (The Star Online, 2015). This slowdown also had an impact on the GDP figure of Indonesia and Islamic banking proved to be an abysmal saviour for the country's growth. Similar was the case when Indonesia's consumption slowed down due to rise in interest rates, taken as a measure to bring down the rate of inflation. (Investments, I. 2015). Unlike Malaysia, Indonesia is deprived of government support when it comes to Islamic banking sector, which explains why the growth has been painfully slow, despite the greatness of the Muslim population residing in the country (GBG. 2016). Maldives has been the only country that exhibited a positive upward relationship between bank performance and macroeconomic components in account, with exception of the rate of unemployment and the slight fluctuation in FDI net inflows.

It is thus concluded that the performance of Islamic banks have connection with the macroeconomic variables of their respective economies. Islamic banks have potential to grow with stricter application of Sharia guidelines and establish their relationship with the overall performance of economies they operate in.

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