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Original Article

Financing growth within the constraints of monetary policy and the economic environment: A case study of the Malaysian Islamic banks

Mohammad Taqiuddin Mohamad[a,*]

[a] Department of Shariah and Economics, Academy of Islamic Studies, University of Malaya, Malaysia
[*] m.taqiuddin@um.edu.my

ABSTRACT

This article analyses the effect of bank specifications, changes in monetary policy and economic environment in Malaysia towards Islamic banking behaviour in offering financing. In theory, any change that occurred as indicated above will lead financial authorities, especially banking management, to make modifications on financing offered by referring to profit maximization objective apart from minimizing default. This study employs panel data estimation for the period 1994-2010 of 17 Malaysian Islamic banks. It is found in this study that the pattern and behaviour of Islamic banking in offering financing is influenced by factors such as level of last financing, exposure to risk, as well as size and structure of the capitalization level. With regards to monetary policy, finacing behaviour of Islamic banking is influenced by investment in Islamic Interbank Money Market (IIMM) and Malaysian government securities. As for economic environment, the study found that there is no significant relationship between this factor and the behaviour of financing of Malaysian Islamic banks.

Keywords: Islamic banking, financing, monetary policy, economic environment, Malaysia

Introduction

Islamic banking is now among the most important financial mediator in the Malaysian economy. Like conventional banking, Islamic banking also acts as a platform for the implementation of monetary policy through financing mechanisms. The funds obtained from various sources where the majority are from depositors are used in investment activities, such as financing of procurement of assets, project financing, trade financing, and so on. This process is known as credit creation, and is aimed to generate bank income based on various guided Shariah principles.[1]

[1] Depositors deposit their money in the bank to claim and receive the return (interest) from the bank on capital contribution made and the bank in turn channelling the funds to the borrower. See for instance, Naser, K., Jamal, A. and Al-Khatib, K., "Islamic Banking: A Study of Customer Satisfaction and Preferences in Jordan," *International Journal of Bank Marketing* 17(3) (1999): 135-150; and Podder, J. and al Mamun, A., "Loan Loss Provisioning System in Bangladesh Banking: A Critical Analysis," *Managerial Auditing Journal* 19(6) (2004): 729-740.

Profit rate and profit[2] share on the other hand is used as guide in determination of a decision and amount of financial that will be offered.[3] Through this function, unit credit economy requirement of Muslims and non-Muslims would be catered for, be they short-, medium- or long-term.

Financing is the main income of any institution that functions as mediator of finance including Islamic banking which represents the largest asset composition compared to other assets. The growth in financing also acts as the main contributor to the bank's goal achievement through valid credit requirement community that receive services from Islamic banking.[4] If this credit needs could not be met, there will be situations where Islamic banking have to contend with various risks. This would also result in other banking institutions, in particular conventional banks, finance companies, non-financial institutions and other agencies to take over the role of Islamic banking when Islamic banks fail to accommodate the credit needs of the community.[5]

The role of Islamic banking is not limited to only providing financial facilities to the borrower and the lender, but a variety of other roles such as partner either as investor (*sahib al-mal*) or operator (*mudarib*). In this relationship, the funding ratio of customer deposits will provide important information on the effectiveness of Islamic banking in carrying out the functions as mediator. Higher ratio will mean that Islamic banking is more effective in carrying out the functions as mediator, and vice versa. The effectiveness of Islamic banking in carrying out the functions as mediator has significant impact on economic growth through the increased levels of output, price stability, low unemployment rate, and so on.[6]

Financing from the Islamic perspective

In the Islamic context, the difference between financing and loans in conventional

[2] Islamic banking contracts are classified into two broad categories, namely: (i) A contract variable returns as *musharakah* and *mudharabah*; and (ii) A contract with a fixed return such as instalment sales, hire purchase and sales. The second category can be described as additional contracts that can be used in conjunction with the first category or after it. While the first category involves risks, the second type is without risk, which may be more attractive to Islamic banks. See for instance, Toutounchian, I., *Islamic Money & Banking: Integrating Money in Capital Theory*. (Singapore: John Wiley & Sons, 2009); Hoshi, T., "Creditor Rights and Credit Creation by Banks in Transition Economies," Working paper. (San Diego: Graduate School of International Relations and Pacific Studies University of California, 2006).

[3] According to Hoshi, credit was not just free but still involved some costing even in an interest-free banking system.

[4] "Authorised credit requirements" means that the financing needed for a specific purpose in accordance with the law and relevant to society in general. For example, the provision of funding for the purpose of smuggling drugs and illegal goods in accordance with the national legislation does not belong to the "legitimate credit needs." See Shamsudin Ismail, *Pengurusan Bank Perdagangan di Malaysia*. (Kuala Lumpur: Dewan Bahasa dan Pustaka, 2009).

[5] Shamsudin Ismail, *Pengurusan Bank Perdagangan di Malaysia*.

[6] Some studies at the macro level found that development and increase in efficiency of financial sector enhance the economic performance by optimum capital distribution towards activities that give high social returns. There are also studies that found that the increasingly developed financial intermediaries in a country makes a greater positive impact on the growth of productivity, economic growth and the growth of physical capital.

banking is the prohibition of benefits or interest (*riba*). The prohibition is indirectly managed to gradually reduce the domination of Western financial model at each type of economic activity which in turn leads to productivity improvement.[7] The financing concept offered had placed Islamic banking as the financiers to bear the co-operation risk with customers who are responsible for the success or failure of any particular investment project or business.[8] On the other hand, in conventional banking, the process of lending money involves interest. The conventional approach goes against the teaching of the *Quran* which prohibits any financial activity that contains interest element. In Islam, money cannot be used as a commodity in business exchange, while in conventional banking, money is a commodity for profit-gaining through loans which use interest as the pricing mechanism.[9]

The growth of Islamic banking financing

Since Islamic banking is established in Malaysia in 1983, financing growth rate shows an encouraging performance. However, the performance shown is still not consistent over the operation period of 27 years since there are circumtances which affected the nation's economy as was evidenced in 1987 and 1998 when the global economy suffered from recession resulting in the decrease of value of Islamic banking financing. However, this situation has improved, and the amount of Islamic financing continues to rise as the world economy improves.

Table 1 shows the use of the Malaysian Islamic banking funds (fund mobilisation) by aggregate in the form of several types of financing. In reference to the table, the Islamic banking financing flows are broken down into overdraft financing, term financing, financing bill, trust receipts, revolving credit in foreign currencies, and the rest is represented by other available financing. During the five-year period between 2006 and 2010, the direction of financing flow of Malaysian Islamic banking increased around 11 to 25 percent annually, with the latest financing in December 2010 stood at RM162,412.6 million. The majority of the total financing is contributed by term financing that covered the financing such as leasing, financing by block, syndicate financing, factoring, private financing, home financing and others.

[7] ElGindi, T., Said, M., and Salevurakis, J.W., "Islamic Alternatives to Purely Capitalist Modes of Finance: A Study of Malaysian Banks from 1999 to 2006," *Review of Radical Political Economics* 4(4) (2009): 516-538.

[8] Chong, B.S. and Liu, M.H., "Islamic Banking: Interest-Free or Interest-Based?" *Pacific-Basin Finance Journal* 17(1) (2009): 124-144.

[9] Fauziah Md. Taib, Ramayah, T. and Dzuljastri Abdul Razak. "Factor Influencing Intention to Use Diminishing Partnership Home Financing. *International Journal of Islamic and Middle Eastern Finance and Management* 1(3) (2008): 235-248.

Table 1
Financing According to Type/Sector

Type of Financing			2006	2007	2008	2009	2010
					RM Million		
Overdraft			2731.0	3,278.0	3,740.1	4,203.5	4,446.7
	Hire purchase	Total	26567.7	29,208.8	33,570.7	39,164.1	44,959.0
		where: Passenger car	23127.2	25,422.9	29,154.8	36,498.9	41,569.3
	Leasing		376.5	505.2	331.1	760.4	875.4
	Financing based on block		0.0	0.0	0.0	0.0	0.0
	Connector financing		369.2	465.9	384.4	413.5	397.6
Term financing	Syndicate financing		1199.1	772.2	521.8	2,504.4	2,061.1
	Factoring		0.0	0.0	0.0	0.0	0.0
	Personal financing		4526.4	6,001.0	8,484.0	11,727.3	15,540.2
	Home financing		16403.0	17,036.6	18,940.8	22,728.3	29,792.6
	Others		14027.9	17,764.8	23,882.5	34,453.2	43,181.6
	Due time which:	Until 1 year	1255.6	2,096.6	4,289.4	4,183.1	3,878.4
		Exceeding 1 year	53460.3	60,720.5	75,642.8	104,596.9	127,185.1
Financing Bill			9164.2	10,291.8	10,070.0	8,056.9	7,881.8
Trust receipt			512.4	571.3	728.2	652.8	664.3
Revolve credit			2117.3	2,079.6	3,058.5	5,268.8	6,230.4
Financing in foreign currencies			327.4	841.6	2,628.2	3,132.9	3,956.9
Lain-lain			1004.6	1,050.8	1,381.6	1,907.6	2,425.0
Total			80460.5	89,867.6	107,721.8	134,973.5	162,412.6

Source: Modified from Bank Negara Malaysia (BNM)

Meanwhile the type of financing least in demand by the client is the trust receipt which only represents around 0.4 percent from the total financing every year.[10] It should be noted that although Islamic banking offers client interest-free financing, the reality is that Islamic banking still faces various forms of risk especially credit risk which involves the capability of the bank to offer more financing. When this situation occurs, the bank will strive to reduce the financing volume in the future where this will directly leads to the fall in bank's profit. Apart from credit risk, another risk that could not be taken lightly is the interest risk rate which involves the existence of substitution effect where client switches to conventional bank financing due to the decrease in interest rate causing the financing cost in conventional bank is much lower compared to financing cost of Islamic banking.[11]

Literature review

In this section, the author puts forth some past researches that touched directly and indirectly on the bank's loans/financing behaviour relating to the bank's specifications, the economic environment, and the market. The review covers both local and international researches.

A research conducted by M.K. Hassan studied the loan sales activities of commercial banks in the United States that refers to the risks vulnerability in the capital market. To achieve the set objectives, six bank specification variables are included which are the credit variables, interest rate and also business variables. Based on five market of risk measurement, this study found that specification and loan expansion have a positive connection with all forms of market risk.[12]

Hatakeda studied the banks loan in Japan under liquidity constraint from 1975 to 1995. This study used the estimation method of Ordinary Least Squares (OLS) towards bank sample data as well as other methods such as Augmented Dickey Fuller (ADF) unit roots test and cointegration relation between variables. This study is successful in finding the empirical evidence of the existence of the third regime in any bank sample financing under their liquidity constraint. From this regime, both land price index and bank capital have positive and great effect on bank financing. On the other hand, the call rate and economy activity (true GDP) have a negative effect. This study also discovered how the liberation and regulation on bank capital also influenced by bank financing behaviour.[13]

Cebenoyan and Strahan studied how domestic commercial banks in the United States managed credit-exposed risk through sales loan affect the bank capital structure, loan, benefits and risk from 1987 to 1994. This study used a series of cross-section estimation

[10] Trust receipt is a document signed by the importer, confirming receipt of the shipping documents from the bank and allows the importer to take action on behalf of the bank to get the imported items of shipping companies. Upon receipt of the goods, the importer will be selling it and using the revenue to pay the bank. See for instance, Rosli Mahmood, *Konsep Asas Perbankan*. (Kuala Lumpur: Dewan Bahasa dan Pustaka, 1997).

[11] Radiah Abdul Kader, "The Impact of Interest Rate Changes on Islamic Bank Financing," *International Journal of Business Research Papers* 5(3) (2009): 189-201.

[12] Hassan, M.K., "Capital Market Tests of Risk Exposure of Loan Sales Activities of Large US Commercial Banks," *Quarterly Journal of Business and Economics* 32(1) (1993): 27-49.

[13] Hatakeda, T., "Bank Lending Behaviour under a Liquidity Constraint," *Japan and the World Economy* 12 (2000): 127-141.

method to measure the usage of loan sales market for risk management. The study discovered bank samples balancing the financing portfolio exposure through loan trading, where bank used loan sales market as a platform in risk management and not for changing loan principal, having less capital from other banks. They produced more risky financing (business financing) as percentage to total asset compared to other banks. The study also discovered sample banks had a low risk and high profit compared to other banks. The study concluded that sophisticated risk management practice in banking affair increase the readiness bank credit but this did not fully decrease the bank's risk.[14]

Altunbas, Gambacorta and Marques studied the effect of drastic increase in security activity on banks credit offered in Europe. Regarding this matter, the security was found to change the function of credit market by reducing fundamental liquidity role which played by financial mediator. The variation of bank role from its original function had also changed the bank capability in offering credit and bank financing channel efficiency for finance principle. This study found that the security usage had protected bank financing offer from finance principle effect.[15]

Roza Hazli Zakaria and Abdul Ghafar Ismail meanwhile studied the effect on Malaysian Islamic banking involvement in securitisation activity towards loan/financing offer and risk tolerance level. Theoretically, securitisation activities will decrease the degree of bank avoidance risk. Thus, banks are motivated to increase the percentage of assets with a concentration of the risk through the granting of loans to economy sectors. This study referred to Islamic commercial banks in Malaysia for the years 1994 to 2004 by using the panel data analysis. The findings showed significant securitisation activity cut the growth financing. This indicated that securitisation is the replacement to the Malaysian Islamic banking financing. In addition, this study supported the moral hazard hypothesis where the bank involved in the securitisation will reduce financing with least risk and financing on more risky one.[16]

Aishah Abdul Rahman studied the relationship between the loans structure and market risk exposure of banks in Malaysia by adapting an estimation of unbalanced panel data to the eleven banks from 1994 to 2006. In this study, the influence of the loans structure is analysed using four main measurements which are the properties lending, specialization index, short term loans stability and long term stability loans. The study found a phase of loan structure influence the level of high market risk when the financial crisis in

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Matousek and Sarantis conducted an empirical research on the bank loan channel for

[14] Cebenoyan, A.S. and Strahan, P. E. "Risk Management, Capital Structure and Lending at Banks," *Journal of Banking & Finance* 28 (2004): 19-43. This study also found all of the bank specification variables are significant in relation to the risk.Variable capital and liquidity in negative relation to the risks, while credit variables in positive relation with risk.

[15] Altunbas, Y., Gambacorta, L. and Marques-Ibanez, D., "Financial Innovation, Bank Capital and the Bank Lending Channel: A European Empiricist's Perspective," Working paper presented at the Seminar on Monetary Policy Transmission Mechanism in the Euro Area in its First 10 Years. Frankfurt: European Central Bank, 2009).

[16] Roza Hazli Zakaria and Abdul Ghafar Ismail, "Does Islamic Banks' Securitization Involvement Restrain Their Financing Activity?" *Humanomics* 24(2) (2008): 95-109.

[17]Aisyah Abdul Rahman, "Lending Structure and Market Risk Exposures: The Malaysian Case," *Asian Academy of Management Journal* 14(1) (2009): 1-20.

financial transmission in eight Central and Eastern Europe (CEE) countries, namely the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, the Republic of Slovakia and Slovenia who have joined the European Union. In this study, the researchers tested whether changes in monetary policy affected bank loans which are different in terms of size of the bank, capital strength, liquidity and structure of ownership. To achieve the objective of the study, the researchers used a method of estimating dynamic panel on bulk of the data bank panel between 1994 and 2003. This study found that the size of the bank and liquidity has the most significant role in differentiating the reactions of banking financial policy changes. The study also looked at macroeconomic effects through bank borrowings and found evidence that linking the aggregate lending to economic activities in CEE countries.[18]

Radiah Abdul Kader reviewed the impact of interest rate changes on the demand for Islamic financing in the dual system of banking in Malaysia. In their analysis, the researchers using time series on political Unit Root Test, Cointegrasi, Vector Autoregressive (VAR), Granger Causality and Impulse Response Function (IRF) on monthly data provided by Bank Negara Malaysia (BNM) from 1999 to 2007. Several variables are included which are the total number of conventional banking financing of residential properties, the number of real estate financing Islamic banking and the base lending rate (base rate was, BLR). The study concluded that any increase in base lending rate (BLR) will encourage users to obtain financing from Islamic banking, and vice versa.[19]

Salina H. Kassim and M. Shabri Abd.Majid studied the effects of financial shocks during the financial crisis in Asia in 1997 and the global financial crisis in 2007 on Islamic banking and conventional banking. The researchers also tested the validity of the statement that said that Islamic banking is more resilient against financial shocks as compared to conventional banking. This study used the method of Impulse Response Function (IRF) and the vector auto-regression (VAR) for analysing Malaysia macroeconomic data bank and which divided into three time periods of 1997 to 1999 (Asia financial crisis), 1999 to 2007 (stable period), and 2007 to 2009 (world financial crisis). Several bank specification variables that were included are conventional loans, Islamic financing, Islamic and conventional deposits to test the response of each of the variables, the effects of changes in the macroeconomic variables such as the overnight policy rate (OPR), industrial production index, inflation and foreign exchange rates. The study found that both the banking system

Olivero, Li and Jeon reviewed how competition between banks influenced monetary policy transmission through loans channel of commercial banks in ten Asian countries and ten Latin American countries. This study used the procedure of two-step estimation data panel from 1996 to 2006. The first stage of the estimation was to measure the level of competition between the banks by adopting the methodology done by previous researchers. Then the next step was to estimate the equation in loan growth and including the independent variables of the bank competitor. Estimation results provided consistent

[18] Matousek, R. and Sarantis, N., "The Bank Lending Channel and Monetary Transmission in Central and Eastern European Countries," *Journal of Comparative Economics* 37 (2009): 321-334.

[19] Radiah, "The Impact of Interest Rate Changes."

[20] Salina H. Kassim and M. Shabri Abd. Majid, "Impact of Financial Shocks on Islamic Banks: Malaysian Evidence during 1997 and 2007 Financial Crises," *International Journal of Islamic and Middle Eastern Finance and Management* 3(4) (2010): 291-305.

evidence that the increased competition in the banking sector weakened financial transmission policy through bank borrowings. This was true especially for banks in Latin America and small-sized banks with low liquidity and capitalisation.[21]

Based on the above studies, it can be summed up that a specific study relating to financing institutions behaviour is still dominated by studies involving conventional banking. In the context of Islamic banking, studies on these issues have yet to be conducted in a comprehensive manner. The existing studies on Islamic banking financing done were only from a different perspective which leaves a literature gap that can further be explored by other researchers.

Model and data specification

Financing model specification in this section adapted the approach by earlier researchers such as Hassan,[22] Hatakeda,[23] Cebenoyan and Strahan,[24] Salina and Shabri,[25] as well as Matousek and Sarantis[26] by using annual bank data for viewing the responses of institutional banks in offering loans/financing. Based on the evaluation, the study proposes the following model specifications as the basis to conduct Islamic banking in offering financing:

$$Financing_{it} = \beta_1 + \beta_2\, financing_{it-1} + \beta_3 profit_{it} + \beta_4 risk_{it} + \beta_5 capital_{it} + \beta_6 size_{it} + \beta_7 \Delta M3_t + \beta_8 iibr_t + \beta_9 mgs_t + \beta_{10} \Delta gdp_t + \beta_{11} cpi_t + \beta_{11} econfree_t + \varepsilon_{it} + u_i$$

$$i = 1,2,....N \;\; (bank \;\; amount) \qquad t = 1,2....T \;\; (period)$$

where, $\boldsymbol{\mu_{it}}$ is the fixed effect time, $\boldsymbol{V_i}$ is fixed effect firm and $\boldsymbol{\varepsilon_{i,\,t}}$ is the pronunciation errors which do not serially correlate nor it correlates with all variables at time *t-1*. This study defines $financing_{it}$ as level of financing offered by Islamic banking that covers every economic sub-sector from year 1994 to 2010. Due to the variable lat $financing_{it-1}$ is independent variables in this study, the above specifications of the model developed become inconsistent. Therefore, Arellano and Bond recommended the use of estimation method of GMM which is more effective and consistent.[27]

Empirical results

[21] Olivero, M.P., Li, Y. and Jeon, B.N., "Competition in Banking and the Lending Channel: Evidence from Bank-Level Data in Asia and Latin America. *Journal of Banking and Finance* 35 (2010): 560-571.

[22] Hassan, "Capital Market Tests."

[23] Hatakeda, "Bank Lending Behaviour."

[24] Cebenoyan and Strahan, "Risk Management."

[25] Salina and Shabri, "Impact of Financial Shocks."

[26] Matousek and Sarantis, "The Bank Lending Channel."

[27] Arellano, M. and Bond, S., "Some Tests of Specification for Panel Data: Monte Carlo Evidence and an Application to Employment Equations," *Review of Economic Studies* 58 (1991): 277–297.

Descriptive analysis

The descriptive analysis to view statistics data and variables used in the model study was formed. Some of the statistics used in determining the statistical behaviour of variables are the mean, median, standard deviation, skewedness, kurtosis and Jaque-Bera. Min refers to the average value of each variable for the whole samples, while the standard deviation shows the variation (dispersion) of data from the mean value.

In Table 2, the variable specification sample which Islamic banking has a value of $capital_{it}$ while the largest mean has a value of $profit_{it}$ meant the smallest and least disperse in terms of the distribution of data. The summary of the statistics also showed that the total Islamic banking specification data sample skewed to the left except $capital_{it}$ which skewed to the right. Kurtosis value showed the value exceeding its normal distribution where data distribution has a leptokurtic shape and $capital_{it}$ had the highest peak of 76069.9800 whereas $risk_{it}$ recorded the lowest value of 2.3744 that is close to normal data distribution.

Table 2
Descriptive Variables Statistics

Variable	Mean	Std. Dev.	Skewness	Kurtosis	Jarque-Bera
$financing_{it-1}$	13.5035	2.9507	-1.9735	8.8011	377.4452*
$profit_{it}$	0.0166	0.0136	-0.1227	11.3970	511.6355*
$risk_{it}$	0.4636	0.2323	-0.1069	2.3744	3.3331
$capital_{it}$	41.5099	364.8374	9.8176	101.2124	76069.9800*
$size_{it}$	14.5401	2.1181	-0.3741	4.5875	24.7698*
$\Delta M3_t$	13.1333	0.4106	-0.2040	2.2620	8.0588*
$iibr_t$	4.0617	1.9166	1.1957	2.9798	64.8143
mgs_t	3.7845	1.5326	0.9809	2.4339	47.2523*
Δgdp_t	12.8396	0.4010	0.1436	1.9537	13.3413*
cpi_t	2.7077	1.3733	0.4847	2.4176	14.4924*
$econfree_t$	64.6000	3.6385	0.4004	2.0562	17.3642*

For Malaysia monetary policy variables, the distribution data showed the average value of a dispersion of $\Delta M3_t$ was the highest with the value 13.1333 and mgs_{it} indicated the average value of the lowest at 3.7845. The distribution data for $interbankrate_{it}$ and mgs_{it} is a skew to the right with the exception of data for mgs_{it} that skewed to the left with 0.2040. Thus, the value of kurtosis for $\Delta M3_t$, $iibr_t$ dan mgs_t all approaching the value of normal

The variable of economic cycles, data $econfree_t$, indicating the highest dispersion distribution data of 64.6000 with the value of the standard deviation of 3.6385. Meanwhile, the data for the variable $inflation_{it}$ indicated the lowest data distribution that is the value of 64.600 with the value of the standard deviation of 3.6385. Thus, the distribution data for Δgdp_t, cpi_t , and $econfree_t$ indicated the data had skewed to the right. Kurtosis value of

Δgdp_t data had less than the normal distribution which is 1.9537 while the data for cpi_t and $econfree_t$ approaching the value of normal distribution with the value of each is 2.4176 and 2.0562 respectively.

The *jarque-Bera* test was carried out to evaluate whether the data used are scattered normally or not. The results are that all data for variables used showed a significance level of 0.05 per cent with the exception of data for the variable $iibr_t$. These results showed that almost all the data used in this study are not normally scattered.

Result estimation

Table 3 shows the estimation of a dynamic model for financing Islamic banking. The results showed that the Islamic banking financing behaviour in this study is determined by three main factors namely, the Islamic banking specifications, changes in monetary policy, and economic environment.

Table 3
Model Estimation Result

Specification	Estimation Parameter	
	GMM-Difference	GMM-System
$financing_{it-1}$	0.0871*	0.1046*
	(2.4755)	(2.2779)
$profit_{it}$	-1.1897	1.2797
	(-0.4768)	(0.3381)
$risk_{it}$	3.0248*	2.2700*
	(11.6600)	(2.9838)
$capital_{it}$	-0.0019*	-0.0020*
	(-15.9870)	(-15.6427)
$size_{it}$	0.7042*	0.7783*
	(8.6663)	(8.8067)
$\Delta M3_t$	1.0876	0.4277
	(0.7368)	(0.7483)
$iibr_t$	-0.5965*	-0.3869*
	(-4.4083)	(-2.6096)
mgs_t	0.6559*	0.4755*
	(3.3014)	(2.3540)
Δgdp_t	-0.5927	-0.0037
	(-0.4413)	(-0.0061)
cpi_t	-0.0065	-0.0229
	(-0.2271)	(-1.0957)
$econfree_t$	0.0070	0.0085
	(0.3458)	(1.0097)
Sargan Test	126.3045*	3.7883*
AR(1)	-0.42	-0.11
AR(2)	-0.89	-0.77

*Significant at 5% **Significant at 1% *Significant at 10%
( ) t-value
Sargan Test is referring to exceed limitation recognition

Referring to Islamic banking specification, the estimated result in Table 3 shows

variable lat financing ($financing_{it-1}$) to increase current levels of funding Islamic banking, and this decision confirms the dynamic specifications at the level of five percent. The higher level of past financing is influenced by prudent "Give monetary policy" which then brought an excellent repayment track record of the client. In addition, the past Islamic banking financing flow had provided in many productive sectors which were capable of generating high returns to the institution which in turn encouraged Islamic banking to offer more financing for the following year.

The results also show an increase of one per cent risk level, which is an increase in the level of financing of Islamic banking by 2.2700 percent. This situation reflected the Islamic banking changing their financing portfolio by moving towards a more risky financing as a reaction to highly decreasing profit from low-risk financing. Islamic banking is generally involved in various forms of financing such as property, consumer, commercial, and industrial financing, which involved various risks. The effect of their active engagement in the securitisation activity also resulted in the bank to focus on their assets which motivated banks to be involved in risky financing for the potential high returns.[28]

The study also shows $size_{it}$ have a positive relation to financing with a value of 0.7783 percent. This shows the size factor as the main determinant of whether a bank will add financing or otherwise. These findings are consistent with the findings of Matousek and Sarantis who found that the size of the bank has the most significant role in differentiating the reactions of banking monetary policy changes.[29] Olivero, Li and Jeon also found that smaller banks with low liquidity and capitalisation have limited ability in offering financing/loans.[30]

For monetary policy variables, only two variables, namely $iibr_t$ dan mgs_t show the importance of the level of financing in Islamic banking. However, there is a difference of the two variables where $iibr_t$ is negative while mgs_{it} is positive. The negative relationship between the variable $iibr_t$ with the $financing_{it}$ in the study showed an increase of one percent in the interbank money market activities which led to Islamic banking to reduce level of financing by -0.3869 percent. These findings proved that the investment activities between Islamic interbank investment had the effect of replacement which was high enough with the level of financing as well as their tendency to maintain liquidity.[31]

The mgs_t variable shows an increase of one percent which is significant in government securities in increasing the level of financing Islamic banking of 0.4755 per cent. This shows the retention level of high government securities held by Islamic banking which will result in high profit return upon sales at maturity. These returns then are distributed in the capital

Next, the money supply growth of $\Delta M3_t$ variable indicates a positive sign for financing level. This result is consistent with the theory of financing policy to link money growth increase with the level of funding of banking institutions. Although consistent with the theory of money supply, the study found the relationship to be insignificant.

[28] Roza Hazli and Abdul Ghafar, "Does Islamic Banks' Securitization Involvement Restrain Their Financing Activity?"
[29] Matousek and Sarantis, "The Bank Lending Channel."
[30] Olivero, Li and Jeon, "Competition in Banking and the Lending Channel."
[31] Zulkifli Osman, Jaafar Ahmad and Md Zahir Kechot, *Ekonomi Kewangan*. (Kuala Lumpur: Dewan Bahasa dan Pustaka, 1992).

For the economic cycles variables, the three variables do not indicate the importance of Islamic financing level even though the resulting mark is in line with theories and studies carried out previously. On the other hand, one percent increase in $econfree_t$ found to increase Islamic banking financing by 0.0085%. This condition exists when economic units, especially traders and entrepreneurs have freedom and confidence doing business. The higher the level of freedom will encourage economic units to get financing from Islamic banking which in turn contributed to Islamic banking profits.[32] However, the result obtained is not significant in influencing levels of financing in Islamic banking.

Conclusion

The results of the study showed that while the level of domination of the Islamic banking market is still small, the level of public confidence in the Islamic banking financing is always high and increases from year to year since the establishment of the first Islamic bank in 1983. This study presents the following implications of the conduct of Islamic banking in offering financing:

i. Islamic banking should minimize the production of unproductive financing which has a high potential for problems to customers involving speculative financing such as purchase of shares, acquisition of corporations, and so on.

ii. The Government's efforts through the implementation of physical and financial policy will need to view and take into account the unique features and capabilities of Islamic banking in offering financing. This is to prevent the occurrence of shock within the industry which eventually results in Islamic banking unable to react well. Failure to respond will ultimately derail Islamic banking into instability, and in turn exposes the bank to various forms of credit risks.

In a nutshell, this study found a pattern and behavior of financing in Malaysian Islamic banks. The study only provided limited information in relation to the conduct of Islamic banking in offering financing, especially in terms of samples, the use of the formulation and the variables included in the model construction research. To make this research more significant, it is hoped that future researchers can compare the patterns and behaviour of Islamic banking financing with conventional banking sector while also taking other factors into account, in particular fiscal developments in Malaysia.

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