

# [The was first commence in 1970’s. malaysia is](https://assignbuster.com/the-was-first-commence-in-1970s-malaysia-is/)

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The meaning of Islamic Banking (IB) refersto a banking activity or a system of banking that follows the basic principlesof Shariah (rules and values in accordance with Allah’s (God) decree in theHoly Quran and according to the hadith. Islamic banking is also known asinterest free banking system as the Shariah disallows the acceptance of “ Riba” or interest rate for the accepting and lending of money. In IB system, abusiness that offers good interest rates or services is strictly prohibited andit is in fact considered Haram (forbidden).

Islamic banking offers the samefacilities as conventional banking system except that it strictly follows therules of Shariah or Fiqh al- Muamalat. The IB system offers almost similar withits conventional counterpart such as saving account, current account, creditcard, loan and other financial product but it must follow and not prohibited byprinciples of Shariah. Islamic Banking has gone through numerous changes andhas been evolved since it was first commence in 1970’s. Malaysia is playing an iconic role inIslamic banking, having been a pioneer in the beginning and a frontrunner inthe global arena at present. Malaysia Islamic Finance industry has been inexistence for more than 30 years. The enactment of Islamic Banking Act 1983allow the first Islamic Bank to established The first shariah based bankingsystem was introduced through the establishment Bank Islam Malaysia Berhad(BIMB) and has been playing the leading role in the development of thecountry’s IB Industry. BIMB has been providing technical assistance in thesetting up of several Islamic institutions in the Asian region such asIndonesia, Thailand and Sri Lanka..

In1993, the “ Islamic banking window” concept was introduced, which allowedinterested conventional banks to use their existing banking infrastructure tooffer the IB products. Through this concept, bank customers could opt foreither the conventional or Islamic banking products by patronizing a particularconventional bank. The window concept was well-received by the conventionalbanks, as they were able to leverage on their existing reputation and networkinfrastructure to capture new market segments and diversify their customerbase. More importantly, the Islamic banking windows provided a positivecompetitive pressure to the full-fledged BIMB to increase its efficiency and beinnovative in its products offering and delivery channels (Shabri & Salina, 2015). Accordingto RAM Rating Service Berhad, the expansion of Malaysia Islamic financing continuedto surpass conventional banking loans in 2016 amid weaker economic conditions. The agency also noted that the size of Islamic financing grew to RM45 billionlast year, compared to RM32 billion that was achieved by the conventionalbanking sector.

Despiteof the rapid expansion of Islamic bank all over the world, Islamic banks arestill being treated as territory for some capitalism countries. This is due tothe practices of IB are conflicted with the practices that have been held bythe capitalist for a long time. It is to believe that the trend of penetrationof Islamic bank into the conventional banking system will continue.            TheIB rapid growth and increasing demand on Islamic Banking products require adeeper understanding and further re-assessment of the contribution of IB to theoverall economic performance. The industry rapid development also requiresfurther enrichment as there are limited studies conducted in this field on acountry, specifically a developing country such as Malaysia which is certain tofind a way to advanced them toward becoming a well-developed country. The conventionalbanking are based on interest whereas the IB like have been stated abovefollows the Shariah law in all of its operation. In 2008, the global economicworld has been shocked with one of the largest financial crisis happened in themodern world and it revolved with the used of interest in conventional banking.

During this time, the IB industry was seen to have manage to minimize theeffect created by the financial crisis because of their focus on themaintaining the stability of the financial system with its profit sharingsystem and also the disallowed of the interest-based activity. Based on thestudy made by (Arouri 2013), he has found that the Islamic bank does help theinvestors from the financial crises by comparing the Islamic stock indices tothe conventional ones. This context however has been contradicted by some ofthe other researchers such as (Charles, 2011) who had found that the Islamicfinances indices are as likely to be affected as its conventional counterpartsand they also conclude that there were no empirical evidence that could provethe IB to be more resilience towards the impact of the financial crisis ratherthan the conventional. In order to validate this issue, as such furtherinvestigation are needed regarding this topic since the IB industry has alwaysbeen said to be able to withstand and survive the effects of a financial.

Furthermore, one ofthe indicators that will be used in this research is the total deposit (TD) ofthe chosen Islamic banks in Malaysia. Total deposits are really important forbanks since it can provide the needed funds for the banks to carry out theiractivities. By having these funds, banks can then provide loans or any otherfinancial service for its consumers or businesses thus promoting the economicgrowth of the country itself. That is why the total deposits in banks arereally important for the economy. (Walid, 2015) said that operations conductedby Islamic banking system have been characterized by the ability of attractinglarge amount of deposit from both Muslim and Non-Muslims customers throughsyariah-compliance retail banking, wholesale and investment banking services, which serve as a mechanism that allow sustainable growth to businesses thatcould encourage economic development.

However, conventionalbanks also have the funding from the collection of interest payment from itsconsumers. Whereas IBs which forbid the usage of any interest-based activityrely mainly on the deposits gained from its consumers thus making the totaldeposits in IBs are much more important than their conventional counterparts. This may be a problem for the IBs to gain more fund to finance their activitiesthus making it really important for us to see whether or not the total depositsof IBs affect the economic condition of the country itself. In the studyconducted by (Walid, 2015) has found that the total savings of the IB’s inKenya does have a positive relationship with the economic growth of the countrythus proven that the IB activity does influence the economic growth of thecountry in a good way. So even though the IB has harder time to gain theirfund, it might help them in the long run to see it affecting the economic growthpositively particularly in Malaysia. Therefore there is a need for this studyto be conducted so that we can determine the actual relationship between thesaid indices with the dependent variable. This two main issueswhich were the possibility of another global financial crisis affecting thecountry and how the IBs can survive with the funding mostly from its totaldeposits has led us to prioritize on this topic so that we can find therelativity between the said problems and the Islamic banking which will then bedetermined whether or not it affect the Malaysian economy as a whole.

The otherreason for the research would also because of the lack of research in thisparticular area and since the future of Islamic banks remains vague in thecurrent financial world. The condition of the issue also has been stated to beambiguous and there are scarce information to prove that the IB activities doesaffect the economic growth of a country by being better than the interest-basedbanking activity (Furqani and Mulyany, 2009). By completing this study, itwould contribute to the fact of the relationship between the chosen indiceswhich are the total financing (TF) and also the Total Deposit (TD) of the IBstowards the economic growth of Malaysia and with those results, it might helpus to determine and guess the pathway of the IBs in the country. This paper aims to explore the effect ofIslamic Banks total deposit and total financing towards the GDP of Malaysia inthe short-term and immediate effect. The basic system of the IB that it followsthe Shariah Law as its guidance. The possibility of another global financialcrisis affecting the country and how the IBs can survive with the fundingmostly from its total deposits has led us to prioritize on this topic so that wecan find the relativity between the said problems and the Islamic banking whichwill then be determined whether or not it affect the Malaysian economy as awhole. The detailed review from the prior studies will be presented in thefollowing chapter.