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[Business](#), [Industries](#)



The meaning of Islamic Banking (IB) refers to a banking activity or a system of banking that follows the basic principles of Shariah (rules and values in accordance with Allah's (God) decree in the Holy Quran and according to the hadith. Islamic banking is also known as an interest free banking system as the Shariah disallows the acceptance of "Riba" or interest rate for the accepting and lending of money. In IB system, a business that offers good interest rates or services is strictly prohibited and it is in fact considered Haram (forbidden).

Islamic banking offers the same facilities as conventional banking system except that it strictly follows the rules of Shariah or Fiqh al-Muamalat. The IB system offers almost similar with its conventional counterpart such as saving account, current account, credit card, loan and other financial product but it must follow and not prohibited by principles of Shariah. Islamic Banking has gone through numerous changes and has been evolved since it was first commence in 1970's. Malaysia is playing an iconic role in Islamic banking, having been a pioneer in the beginning and a frontrunner in the global arena at present. Malaysia Islamic Finance industry has been in existence for more than 30 years. The enactment of Islamic Banking Act 1983 allowed the first Islamic Bank to be established. The first Shariah based banking system was introduced through the establishment of Bank Islam Malaysia Berhad (BIMB) and has been playing the leading role in the development of the country's IB industry. BIMB has been providing technical assistance in the setting up of several Islamic institutions in the Asian region such as Indonesia, Thailand and Sri Lanka..

In 1993, the "Islamic banking window" concept was introduced, which allowed interested conventional banks to use their existing banking

infrastructure to offer the IB products. Through this concept, bank customers could opt for either the conventional or Islamic banking products by patronizing a particular conventional bank. The window concept was well-received by the conventional banks, as they were able to leverage on their existing reputation and network infrastructure to capture new market segments and diversify their customer base. More importantly, the Islamic banking windows provided a positive competitive pressure to the full-fledged BMB to increase its efficiency and be innovative in its products offering and delivery channels (Shabri & Salina, 2015). According to RAM Rating Service Berhad, the expansion of Malaysia Islamic financing continued to surpass conventional banking loans in 2016 amid weaker economic conditions. The agency also noted that the size of Islamic financing grew to RM45 billion last year, compared to RM32 billion that was achieved by the conventional banking sector.

Despite of the rapid expansion of Islamic bank all over the world, Islamic banks are still being treated as territory for some capitalism countries. This is due to the practices of IB are conflicted with the practices that have been held by the capitalist for a long time. It is to believe that the trend of penetration of Islamic bank into the conventional banking system will continue. The IB rapid growth and increasing demand on Islamic Banking products require a deeper understanding and further re-assessment of the contribution of IB to the overall economic performance. The industry rapid development also requires further enrichment as there are limited studies conducted in this field on a country, specifically a developing country such as Malaysia which is certain to find a way to advanced them toward

becoming a well-developed country. The conventional banking are based on interest whereas the IB like have been stated above follows the Shariah law in all of its operation. In 2008, the global economic world has been shocked with one of the largest financial crisis happened in the modern 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 the effect created by the financial crisis because of their focus on the maintaining the stability of the financial system with its profit sharing system and also the disallowed of the interest-based activity. Based on the study made by (Arouri 2013), he has found that the Islamic bank does help the investors from the financial crises by comparing the Islamic stock indices to the conventional ones. This context however has been contradicted by some of the other researchers such as (Charles, 2011) who had found that the Islamic finances indices are as likely to be affected as its conventional counterparts and they also conclude that there were no empirical evidence that could prove the IB to be more resilience towards the impact of the financial crisis rather than the conventional. In order to validate this issue, as such further investigation are needed regarding this topic since the IB industry has always been said to be able to withstand and survive the effects of a financial.

Furthermore, one of the indicators that will be used in this research is the total deposit (TD) of the chosen Islamic banks in Malaysia. Total deposits are really important for banks since it can provide the needed funds for the banks to carry out their activities. By having these funds, banks can then provide

loans or any other financial service for its consumers or businesses thus promoting the economic growth of the country itself. That is why the total deposits in banks are really important for the economy. (Walid, 2015) said that operations conducted by Islamic banking system have been characterized by the ability of attracting large amount of deposit from both Muslim and Non-Muslims customers through syariah-compliance retail banking, wholesale and investment banking services, which serve as a mechanism that allow sustainable growth to businesses that could encourage economic development.

However, conventional banks also have the funding from the collection of interest payment from its consumers. Whereas IBs which forbid the usage of any interest-based activity rely mainly on the deposits gained from its consumers thus making the total deposits 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 activities thus making it really important for us to see whether or not the total deposits of IBs affect the economic condition of the country itself. In the study conducted by (Walid, 2015) has found that the total savings of the IB's in Kenya does have a positive relationship with the economic growth of the country thus proven that the IB activity does influence the economic growth of the country in a good way. So even though the IB has harder time to gain their fund, it might help them in the long run to see it affecting the economic growth positively particularly in Malaysia. Therefore there is a need for this study to be conducted so that we can determine the actual relationship between the said indices with the dependent variable. This two main issues which were the possibility of

another global financial crisis affecting the country and how the IBs can survive with the funding mostly from its total deposits has led us to prioritize on this topic so that we can find the relativity between the said problems and the Islamic banking which will then be determined whether or not it affect the Malaysian economy as a whole.

The other reason for the research would also because of the lack of research in this particular area and since the future of Islamic banks remains vague in the current financial world. The condition of the issue also has been stated to be ambiguous and there are scarce information to prove that the IB activities does affect the economic growth of a country by being better than the interest-based banking activity (Furqani and Mulyany, 2009). By completing this study, it would contribute to the fact of the relationship between the chosen indices which are the total financing (TF) and also the Total Deposit (TD) of the IB towards the economic growth of Malaysia and with those results, it might help us to determine and guess the pathway of the IBs in the country. This paper aims to explore the effect of Islamic Banks total deposit and total financing towards the GDP of Malaysia in the short-term and immediate effect. The basic system of the IB that it follows the Shariah Law as its guidance. The possibility of another global financial crisis affecting the country and how the IBs can survive with the funding mostly from its total deposits has led us to prioritize on this topic so that we can find the relativity between the said problems and the Islamic banking which will then be determined whether or not it affect the Malaysian economy as a whole. The detailed review from the prior studies will be presented in the following chapter.