

CHAPTER I

INTRODUCTION

A. Research Background

The need of capital either for company or person tends to increase each year. The increasing activities can be seen from the increasing rate of production. In order to ease the society's activities to rise capital; the government along with the related institutions should be able to create environment for the capital market participants. Furthermore, government has power to create the strict regulation to the participants to prevent the confusion in the market.

Capital market is a part of financial market that functions as both for economic and financial function. As economic function; capital market allocates fund from the issuer to the fund-seeker. While as financial function; capital market gives return (capital gain) for the fund issuers based on the types of investments they have (Sri 2012).

Capital market development is influenced by a number of factors which is the long-term supply and demand. There are securities supply and securities demand. The companies that will issue the beneficial securities categorized in securities supply. While the investors who will buy the securities categorized in securities demand. The development of capital market is supported by the increasing of fund in the market. It should also followed by the regulation to protect the involving parties.

According to Beik and Fatmawati (2004) capital market has an important role in the development of global economy. As a country in which experiencing the booming financial market, capital market takes over the Indonesian economy to play an important role. The capital market can be used as the fund intermediary, as an alternative market to invest, or as indicator of macroeconomic stability.

Since the 1980's the capital market in Indonesia highlighted a significant growth. It marks the positive growth in accordance with the ratification of Law No. 8 of 1995 on Capital Market, and also the regulation after the crisis on 1997 on the good cooperate governance (GCG). In 2013, the supervisor of the capital market in Indonesia has been transferred from Bapepam-LK and the Central Bank to the Indonesian Financial Service Authority (OJK). IDX is a result of Jakarta Stock Exchange and Surabaya Stock Exchange merger (Jeffrey 2013)

The value of market capitalization in Indonesia started from the year of 2010 until 2016 is also increasing. According to the report from Saham OK (2016) the total value in 2010 is Rp.3.258 Trillion. While in 2011, the total is Rp.3.538 Trillion. The number increases to Rp4.128 Trillion in 2012. In the year of 2013 the total value slightly increasing to 4.219 Trillion. Afterward in 2014, the total reaches to Rp.5.228 Trillion. In fact, in the following year, the total values decreasing to Rp4.782 Trillion. By the end of 2016 the market capitalization increases to the total of Rp5.753 Trillion.

The performance of the market capitalization is quite excellent. It can be seen from the value which keeps increasing. Although in 2008 the value slumps from the previous year, it might be caused by the global crisis back then. The good capital performance is an excellent indicator to trigger the economic performance in Indonesia. Comparing to other countries in ASEAN, Indonesia's market capitalization is still lack behind.

TABLE 1.1
The Development of Market Capitalization of Listed Companies in 4
ASEAN Countries

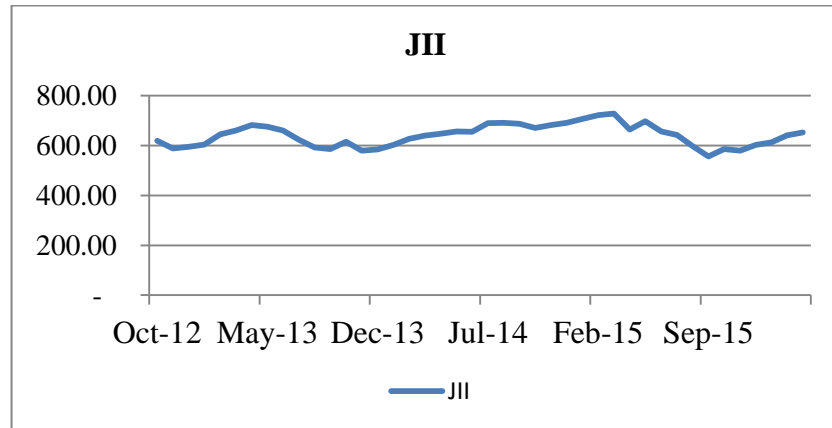
Country	Market Capitalization of Listed Domestic Companies 2014 (% of GDP)
Indonesia	54.76
Malaysia	63.59
Singapore	73.1
Thailand	62.63

Source: Global Financial Development Database (GFDD)

The idea of Islamic Conventional Market in Indonesia is started in the year of 1997 when PT Danareksa Investment Management issued the Islamic Mutual Fund. Then on July, 3 2000, the company along with Indonesia Stock Exchange on (formerly known as Jakarta Stock Index) launched the Jakarta Islamic Index (JII) (Oxford Business Group 2015).

Indonesia ranks as the highest Muslim population with 202.867.000 million or 88.2 % from the total population (Centre 2009). The high population gives perfect chance for JII market capitalization to

grow up. From the year of 2012 until 2016, the rate keeps increasing. Although in the end of 2015, the value slumps a little.



Source: Fusion Media.Ltd

FIGURE 1.1

The Pattern Movement of Jakarta Islamic Index

From the research by Shiller (1988) it showed one of the things causing the volatility is the regulation made by the government. The regulation which initially aims to reduce the policy might actually increase the volatility; while the regulation aims to improve the economic performance might decrease the volatility. The volatility in 2008 can also happen because of the global crisis. The crisis led to the slump market yet the recovery took such a short time to get back to normal.

In other country cases, such as Malaysia and Bahrain, the Islamic Capital Market prolific to all level of capital market and the derivatives product. In each country, the market development is quite high. Capital market also records in rapid speed in terms of the development. For the international market, Dow Jones as one of the renowned market provider

along with the prominent apprentice and scholar outline the Dow Jones Islamic World Markets (DJIWM) functions to refine the Sharia based investment (Bacha and Mirakhor 2013).

Up to 2014 Malaysia ranks in the first position for the countries with the largest ICM, followed by Indonesia, Saudi Arabia, Turkey and Kuwait. Malaysia has become the pioneer in the ICM. Malaysia has relative market stability among the countries with ICM.

TABLE 1.2

Top 5 Countries with Largest Islamic Market Capitalization

Country	Total Market Capitalization of 5 Muslim Countries 2014 (US\$ Millions)
Malaysia	516.000
Indonesia	512.800
Saudi Arabia	397.300
Turkey	312.800
Kuwait	151.000

Source: INCEIF Report

As one of the active members in ASEAN Economic Community (AEC) and in the capital market, exchange rate shows the strength of the currency. The exchange rate is a crucial tool for the industry activities. A number of companies doing import and export rely on the stability of ER. Typically, US Dollar is a benchmark for the trade in international level.

Rupiah appreciation is a positive signal for investor in capital market. Meaning rupiah appreciation will make stock market stronger and vice versa. Rupiah depreciation will increase the export value of a certain company. An increasing in export value will increase the company's revenue, leads to the increasing profit that in the end will increase JII. When one company has higher profit, overall stock market will also have increasing value.

Capital market in Indonesia is developing as well. According to the report from Indonesia: Financial System Stability Assesment (2010) it declares that Indonesia capital market is still limited to several types of investments. The government has to actively maintain the strategy on getting the economic stability, for example using the macroeconomic stability.

Besides exchange rate, another important macroeconomic variable influencing stock market is oil price. Oil price impacts most of the economic activities. The impact of oil price influences the supply and demand side in the market. Oil price has continuously becomes an indicator to estimate the stock market. While majority it gives significant relationship on the stock market, different countries will have the different result on this.

Brent oil has become the standard in the international price of oil. After the normal price for a couple of years, the price drastically fell from

\$112 to \$47 on the period of June 2014 until January 2015. It can be caused from the financial crisis at that time (Baumeister and Killian 2014).

As one of the AEC members, Indonesia should maintain the relationship with the neighbor countries. In terms of economy activity, the effect of regional stock market to Jakarta Islamic Index (JII) performance is also important. One of the advanced stock markets in ASEAN besides Indonesia is Malaysia. Malaysia also has stock market which is FTSE Malaysia. Established in January, 12 2006 Bursa Malaysia Berhad and FTSE International cooperation signed an agreement to establish Islamic indices in Malaysia. The index was officially launched in 26 June 2006 (Russel 2009).

The report from Arslanalp, et al. (2006) concludes that a shock from one country to the financial condition to other countries can be said as a financial spillover. There are a number of reasons on the countries shock influences to the others, namely; the magnitude, the linkage, and the vulnerability. So, it can be concluded that there are the linkages of one country financial stability to the other countries.

Another factor which is counted to the stock market influence is gold price. Gold price is likely having a correlation in the stock market. Gold becomes an important element. As one of the scarcest metal, the gold price surely is high. No wonder why the use of gold mostly used for jewelry. Besides, gold also becomes a valuable investment. Gold is also

used in the financial industry as a holding. Another use for gold is also become the source of wealth for the owner of gold (Bilal, et al. 2013).

Nowadays holding gold is regarded an important to do, especially in the stock market development. The result from the gold price on the stock market relationship shows the interesting finding. According to the result from the research of (Bhunia and Das 2012) shows the movement between the gold prices and the stock market returns. The movement even occurred during the crisis period. In case of India, people not only think gold as a precious yellow metal, but also as the kind of important investment. The sentiment also reasons why people hold gold as an investment in India. It is an interesting research that suggests the investors to consider the fluctuation on oil prices and gold prices surely affect the stock market return both in short and long run.

As the macroeconomic variable such as exchange rate and oil price, and external variable such as, FTSE Malaysia and gold price are all likely having various impacts on Jakarta Islamic Index (JII), thus the factors are interesting to be analyzed. Hence, this study entitled **“The Analysis of Macroeconomic Variables, Regional Stock Index, and Gold Price Impact on Jakarta Islamic Index: An Approach of Vector Error Correction Model (VECM) (Period October 2012- March 2016)”** is going to analyze the impact among exchange rate (ER), oil price, FTSE Malaysia and gold price on Jakarta Islamic Index (JII) price. This study uses monthly closing price of Jakarta Islamic Index (JII), oil price

and gold price. The monthly data basis is also applied on the exchange rate (ER) and FTSE Malaysia price. This research will use the Vector Error Correction Model (VECM) analysis.

B. Research Limitation

A number of factors are influencing the stock market volatility. Thus, the research limitation restricts what are the problems that will be analyzed and occurred in the analysis. This study restricts to the following limitations:

This research only limits the variables of Jakarta Islamic Index, Exchange Rate, Oil Price, FTSE Malaysia and Gold Price during October 2012-March 2016 period.

C. Research Question

Based on the background explained earlier, these following problems will be solved throughout the research:

1. What is the impact of exchange rate on JII both in short run and long run?
2. What is the impact of oil price on JII both in short run and long run?
3. What is the impact of FTSE Malaysia on JII both in short run and long run?
4. What is the impact of gold price on JII both in short run and long run?

D. Research Objective

Based on the research questions, thus the research objectives from this paper are as follows:

1. In order to know the impact of exchange rate on JII both in short run and long run
2. In order to know the impact of oil price on JII both in short run and long run
3. In order to know the impact of FTSE Malaysia on JII both in short run and long run
4. In order to know the impact of gold price on JII both in short run and long run

E. Research Benefit

The benefits from the research are surely for the development of Islamic Capital Market in Indonesia. The detailed objectives will be mentioned as follow:

1. It is expected to explain the long-run and short run relationship among: JII, exchange rate, oil price, FTSE Malaysia, and gold price
2. It is expected to give deeper knowledge to the current investor, or to the future investor on the factors affecting the Islamic Capital Market in Indonesia
3. It is expected to be the relevant input or comparison to the current researchers or to the future researcher.

