

CHAPTER I

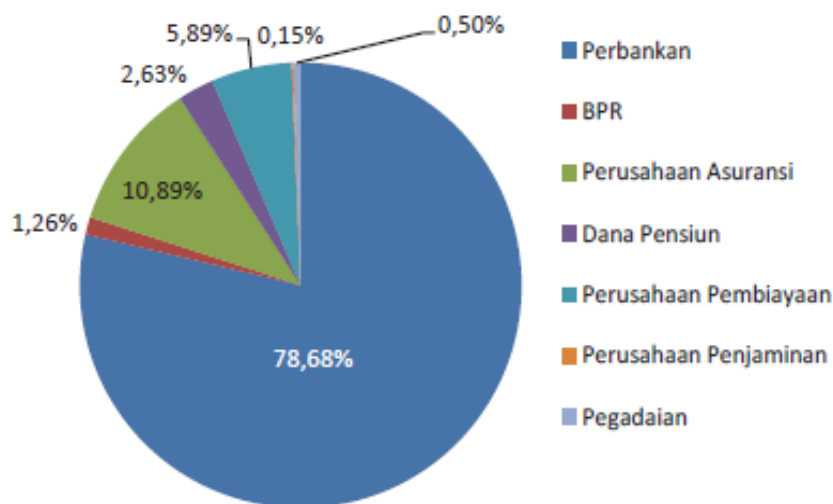
INTRODUCTION

A. Background

Banking stability is a very important issue in the current economic times, due to the 1997 economic crisis and the global crisis in 2008, the crisis serves as proof of the economic stability of a country that is affected by the stability of the financial system (Simorangkir, 2004). Banking is one part of the financial system. One of the functions of banks is as an intermediary institution, According to Law 10 of 2008 on banking, Bank is a business entity that collects funds from the public in the form of deposits and distribute to the public in the form of savings and the distribution of funds to the public in the form of credit or other forms to improve people's lives. where banks as inter-party financial institutions that have excess funds with the parties who need funds.(Mishkin, 2001).

One of the characteristics of a good financial system, including the banking system, is that the financial system is in a condition where it can absorb shock from financial disturbances and real economic disturbances. This serves to provide supplies and a sense of security and increase confidence in the product as a whole, A good financial system will encourage the creation of financial system stability.

The composition of assets in financial institutions in Indonesia dominated by banking becomes one important cause for maintaining stability, this can be seen from the following figure:



Source: *Kajian Stabilitas Keuangan Bank Indonesia, 2014.*

FIGURE 1.1
Composition of Assets Among Financial Institutions (Juni 2013)

On the other hand, the role of the banking system is important in maintaining and operating the stability of the financial system. The many failing banks in mobilizing public funds will destabilize the financial system of a State, even bringing systematic impacts on the State around the world.

Based on figure 1.1, it can be seen that banking financial institutions dominate the composition of financial institution assets by 78.68%. Insurance became the second largest financial institution with assets of 10.89%, finance companies to become the third largest financial institution with assets of 5.8%, other financial institutions such as BPR (Bank Perkereditan Rakyat), royalty, pension funds, venture capital firms, and investment management companies have an asset of not more than 3% each, and the dominance of banking assets makes

this financial institution have a big influence on the stability of the economy in Indonesia.

The stability of the banking system is very important because the good and bad banking system will affect the overall economic and social aspects. This condition requires banks to apply strict regulations. This serves to provide protection and a sense of security for banking customers and increase confidence in the products of Sharia Banking.

The stability of the banking system and the macroeconomic variables are two interrelated and determining aspects of each other. The stability of the banking system, in general, is reflected in the sound banking condition and the intermediary function of the banking system, whether the banking performance (in this case the sharia bank) influenced by the internal conditions of bank management and external economics such as macro conditions

According to (Basurto & P.Padilla, 2007) a strong and good financial system is a major factor for macroeconomic stability, in terms of supporting savings and the efficiency of resource allocation in investment opportunities. According to Bank Indonesia, the stability of the financial system can be defined through several approaches: (1) A stable financial system able to allocate resources and be able to absorb the Shock that occurs (II) A stable financial system is a financial system capable of performing the intermediary function, Implementing payments and distributing risks properly if there is economic disturbance and (III) Financial system stability is the conditions under which price

fixing, allocation of funds, and risk processing function well and support economic growth

Indonesia adheres to the dual Banking system (Islamic Banking and Conventional Banking). According to Bank Indonesia Law No.10/1998, Islamic Banks or Islamic Banks are banks conducting business based on sharia principles, namely the rules of an agreement under Islamic law between the Bank and other parties to deposit funds or financing business activities.

Islamic banks as one intermediary institution have a strategic function of collecting funds from units of the economy that have *surplus units* with other units that suffer from lack of funds *deficit units*. The activities of banks to raise funds called the finding activity. While the activities of channeling funds to the community by the bank called the activities of financing or lending (Sudarsono, 2003)

In Islamic banks, the services provided to customers adapted to Islamic principles in accordance with Islamic law. Sharia principles as applied by Islamic banks is financing based on the principle of profit sharing (*Mudharabah*), financing based on principle of capital participation (*Musharakah*), principle of selling goods to obtain profit (*Murabahah*), or financing of capital goods based on principle of the lease without option (*Ijarah*), or with the option of transfer the ownership of the leased goods from the bank by another party (*Ijarah wa Iqtina*).

According to Antonio (2001), Islamic banks are not tailored with interest rate system. Hence, the profit is derived from profit sharing system with

businesses that use the funds of Islamic banks as well as investments of Islamic banks themselves. Characteristics of the operational principles of sharia banks is to use a profit-sharing system, it is different to the interest system (Yuliadi, 2001). In general, Islamic banks are financial institutions whose main business is providing financing and other services in traffic in payments as well as money circulation which operates in accordance with the principles of Islamic Sharia (Yuliadi, 2001)

The presence of sharia banking in the world gets great enthusiasm from all over the world. This is evidenced by the rapid development of Islamic Banks in each country that occurs not only in the Islamic State. Western countries are beginning to apply sharia banking as one of their banking systems, such as the UK and Australia (Kurniati, 2012)

The development of sharia financial industry in Indonesia began in 1991 the establishment of the first Sharia Bank (BUS) in Indonesia, namely Bank Muamalat Indonesia, It shows the needs of the public will the presence of financial institutions that can provide financial services in accordance with sharia (Bank Indonesia, 2002). Islamic banks are emerging as the solution of the wishes of Muslims in Indonesia who want to release from usury as used by conventional banks (Rivai & Ismail, 2013). Not only that, sharia banks also appear as a solution to the weakness of resilience or stability that occurs in conventional banking in the face of crisis shocks. This is because sharia banks are pointed out by some experts have better resistance to crises than conventional banks. This is because the distribution of benefits and risk sharing takes place fairly (Faiz, 2010)

Currently in Indonesia experiencing rapid growth in sharia banking, This is proved because Islamic banks have been able to deal with and withstand Macroeconomic shocks especially during the Global crisis, This has broken the resilience of the capitalist system that has been applied, although in Indonesia has not Banks fully use sharia principles, so that sharia banking has not been involved in creating monetary stability in Indonesia (Putri, 2008).

TABLE 1.1
Islamic Banking Network
Periode 2012-2016

| Indicators | Years | | | | |
|-------------------------------|-------|------|------|------|------|
| | 2012 | 2013 | 2014 | 2015 | 2016 |
| Islamic Commercial Bank (BUS) | 11 | 11 | 12 | 12 | 12 |
| Islamic Business Unit (UUS) | 24 | 23 | 22 | 22 | 22 |
| Islamic Rural Bank (BPRS) | 158 | 163 | 163 | 163 | 165 |

Source: Statistik Perbankan Syariah OJK 2016

Table 1.1 shows the development of sharia banking based on OJK annual report (August 2016). In quantity, the achievement of sharia banking is really satisfying because of the gradual increase in the number of banks. In 1998, there was only one Islamic Commercial Bank and 76 BPRS, then in August 2016, the number of sharia banks has reached 34 units, consisting of 12 Islamic Commercial Banks and 22 Islamic Business Units. In addition, the number of BPRS has reached 165 units

The important role of sharia banking can be measured from the institutional development and how much financing is channeled. In general, sharia banking business consists of Sharia Commercial Bank (BUS), Sharia Business

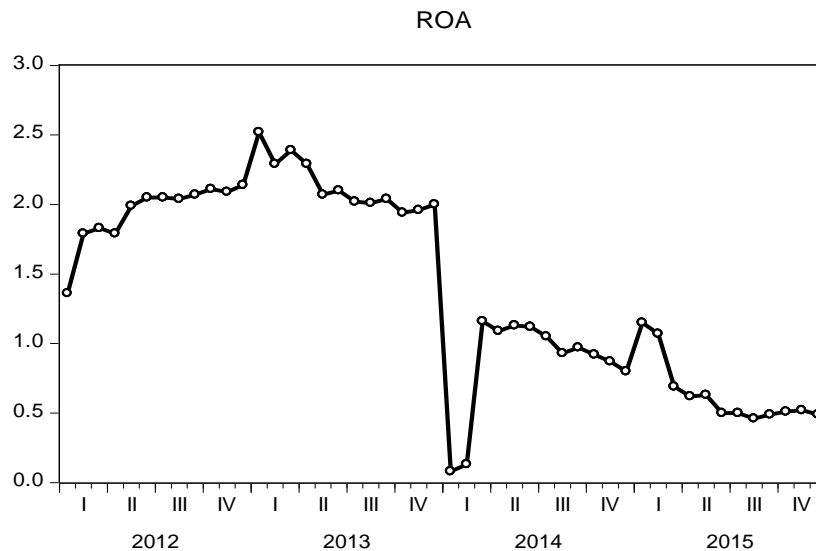
Unit (UUS), and Sharia Rural Bank (BPRS). The number of banks continuing to conduct business based on sharia principles continues to grow in line with the operation of new sharia Banks.

Islamic banks have proven their performance as a financial institution that can survive in the midst of global crisis so that Islamic banks can survive until now, research conducted by (Boumediene & Caby, 2009) found that Islamic banks are more resistant to flare subprime mortgage crisis.

On the other side of sharia banking in indonesia in general has shown a very good development since the first stand in 1992, in the last 8 years, syariah banking has shown rapid growth, It is proved by the increase of syariah banking assets from Rp26, 7 trillion in 2006, to Rp 244 trillion in mid 2014, from 2007 to 2011 the growth of sharia banking was able to reach 40.27% per year, while the average national banking growth was only about 16.7% per year during the period shows that the potential contribution of Islamic banking is very large to the national economy, therefore the Islamic banking industry is dubbed as the fastest growing industry.

According to sharia banking statistics data of Bank Indonesia in 2011, sharia bank ROA has increased from the previous year that is 1.7% to 1.8%, And in 2012 ROA of sharia banks experienced an increase from 1.8% to 2.1%, while in the year 2013 sharia bank ROA tends to decline from the previous year. Profitability and the net profit of BUS and UUS were recorded at Rp 3.3Trillion

increased by 29.0% from the previous year. However, the growth slowed from the previous year which reached 72.3%.



Source: Data statistik perbankan syariah Bank Indonesia.

FIGURE 1.2
Return on Assets (ROA) of Islamic Bank in Indonesia
In period 2012-2015

In terms of return on asset, the slowing profit growth is also reflected in the decrease in ROA from 2.1% in 2012 to 2.0% in the reporting year, Compared to the national banks which have ROA of 3.1% the level of profitability, Islamic banking tends to be lower considering the ability to generate revenue apart from the relatively limited fund distribution activities (Bank Indonesia).

Profitability is the level of the bank's ability to increase profits. Profitability level can be measured using Return On Asset (ROA) ratio. Is a ratio to measure the ability of management in managing assets to generate profits. Rasio ini is one element in measuring the soundness of banks (CAMEL) of Bank

Indonesia. In the business activities of banks that encourage the economy, high ROA ratio shows the Bank has distributed credit and earn income.

Identification of macro variables that can affect the profitability of banks needs to know to get the maximum performance. ROA is important for the bank because to measure the effectiveness of the company in generating profits by utilizing the owned, ROA is the ratio between profit after tax to total assets. the performance of the company the better, because the rate of return (return) is greater(Husnan, 1998)

According to Haron (1996), divides the determinants of bank profitability into two, namely internal factors and external factors. the internal factor determinant consists of several variables such as fundraisers, capital management, liquidity management and cost management, all internal variables are deemed to be controlled by bank management, while external variables are factors considered under the control of bank management. Among the external variables are discussed much is competition, regulation, market share, ownership, the amount of money in circulation, inflation, interest rates.

Therefore, the objectives to be achieved in this research are to know the effect of inflation, the exchange rate, and the gross domestic product to the profitability of sharia banking in Indonesia period 2012 to 2015 which is proxied through Return On Assset (ROA).

Based on the above description, the researcher is interested in research entitled "**Analysis of the Impact Macroeconomic Indicators on Islamic Banks Profitability in Indonesia Period 2012-2015**".

B. Research Limitations

There are a lot of factors that may influence of performance of Islamic Banking In Indonesia. However, As for the limitation of the problem to be investigated further so that the discussion of the problem can be directed, the authors provide limits on the object in the study where the discussion of the problem is only specified in :

1. Only focusing on Islamic banks in Indonesia during research period.
2. The Object of research in the analysis of factors that affecting performance of Islamic Banking, which is measured by ROA, consist of independent variable those are Inflation, Exchange Rate, Gross domestic product While, dependent variable is Return On Assets (ROA) of Bank Syariah In Indonesia Period January 2012 - December 2015.
3. This research is using Multiple Linear Regresion analysis.

C. Research Question

Based on the background that explained before, then the problem which is going to solve in this research defined as:

1. How does inflation affect on the profitability of Islamic banking as measured with ROA?
2. How does exchange rate affect on the profitability of Islamic banking as measured with ROA?

3. How does Gross domestic product affect on the profitability of Islamic banking as measured with ROA?

D. Research Objectives

Based on the formulation of the problems that have been described above, then the purpose of this research are:

1. To determine the effect of inflation on the profitability of Islamic banking as measured with ROA.
2. To determine the effect of exchange rate on the profitability of Islamic banking as measured with ROA.
3. To determine the effect of gross domestic product on the profitability of Islamic banking as measured with ROA.

E. Research Benefits

The existence of a study is expected to provide benefits, especially for the field of science in carefully, the benefits obtained from this study are as follows:

1. For Banking

It is expected to give a suggestion for the banker to have a deep understanding of financial determinants which influence profitability and performance in Islamic banks.

2. For Researchers

The results of this study is the application of science acquired during the study and increase knowledge and insight, especially related to financial management in banking.

3. For Society

It is expected to add insight in banking especially sharia banking in terms of profitability.