CHAPTER I

INTRODUCTION

A. Background

According to Jaribah (2008), capitalization or the amount of capital owned by people becomes the most important milestone in developing national economy. He defined capitalizations into two kinds, as basic and social capitalization. Basic capitalization refers to basic factors of production including investment. Social capitalization refers to infrastructure such as cities, mosque and market. Islamic capital market represents those capitalizations where investors develop their portfolio. These will increase the wealth and capital market capitalization in the same time. A modern economic country develops its capital market for supporting their national economy.

Islamic economic system arises after global monetary crisis in 2008. It comes as an alternative economic system offering fair and justice in the economy. The system comes along with its instrument such as Islamic capital market to be the centre of muamalah activities which permitted as long as in line with shariah law. Karim (2004). An Islamic capital market offers investment portfolios regarding to Islamic investment principles. There is different meaning of investment between conventional and Islamic economic system. The conventional system defines investment as the total income subtracted by total consumption and saving for consumption.
maximizing returns. The Islamic economic system explains investment as part of wealth consists of return and social values such as generosity, worship and al magashid al shariah. In the other words, Muslim investors are expected to bear risk beside return in different perspective comparing to investor in general.

Indonesia is a country with the largest Muslim population; therefore, Indonesian Muslim have to realize and consider their fast economic development by initiating strong foundation of national economy thought its real and monetary sector and supposed to develop an economy. Islamic capital market has two functions to support national economy as financial market where investment portfolio is traded and as real economic financial intermediary where fund is distributed from lender to borrower.

Indonesia Islamic capital market is a part of conventional capital market. So it is almost impossible to separate both market. Therefore, we would like to examine how far Indonesia capital market capitalization is developed as a national economic growth indicator. Capital market capitalization indicates the multiplication of aggregate number of stocks and regular market closing price. The Indonesia Exchange (IDX) market capitalization ratio to GDP becomes an indicator of Indonesia economic growth. The 2008’s IDX market capitalization was 1.076,50 trillion, decreasing for about 46,42% from 2007s’ capitalization which was 1.988,33 trillion. In 2009 IDX market capitalization is significantly increased around 87,59%
increased approximately 46.13% from 2.091.38 trillion in 2009 to 3.247.10 trillion in 2010; Furthermore in 2011, IDX market capitalization also increased slightly to 3.20% from 3.247.10 trillion in 2010 to 3.821.99 trillion in the end of 2011.

Subject to the economic condition the contribution of capital market ratio to GDP had fluctuated. In 2007 capital market contributed 50.24% and decreased significantly around 21.72% by 2008. By 2009, capital market contribution experienced slightly increased from around 21.72% in 2009, to for about 35.97% in 2010. The increasing of capital market contribution to GDP was continuously increased respectively from about 35.97% by 2009 to 50.55% in 2010 and also around 55.07% 2011 respectively.

Indonesia capital market has experienced excellent performance during past five years. According to Indonesia Capital Market Advisory Board by 2007 it contributed for about 50.24% and there were decreased trends in the next two following years of year 2008 to 2009 due to the global financial crisis at that time. The crisis does not impact Indonesian capital market negatively. It was proven by the increasing in trend of capital market contribution to GDP from year 2008 until 2011. In other words, Indonesia capital market was relatively secure and profitable. In addition, Jakarta Composite Index in year 2009 was awarded as the best index in ASEAN and second best index in the world while by 2010 Indonesia index was
Indonesia conventional capital market and the Islamic capital market is an entity that both could not stand alone. Therefore, that the development of Indonesia capital market represents the development of Indonesia Islamic capital market. Although Indonesia is not Islamic based country, it is the world largest Muslim in population country. It becomes one of potential developing market in the Islamic finance world industry.

Indonesia has to concern to develop Islamic capital market and preparing its society to apply Islamic economic in particular Islamic investment. Recently, there are two major Islamic indices in Jakarta Composite Index. Namely Jakarta Islamic Index abbreviated as JII and Islamic Shariah Security Index (ISSI). JII comes as actualization of Shariah board regulation No. 05/DSN-MUI/IV/2000 concerns stocks trading which issued in April 2000. JII is a part of Jakarta Composite Index that supposed to guide the investors to invest their funds in term of shariah compliance stocks. JII consists of top 30 stocks in several main sectors including agriculture, mining, chemical, consumption, property, infrastructure, utility, transportation and trades which passed from output screening mechanism based on shariah criteria. As well as JII, ISSI is a shariah compliance index consists of indices from more company with less strict than JII in stocks valuation. JII consists of 30 most liquid shariah compliance stocks and this study examines 10 companies which have continuously been listed in JII since 2008 to 2012.
This study uses three analyses in order to understand more about company intrinsic value. Those are economic analysis, industrial analysis and fundamental analysis. The combination of the all three analyses supposed to observe the importance of intrinsic value in a company by conducting market price analysis, capital gain analysis and financial ratio analysis.

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Stocks market investment faces the possibility of generating both risks and returns; JIII10s' stocks will not be free from risk as well. Islam does not merely treat investment for profit maximization, but also consists of worshiping spirit. According to Novia (2011), in more practical market, risk relates to price fluctuation for several stocks or sectors. It happened because of investor responds' on the changing of expected rate of return.

Economic stability becomes important variable to stock returns. Investors always compare their investment possibility of return to the possible risk. The possibility of risk will be higher when the market condition is unstable. The stability
Macroeconomic stability contributes relatively significant influences to company performance. Eventually, an economic stability plays important role for investment world. The macroeconomic stability leads investor to stake their investment in a stable or unstable market in a country.

There are some researches on the influence of macroeconomic variable on stock returns in several countries with various results. According to Ahmet Büyüksalvareci (2010), return on stock in Turkish Stock Exchange Market was negatively influenced by foreign exchange rate, oil price, industrial production index and money market interest rate. In addition, money supply had positive influence on stock returns. Meanwhile, the costumer price index had no significant influence on stock return. Otherwise according to Benaković (2010), return on stock in Croatian Capital Market was negatively influenced by inflation and positively influenced by other macroeconomic variable such as industrial production index, interest rate, and market index and oil price. Nazir (2010) also described return on stock in Pakistan Equity Market was negatively influenced by inflation, exchange rate and interest rate. Meanwhile political stability had positive influence on it. In Malaysia Islamic Stock Market according to Hussin (2012), return on stock was negatively influenced by some macroeconomic variable such as industrial production index and costumer price index. The other macroeconomic variable; such as money supply and exchange rate; was positively influenced return on stock in the market. According to Novia (2010),
index and exchange rate. Furthermore, industrial production index and Indonesia composite index had positive influence to stock returns. Money supply and interest rate had no significant influence to JII stock returns. According to Puteh (2010), Indonesia composite index stock returns were positively influenced by inflation, exchange rate and interest.

However, the different evidence is found in Aman Stock Market. Al-Huda (2012) stated that return on stock in Aman Stock Market was not significantly influenced by the macroeconomic variable such as interest rate, budget deficit and inflation. The research results mentioned before indicating different countries and macroeconomic variables might come with different circumstances and implications. The macroeconomic variable such as CPI, IPI, exchange rate, interest rate, market index, money supply, trading volume, gold and oil price varied on its significance depend on market efficiency in each country.

Investment has two common analytical tools to determine the relationship among the expected return and risk of investment; they are Capital Asser Pricing Model (CAMP) and Arbitrage Pricing Theory (APT) (Chen and Ross in Büyüksalvareci, 2010). CAPM describes balance relationship between risks of each asset in a balance market by strictly take beta of individual stock returns to market portfolios' returns. The Arbitrage Pricing Theory (APT) becomes model to explain risk and return relationship in an investment. It developed by Ross in 1976. APT comes with more general determinants rather than CAPM in explaining risk and
returns of investment, rather than strictly hold on beta of individual stock return to market portfolios' returns. It allows return of investment to be generated from many variables such as macroeconomic variables (Pudjiastuti, 2004).

This study aims to analyze the effects of macroeconomic variables on Jakarta Stock Exchange Market on APT framework and provide further forecast on JII selected 10 companies' stock returns. Jakarta Islamic Index 10 selected companies abbreviated as JII10 is on the basis of monthly data, starting from January 2008 to December 2012 and relates to three macroeconomic variables. The macroeconomic variables in this study are Bank Indonesia Rate, Costumers Price Index and Brent standard oil price. Furthermore, this study will examine 10 companies stock returns which are listed in JII from 2008-2012 with no de-listing record from it. The selection supposed to ensure company healthiness and the fulfillment of Islamic investment principles. Eventually this research entitles with "The Analysis of Macroeconomic Variables that Influence Stock Returns Jakarta Islamic Index and Its VAR Forecasting." (Case study: 10 companies listed in Jakarta Islamic Index Period 2008-2012)

B. Limitations

Study limitations aim to restrict the analysis problems that may occurred. Therefore, this study is restricted to the following limitations:
2. The stock returns refer to the changes of stock price movement of the 10 companies.

3. The study period is January 2008 – December 2012 monthly time series data.

C. Research Questions

There are several types of investors and investment alternatives. According to Huda (2007), there are three characteristics of investors; it is risk averse, risk neutral and risk seeking. Meanwhile, there are two investment alternative with refers to risk and return. Higher possibility of returns drives higher possibility of risks and vice versa. The risk seeking investor takes relatively riskier market. They expect higher possibility of returns. Meanwhile, risk averse and neutral investor relatively takes a lower risk market and expect lower risk burden regarding to their safety preference. The investors relay their decision to some important information in particular financial condition and macroeconomic condition.

The information of companies’ financial condition and macroeconomic condition contribute major suggestion to public companies that have relatively higher sensitivity to macroeconomic fluctuating condition. Previous studies on macroeconomic variables that influence return on stock in Turkey, Aman, Croatia, Pakistan, Malaysia and Indonesia have been conducted. Those studies provided different evidences. According to Benaković (2010), costumer price index had the influence to stock returns in Croatia capital market, while Novio (2010)
found costumer price index had negative influence to Indonesia stock returns as well. In the other hand, according to Hussin (2012) costumer price index had positive influence to stock returns in Malaysian Islamic stock market. According to Puteh (2010), interest rate had positive influence to Indonesian stock returns; In the other hand Croatian stocks' return is positively influenced by interest rate, oil price and market index (Benaković, 2010). According to Nazir (2010), interest rate was negatively influenced by Pakistan stock returns. The former studies found that Industrial production index has positive influence in Indonesian, Malaysian and Croatian stock returns; while negative influence is found in Aman stock returns. The studies also found that money supply was negatively influence to Malaysian stock returns and positively influence Aman stock returns.

The different evidences and information were coming from the former studies. Therefore, further study is needed in order to update the relevant information. Based on those problems, the research questions of this study are declared in these following questions:

1. What is the influence of interest rate to JII10 stock returns?
2. What is the influence of costumer price index to JII10 stock returns?
3. What is the influence of oil price to JII10 stock returns?
4. What is the influence of trading volume to JII10 stock returns?
D. Research Aims

This study defines these following aims in order to answer the research questions:

1. To analyze the influence of costumers price index to JIII0 stock returns.
2. To analyze the influence of interest rate to JIII0 stock returns.
3. To analyze the influence of oil price to JIII0 stock returns.
4. To analyze the influence of trading volume to JIII0 stock returns.

E. Research Objectives

This study contributes useful information for parties which are interested in developing Indonesian capital market in particular Indonesia stocks exchange market. The detail of research objective will be mentioned as below:

1. To investor: as relevant information regarding to their decision on stock investment.
2. To researcher: as relevant study to apply theories and knowledge in his undergraduate study of Islamic economic and finance.
3. To future researchers: as relevant reference for further research.