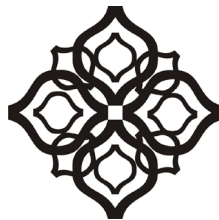


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Macroeconomic Variables on Indonesian Sharia Capital Market

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Abstract

This article emphasizes to analyze the effect of macroeconomic variables on sharia capital market in Indonesia by using Vector Error Correlation Model (VECM) approach method. The variables used are world oil price, Industry Production Index (IPI) Currency Exchange Rate to Dollar and Consumer Price Index (CPI) in Indonesia. The research show that in the Indonesian Sharia Stock Index (ISSI) model, the VECM in the ISSI model can explain in the short term the IPI variable, world oil price, rupiah to dollar, DJIA and CPI does not affect to ISSI variable. While in the long term, world oil prices are positive climate and Dow Jones Industrial Average (DJIA) variables negatively affect ISSI. In addition, FEVD test the world oil price has more dominant contribution than other variable 6.02%.

Keywords: sharia capital market, macroeconomics, VECM, ISSI

Introduction

Such have been empirical studies over the last few years seek to investigate the dynamic relationship between stock prices and macroeconomic variables in both developed and developing countries. Beik (2014) examine the Influence of Sharia International Stock Price Index and macroeconomic variable to Jakarta Islam Index. The results of his study showed that JII was positively and significantly influenced

by DJIEU, DJIMY and IPI and was advised negatively and significantly by DJJIP.IMUS, M2 and SBIS. Asmy et al (2010) have tested the short-term and long-term causal relationships between the qualities of the index mud and macroeconomic variables such as inflation (Aisiyah, 2015). The amount of money subsidized and the exchange rate in the period before and after the crisis in the period 1987-1995 and from 1999-2007. In the results showed that inflation, money supply and exchange rate significant effect on the Kuala Lumpur index.

Naseri & Masih (2014) have analyzed the causal cause between FTSE Sharia Malayisa Gold Shria Index and three macroeconomic variables, those are money supply, CPI and Exchange rate in Malaysia. These are cointegration tendency among syariah stock index with selected macroeconomic variable as expected (Dimic, Kiviaho, Piljak, & Äijö, 2016). Khan (2014) shows that in the first equation of the sharia index (FTSHA), which cointegrated with interest rate (IR) and industrial production index (IPI), these two equations identify that the interest rate and IPI have no significant effect. Al-Majali (2014) analyzes the short-and long-term relationship between capital market index and macroeconomic variable performance in Jordan. It shows that the coefficient of ECT displays significant and negative influence especially for CPI and DR, while ECT in global finance wquation of crisis is not significant. This confirms Johansen's cointegration test presented earlier showing a long-term bi-directional relationship between stock and lending price indices for the private sector. The weighted average rates of time deposit interest and the consumer price index. However, the speed of balance adjustment is relatively slow in all equations.

Hsing (2011) on macroeconomic determinants of capital market indices and policy implications in Europe discusses the relationship between Hungarian stock market indices and relevant macroeconomic

variables. He found that the Hungarian stock market index has a positive relationship with real GDP, the ratio of government debt to GDP, the nominal effective exchange rate and the German stock market index. Negative relationship with real interest rate. Expected inflation rate and government bond yields in the Euro area and quadratic relationship with real money supply M2. This suggests that there is a positive relationship if real M2 money supply is less (greater) than the critical value of 9.563 billion forint. If the quadratic relationship is not specified and tested. The real positive M2 coefficient will be insignificant at 10% level. We can reach a misleading conclusion that the stock market indices are not significantly affected by M2. On the effect of macroeconomic variable towards ISSI has also been conducted by such research as Syafii (2013), Fareed, Arsalan, & Ayubi (2017) and Aisyah (2015). This article examines the effect of macroeconomic variables on sharia capital market in Indonesia by using Vector Error Correction Model (VECM) approach method.

Research Method

Equation model applied in this research refers to a model of Sharia Capital Market Indonesia which represent with ISSI (Indonesian Sharia Stock Index). This article employs five variables of Vector Autoregression model (VAR) or Vector Error Correction Model (VECM). The following equation was being obtained from the equation of Sharia Capital Market in Indonesia.

VAR Equation:

$$\begin{bmatrix} \ln issi_t \\ \ln IPI_t \\ \ln CPI_t \\ \ln OIL_t \\ \ln DJIA_t \\ \ln ER_t \end{bmatrix} = \begin{bmatrix} a10 \\ a20 \\ a30 \\ a40 \\ a50 \\ a60 \end{bmatrix} + \begin{bmatrix} \beta11 & \beta12 & \beta13 & \beta14 & \beta15 \\ \beta21 & \beta22 & \beta23 & \beta24 & \beta25 \\ \beta31 & \beta32 & \beta33 & \beta34 & \beta35 \\ \beta41 & \beta42 & \beta43 & \beta44 & \beta45 \\ \beta51 & \beta452 & \beta53 & \beta54 & \beta55 \\ \beta61 & \beta462 & \beta63 & \beta64 & \beta65 \end{bmatrix} \begin{bmatrix} \ln ISSI_{t-1} \\ \ln IPI_{t-1} \\ \ln CPI_{t-1} \\ \ln OIL_{t-1} \\ \ln DJIA_{t-1} \\ \ln ER_{t-1} \end{bmatrix} + \begin{bmatrix} \varepsilon_{1t} \\ \varepsilon_{2t} \\ \varepsilon_{3t} \\ \varepsilon_{4t} \\ \varepsilon_{5t} \\ \varepsilon_{6t} \end{bmatrix}$$

VECM Equation:

$$\begin{bmatrix} \Delta issi_t \\ \Delta IPI_t \\ \Delta CPI_t \\ \Delta OIL_t \\ \Delta DJIA_t \\ \Delta ER_t \end{bmatrix} = \begin{bmatrix} a10 \\ a20 \\ a30 \\ a40 \\ a50 \\ a60 \end{bmatrix} + \begin{bmatrix} \beta11 & \beta12 & \beta13 & \beta14 & \beta15 \\ \beta21 & \beta22 & \beta23 & \beta24 & \beta25 \\ \beta31 & \beta32 & \beta33 & \beta34 & \beta35 \\ \beta41 & \beta42 & \beta43 & \beta44 & \beta45 \\ \beta51 & \beta452 & \beta53 & \beta54 & \beta55 \\ \beta61 & \beta462 & \beta63 & \beta64 & \beta65 \end{bmatrix} \begin{bmatrix} \Delta ISSI_{t-1} \\ \Delta IPI_{t-1} \\ \Delta CPI_{t-1} \\ \Delta OIL_{t-1} \\ \Delta DJIA_{t-1} \\ \Delta ER_{t-1} \end{bmatrix} - \lambda \begin{bmatrix} \varepsilon_{1t} \\ \varepsilon_{2t} \\ \varepsilon_{3t} \\ \varepsilon_{4t} \\ \varepsilon_{5t} \\ \varepsilon_{6t} \end{bmatrix}$$

The test method proposes to test the stationarity of data for which is the ADF (Augmented Dickey Fuller) test using the five percent real level (= 5%). If the value of t-ADF is less than the critical value of MacKinnon, it may assume that the data is stationary (does not contain the root of the unit). Testing at the roots of this unit would be at the level up to the first difference. The gathered data was derived from those which does not contain the root of the unit. According to Gujarati (2003, p. 853), if the data used contains elements of the root of the unit, it will be difficult to estimate a model because the data tends to fluctuate not around its mean value. The next step is to test the stability of the VAR model, using the stationary data (the first difference data), not level data. The stability of the VAR model have been analyzed from the inverse roots value of its polynomial AR characteristics. A VAR system is considered stable if all of its roots have a modulus smaller than one (Gujarati, 2003).

Optimum lag test is performed to make a good VAR model with determination of optimum lag length. The determination of the number

of lags (orders) to be used in the VAR model can be determined based on the Akaike Information Criterion (AIC), Schwarz Information Criterion (SC) or Hannan Quinnon Criterion (HQ) (Arsana, 2004, p. 6). The lag to be chosen in this research model is the model with the least value, because according to (Gujarati, 2003) too much lag length will increase degrees of freedom. In doing so, a smaller lag is recommended to minimize the specification of autocorrelation problems in the VAR system. Using optimal lag is expected no longer appear problem autocorrelation.

Cointegration test is conducted to see if there is cointegration between variables. Two variables will be cointegrated if the two variables have a long-term relationship or a balance relationship between them (Gujarati, 2003). The existence of cointegration between variables is a condition of whether or not the data is processed by the VECM method. Long-term information can be obtained by the first determining of the cointegration rank to find out how many systems of equations can explain from the whole system. According Arsana (2004, p. 7) determination of the number of cointegration relationships between variables can be seen from the value of his trace statistics. Trace statistic value exceeding its critical value indicates that there is cointegration in the model used.

IRF analysis aims to determine the response of the dependent variable in the VAR system due to shocks in error terms for some future periods (Gujarati, 2003). Estimates made for IRF are focused on the response of a variable on the change of one standard deviation from the variable itself or from other variables contained in the model. In other words, the function of impulse response determines the effect of a variable on a particular variable in case of shock. Another IRF function is to know the value of shocks to the existing variables.

FEVD analysis predicts how big the contribution of each variable to the change of certain variables (Ascarya, 2009, p. 19). This method

characterizes a dynamic structure in the VAR model. This method can see the strengths and weaknesses of each variable in influencing other variables over a long period of time.

Estimation of VESM Model

Table 1. Short-Term

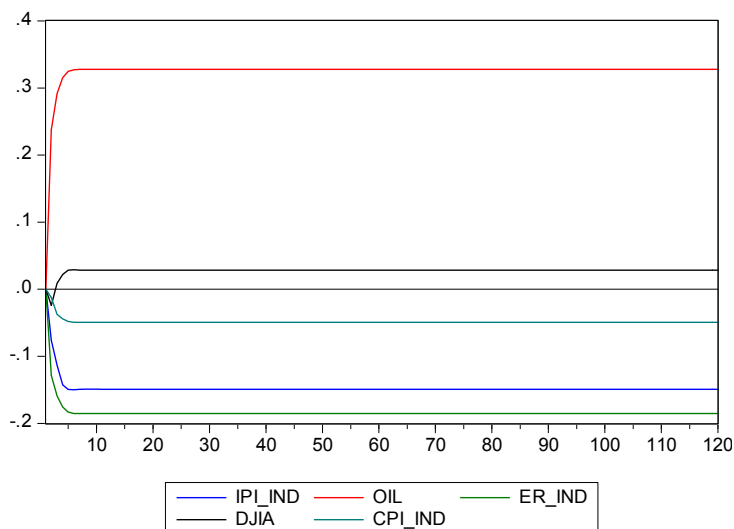
| Short Term (ISSI) | | |
|-------------------|-----------|--------------|
| Variabel | koefesien | T-statistics |
| CointEq1 | -0.00486 | [-0.55643] |
| D(ISSI(-1)) | -0.00712 | [-0.05403] |
| D(IPI_IND(-1)) | 0.553891 | [0.03507] |
| D(OIL(-1)) | 2.761146 | [1.47021] |
| D(ER_IND(-1)) | -6.37235 | [-0.84098] |
| D(DJIA(-1)) | -2.29147 | [-0.42349] |
| D(CPI_IND(-1)) | 0.465849 | [0.02846] |

Table 2. Long Term

| Long Term | | |
|-------------|----------|------------|
| IPI_IND(-1) | 395.6043 | [1.78130] |
| OIL(-1) | 43.48161 | [2.13319] |
| ER_IND(-1) | 41.45236 | [0.44360] |
| DJIA(-1) | -321.364 | [-3.73606] |
| CPI_IND(-1) | 358.2504 | [1.45989] |

Based on the estimation of VECM in ISSI model, it explains that in the short term IPI variable, world oil price, exchange rate of rupiah to dollar, DJIA and CPI have no significant effect on ISSI variable. While in the long term, world oil prices have a significant positive effect on ISSI with coefficient value of 43,481 units. While world oil prices increase by one unit, it takes affect the increase of ISSI value of 43,481 units. The rise in world oil prices will affect the psychology of investors or traders in buying shares related to world oil prices (Trømborg & Solberg, 2010). The high demand caused by rising world oil prices that affect the rise of the index (Ftiti & Hadhri, 2019). Although basically in the rill sector it burden the company in the cost of production, yet the rise of world oil prices is in response more quickly and positively than in the real sector. In addition, comparing to the relatively low world oil prices from 2014-2016, the world oil price hike is relatively less burdening on the real sector of those 2011-2013.

Conversely, the Dow Jones Industrial Average (DJIA) variable in the long run has a negative effect on ISSI with coefficient value of -321,364 units. This means if the Dow Jones Industrial Average increased one unit, it will lower the index by 321,364 units. The majority of the largest investors in the capital market in Indonesia are foreign investors, where they easily move their funds to the US capital market due to the increasingly integrated world capital market (Habib, 2017). DJIA can describe the performance of the American economics. As the value of the DJIA index increases, it indicates an improved performance of the American economics. It may cause foreign investors to withdraw their investments from Indonesia and divert them to America.

Analyzing IRF**Graphics 1. Response of ISSI**

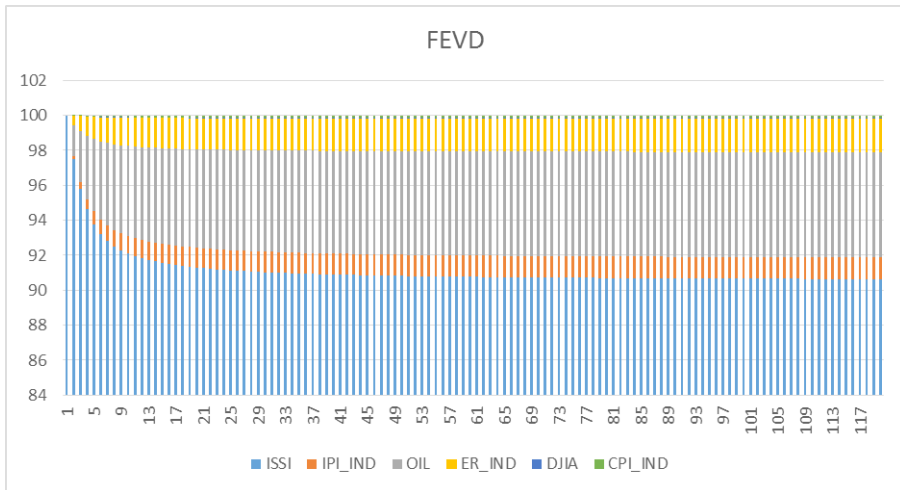
After such pre-estimation as root unit test, VAR stability test, optimum lag test and cointegration test, the model can be used to see the short and long-term effects through VECM estimation. The graphic 1 is the impulse response function (IRF) in the ISSI model. The results listed explain how the response of Indonesia Sharia Stock Index while there is a shock on the variables IPI, CPI, DJIA, exchange rate against dollar and world oil price. While the shock to DJIA and world oil price happened, ISSI positively response to world oil price; ISSI reach stability in period 7-8 until the next period. Similar to the shocks occur in the DJIA, Indonesia Sharia Stock Index goes to respond positively and reach a similar stability that is in the period of eight (8) to the end of the period (Aisiyah, 2015).

Negative responses occur at ISSI when there is a shock to the CPI. At the same level, the ISSI undergoes stable CPI shocks in the 6th and

permanent periods until the next period (Beik, 2014). If ISSI get negative response; there is shock to IPI and rupiah exchange rate against dollar. ISSI experiences stability of IPI shocks in 4-5 periods. Along with the rupiah exchange rate, ISSI stability toward the exchange rate of rupiah against the dollar reaches at the period to 5. From the five variables that have been described previously, it can be conclude that ISSI achieve a fast stability in the five variables. ISSI reaches a stability of no more than 10 periods.

Analyzing FEVD

Graphics 2. FEVD



After analyzing on Impulse Response Function, it important to see the contribution of each variable in the ISSi model that will be seen in the Forecasting Error Variance Decomposition (FEVD). The behavior of Indonesia Sharia Stock Index (ISSI) is mainly influenced by ISSI itself with contribution of 90.6%. Following world oil price (OIL) with contribution of 6.02%, Rupiah Exchange Rate have against US Dollar (er_IND) with

1.91% contribution, Industrial Production Index (IPI) with contribution of 1.24%, Consumer Price Index (CPI) with contribution of 0.134 % and the last is Dow Jones Industrial Average (DJIA) with contribution sebesar 0.0449%. Thus, the largest variables contribute to ISSI is the world oil prices. The increasing mining sector (mining and oil) mostly take such effect on the sharia stock index. World oil prices often have been alleged as representative of the world economic improvement (Ftiti & Hadhri, 2019). This study investigates the causal relationships between economic policy uncertainty, oil prices, investor sentiment, and stock returns of nine Dow Jones Islamic Market Indices.

Specifically, this article analyzes the causal effect of these variables on Islamic stock returns at different time scales using the ensemble empirical mode decomposition model. First, we decompose the economic policy uncertainty proxy, oil prices, and investor sentiment into different independent components called intrinsic mode functions (IMFs): short-term IMFs designate the effects of irregular events; medium-term IMFs present the effects of extreme events; and long-term IMFs capture long-term effects. Second, we employ a nonlinear non-parametric causality model to test the causal relationship between different variables and Islamic stock returns at both the original and decomposed levels. We find causal relationships between the underlying variables and Islamic stock returns in several time frequencies rather than in the whole sample period. Our results suggest that the use of lagged economic policy uncertainty, oil prices, and investor sentiment may improve the predictability of Islamic stock returns. A test of forecast accuracy indicated the robustness of our results (Ftiti & Hadhri, 2019). As rising oil prices reflect the demand of oil that have engaged in economic activities.

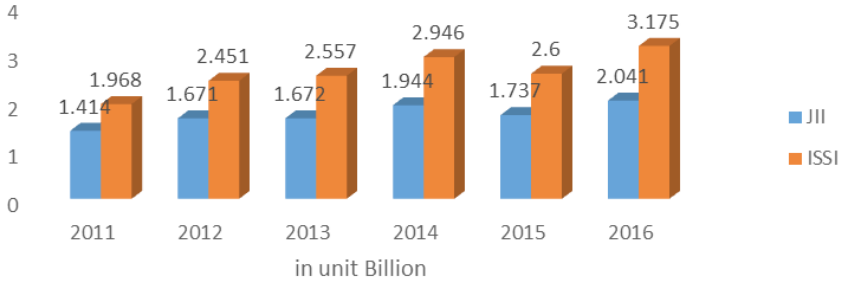
Discussing the Capital Market

In the concept of economic growth, the capital market has an important role in the economic development of a country (Habib, 2017). It has two benefits. First, provide long-term financing for the business world and use it optimally to expand the company. Second, it becomes a intermediary for the society to invest in various forms of investment instruments such as mutual funds, stocks and others according to sharia principles (Basov & Bhatti, 2014; Abdul Rahman, Muhammad, Ahmed, & Amin, 2016; Ahiadorme, Gyeke-Dako, & Abor, 2018). In addition, the stock price value of the capital market comes to the core consideration for investing such fund (Bian, Lin, & Liu, 2018). The stock prices are not only influenced by economic factors and domestic phenomena, but external factors outside the country is very influential on the performance of sharia stocks also (Aloui, Hammoudeh, & Hamida, 2015; Azizah, Satria, & Wahyudi, 2016; Dash & Maitra, 2018).

The role of the government would be necessary to create a good macroeconomic condition. The government should take policies on regulating economic elements. Creating a good economic stability set up a more conducive economics and attracts the local and international investors (Septyanto, Sudarwan, & Dewanto, 2017; Rashid, Hassan, & Yein, 2014; Ftiti & Hadhri, 2019). Although Indonesia has the largest Muslims population, yet the development of sharia-based capital market is still densely packed far behind compare to that of Malaysia. The table below briefly explains the growth of sharia stock index value in Indonesia that has increased every year, although the index value is relatively small compare to the stock price index (JKSE).

Table 3. Comparison of ISSI and JII

The Growth ISSI and JII 2011-2016

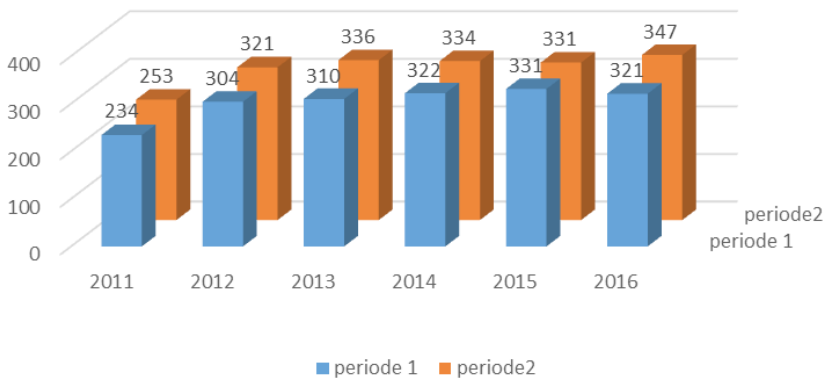


Data Source: OJK Statistical Data

The growth of sharia capital market reflected by Indonesia Sharia Stock Index (ISSI) and Jakarta Islamic Index (JII) in 2011-2016 underwent a relatively significant growth. Albeit it decline in 2015, instead in 2016 both reached the greatest capitalization value for six years.

Table 4. Amount Sharia Stock 2011-2016

Amount Sharia Stock)



Data Source: OJK Statistical Data

In addition, the growth of capitalization in the Indonesia Sharia Stock Index is also followed by the growth of companies included in the list of sharia securities. The graphics above shows the number of listed companies in the list of sharia securities that experienced is latively significant growth over the six years from 2011 to 2016. It is also interesting that based on the State of the Global Islamic Economics 2016, from the total global Islamic financial assets, Indonesia is one of the countries in Southeast Asia that belongs to 10 countries of the largest sharia financial market in the world. Malaysia is currently the largest Islamic financial market in the world (Antonio, 2013; Khan, 2014). With a total population of about 250 million people, Indonesia potentially become the largest market share of Islamic finance in the near future.

The sharia capital market performance in Indonesia will be reflected through Indonesia Sharia Shares Index. This index is a sharia stock index that reflects the total sharia shares listed on the Indonesia Stock Exchange (Septyanto et al., 2017). Through the development of sharia capital market in Indonesia, the capital market industry in Southeast Asia began to apply Islamic Sharia principles as an alternative instrument of investment in capital market activities, while each country has different characteristics to develop and promote the Islamic finance industry, especially in the Sharia Capital Market.

The development of sharia capital market in Southeast Asia can not be separated from the role of religious authority especially Muslim-majority countries which have reaffirmed that usury is haram and prohibited in Islamic sharia (Blowfield, 2012). Similar to the Indonesian Ulama Council which has also issued a *fatwa* that bank interest is usury and haram. The fatwas are based on interpreted sharia principles in the Qur'an and the Sunnah of the Prophet. On the basis of this awareness, sharia capital market may begin to be developed. Moreover, the development of the Islamic

finance industry, especially the capital market, is not only influenced by the religious nature or the majority Muslim population, instead also influenced by macroeconomic variables either through external factors or internal factors.

Conclusion

In VECM estimation of ISSI model, it confirms that in the short term IPI variable, world oil price, exchange rate of rupiah to dollar, DJIA and CPI does not significantly influence ISSI variable. While in the long term, world oil prices have a significant positive effect on ISSI. On the other hand, Dow Jones Industrial Average (DJIA) variable in the long run has a negative effect on ISSI. Impulse Response Function (IRF) shows that in ISSI model, DJIA shock and world oil price, ISSI has a positive response to world oil price, where ISSI reach stability in the period 7-8 until the next period. Similar to the shocks that occur in the DJIA, Indonesia Sharia Stock Index goes come to have positive response and reach a relatively similar stability that is in the period of 8 to the end of the period.

A negative response occurs at ISSI when there is a shock to the CPI, where the ISSI experiences stable CPI shocks in the 6th and permanent periods until the next period. In the case of the IPI variable and Rupiah exchange rate, ISSI get responds negatively when there is shock to IPI and rupiah exchange rate against dollar. ISSI underwent stability of IPI shocks in 4-5 periods. Similar to the rupiah exchange rate, ISSI stability against the exchange rate of rupiah against the dollar at the period to 5. The Forecast Error Variance Decomposition (FEVD) confirms that the value of ISSI is the most important by ISSI itself with a contribution of 90.06. This is followed by world oil price (OIL) with contribution of 6.02%, Rupiah Exchange Rate to US Dollar (er_IND) with 1.91% contribution, Industrial Production Index (IPI) with contribution of 1.24%, Consmer

Price Index (CPI) with contribution of 0.134 % and the last is Dow Jones Industrial Average (DJIA) with contribution sebesar 0.0449%.

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