

# **CHAPTER I**

## **INTRODUCTION**

### **A. Background of Study**

During the economic recession and monetary crisis which attack Indonesia in 1997-1998, the Islamic Bank showed the better performance than the conventional one. Most of the national banking systems were infected by the non-performing loan and caused rush. Islamic banking system somewhat shielded from the risk because the absence of negative spread and non-performing loan. Until the end of the crises, the infected bank reached 55 number and all of them are the conventional bank. Some of banks were stopped for operation (Bank Credit Asia, Bank Centris Nasional, Bank Deka, Bank Subentra, Bank Pelita, Bank Hokindo, and Bank Surya) and some of them were taken over the management by Indonesian Bank Restructuring Agency (BPPN), such as BDNI, Bank Exim, Bank Danamon, Bank Umum Nasional, Bank Tiara Asia, Bank PDFCI, and Bank Modern.<sup>1</sup> By the absence of Islamic bank in this list, so it can be enough reason to see

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<sup>1</sup> Yearly Indonesia Banking Statement Period 1998/1999, p. 146

the Islamic banking system as the alternative financial institution. This supported by the achievement of Bank Muamalat Indonesia (BMI) in 1997 which reached 134% of net profit, asset improvement as 14% and 11% as the growth of third party fund.<sup>2</sup>

This favourable growth of Islamic banking system lent the conventional bank to emerge Syariah Business Unit of a Conventional Bank (UUS). In December 2011 there are 336 branch offices assistance and be 332 offices in December 2016. While the number of Syariah Commercial Bank increases from 1.401 to 1.869 by December 2016. And so do the BPRS offices which increases from 364 to 453 offices.<sup>3</sup>

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<sup>2</sup> Sharia Indonesia Banking Statistic (SPS), Financial Services Authority (OJK), 1997

<sup>3</sup> Sharia Indonesia Banking Statistic (SPS), Financial Services Authority (OJK), 2011-2016

**Table 1.1 Distributions of Branch Offices of Syariah  
Business Unit of a Conventional Bank (UUS), Cash  
Offices of Syariah Commercial Bank (BUS) and Syariah  
Rural Bank (BPRS)**

<b>Year</b>	<b>BUS</b>	<b>UUS</b>	<b>BPRS</b>
2011	1.401	336	364
2012	1.745	517	401
2013	1.998	590	402
2014	2.151	320	439
2015	1.990	311	446
2016	1.869	332	453

Source: SPS 2011-2016

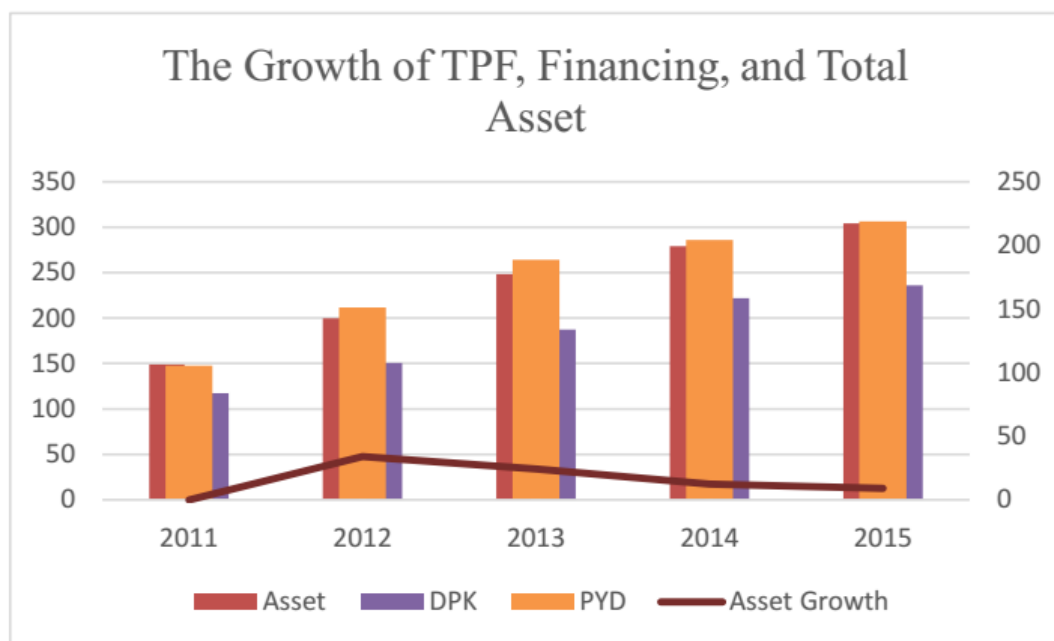
By this number of growth, it can be seen that the growth of third party fund and total asset of Syariah Commercial Bank are also increasing by year. By 2011, the third party fund growth at 117,505 billion rupiahs and still increasing until 236,020 billion rupiahs in 2015. On the other hand, the financing fund grows from 105,335 in 2011 and higher in 2015 by 218,725. The total assets grows satisfying from 148,99 in 2011 to 304,00 in 2015.<sup>4</sup>

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<sup>4</sup> Sharia Indonesia Development Statement (LPKS), Financial Services Authority (OJK), 2015

By mean of this, the syariah banking industry indicates the alternative way in accommodating new monetary channel based on syariah compliance.

**Graph 1.1 The Growth of Third Party Fund, Total Asset, and Financing (PYD BUS-UUS-BPRS)**



Source: LPKS 2015

In other hand, the value of Non-Performing Financing (NPF) of Syariah Commercial Bank per December 2015 is 2,77% which is higher than Non-Performing Loan (NPL) of conventional bank with 1,14%, But, the value of Financing to Deposit Ratio (FDR) of syariah commercial bank in 2015 is 92,14% which is higher than Loan to Deposit Ratio (LDR) of conventional

commercial bank which only 92,11% in 2015. This number shows that financing fund of syariah banking is preferable and attracting the small and micro economic enterprises (SMEs).<sup>5</sup>

**Table 1.2 The Growth of NPF, NPL, FDR and LDR**

<b>Year</b>	<b>NPF</b>	<b>NPL</b>	<b>FDR</b>	<b>LDR</b>
2011	1,34%	2,50%	88,94%	78,77%
2012	1,34%	2,33%	100,00%	83,58%
2013	1,75%	1,7%	100,32%	89,7%
2014	2,94%	0,98%	91,50%	89,42%
2015	2,77%	1,14%	92,14%	92,11%

Source: SPI 2011-2016

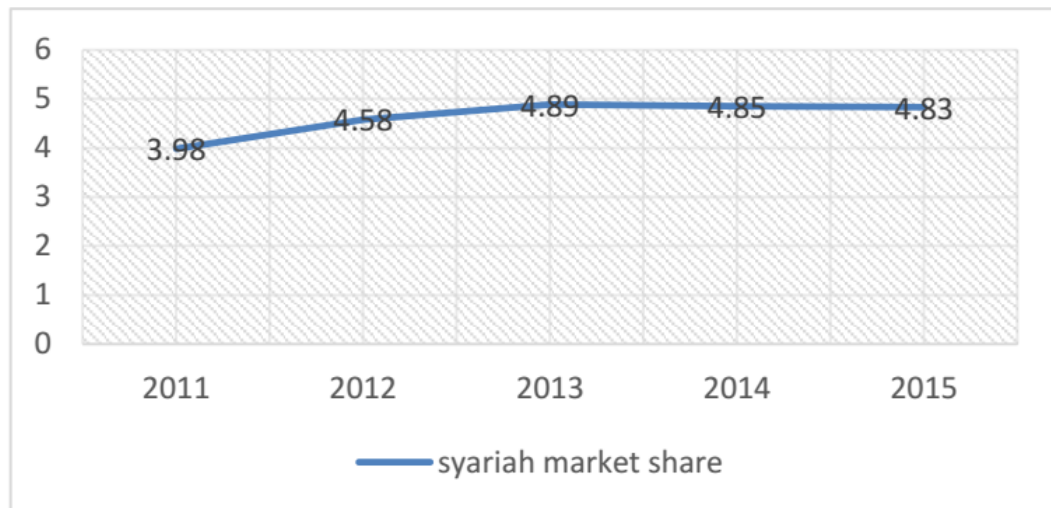
Meanwhile, the total asset of syariah commercial bank is 4,83% comparing with the total bank in 2015.<sup>6</sup> This shows the optimism of Islamic financial institution although the market share is remaining low.

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<sup>5</sup> Indonesian Banking Statistic (SPI) 2011-2016

<sup>6</sup> Sharia Indonesia Development Statement (LPKS), Financial Services Authority (OJK), 2015

**Graph 1.2 The Growth of Market Share of Syariah Commercial Bank of Indonesia**



Source: LPKS 2015

By the new mandate of Indonesian Act No. 23 Year 1999 which changed to No. 3/2004, the macroeconomic target of Indonesia is to reach and maintain the price stability.<sup>7</sup> Where the price stability is reflected by the inflation range or exchange rate. The inflation rate presented by the rise of prices generally and continually in a period. Since 2005, Bank of Indonesia has implemented full-fledged inflation targeting. This new framework called by Inflation Targeting Framework (ITF). Besides, Bank of Indonesia implement dual monetary system as

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<sup>7</sup> UU No. 4 Year 2004

one of the supporting system which has wide variety of monetary instrument.<sup>8</sup>

**Table 1.3 The Comparison of The Inflation Target and Actual Inflation**

Year	Inflation Target	Actual Inflation
2011	$5 \pm 1\%$	3,79
2012	$4,5 \pm 1\%$	4,30
2013	$4,5 \pm 1\%$	8,38
2014	$4,5 \pm 1\%$	8,36
2015	$4 \pm 1\%$	3,35
2016	$4 \pm 1\%$	3,02

Source: Bank Indonesia

Theoretically, the studies supporting the merits of the profit-loss sharing have been extensive. They proved empirically that this system is better than the interest based system.<sup>9</sup> But the study about the efficacy of profit-

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<sup>8</sup> UU No. 23 Year 1999

<sup>9</sup> For a technical discussion, see also Ascarya and Ali Sakti, *Comparing Monetary Policy Instruments under Dual Financial System: Interest System vs. Profit-and-Loss Sharing System*, Journal of Islamic Business and Economics, Vol. 2, No. 1, Yogyakarta: Laboratorium Ekonomi dan Bisnis Islam, Ascarya and Diana

loss sharing contract that applies in monetary policy transmission mechanism is very scarce. So that, it must be empirically proved that the absence of interest based instrument would support the effectiveness of mechanism. Furthermore, it can support the growth of economic and optimizing the monetary transmission mechanism in order to reach the monetary stability.

Based on this problem, the researcher wants to emphasize them in order to conduct the analysis. So, some hypothesis done in systematic ways and written in this simple thesis entitled, **The Effectiveness of Monetary Policy Transmission Mechanism Under Dual Financial System in Indonesia Through Interest-Profit Sharing Channel, Period 2011-2016.**

## **B. Problem Formulation**

This study tries to shed light on the problem follows:

1. How is the effectiveness of the conventional monetary policy transmission mechanism in Indonesia?
2. How is the effectiveness of the Islamic monetary policy transmission mechanism in Indonesia?



### **C. Purpose of Study**

Referring to these problems, so the aims of study are as follows:

1. To analyse the effectiveness of the conventional monetary policy transmission mechanism in Indonesia
2. To analyse the effectiveness of the Islamic monetary policy transmission mechanism in Indonesia

### **D. Significance of Study**

1. Academic

This study hopes to contribute some new ideas and information. So that, this study enriches the literature in monetary policy transmission mechanism studies, conventionally or even Islamic one. Furthermore, hopes this study help to understand the concept and some obstacles in transmission mechanism distortion for further research.

2. Practically

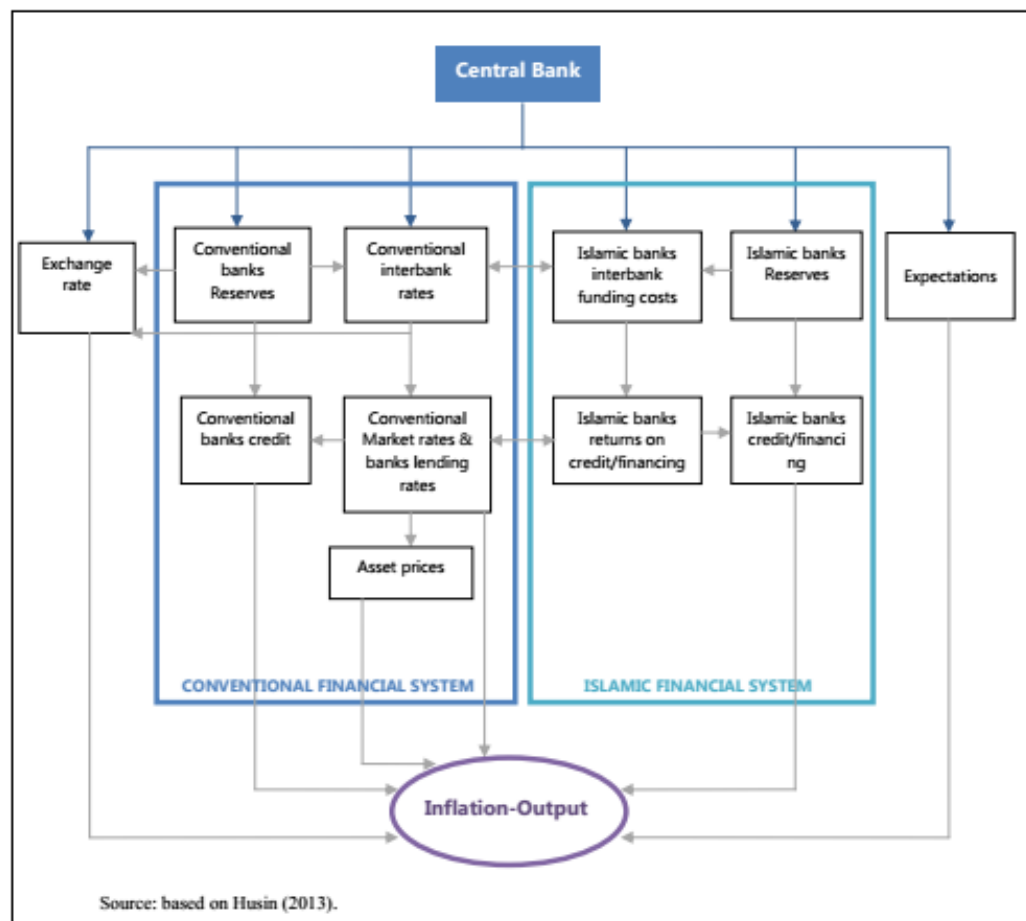
Hopefully, this research proposes specific recommendations on the design of Islamic monetary policy operations and as references for monetary

authority to maintain the price stability through the Islamic financial system in future.

### E. The Research Systematics

The correlation between the problem formulation and the purpose of study can be drawn as follows.

**Figure 1.1 The Framework of Study**



Source: Husin on Mariam (2016)

The monetary policy transmission mechanism signalled from Central Bank policy and transmitted into interbank money market by the fluctuation of interest or return rate. This change makes the bank responses by raising or lowering the deposit and financing rate. Furthermore, total third party fund will fluctuate and then influence the economic growth and prices.

The rest of study is structured as follow:

Chapter one gives an overview of the cases background and the growth of Islamic financial institution in Indonesia.

Chapter two explores the monetary policy transmission mechanism concept under dual monetary system as the theoretical framework and literatures. Some previous studies also provide to strengthening the cases and analytics.

Chapter three provides some discussion in using the methodology and data which will be applied simultaneously to get more robust results.

Chapter four discusses the empirical results of the analysis.

Meanwhile, conclusion and some suggestion will be presented at the last session.