AGREGAT: Jurnal Ekonomi dan Bisnis
Volume 8 (No 2), 2024
http://journal.uhamka.ac.id/index.php/agregat/
p-ISSN: 2549-5658 e-ISSN: 2549-7243
DOI: 10.22236/agregat_vol8.i2/16299
Pp 112-130

RESEARCH ARTICLE OPEN ACCESS

THE ISLAMIC FINANCING ON MACROECONOMIC STABILITY IN INDONESIA

Marro'aini

[1] STAI Al-Kifayah Riau
Marroaini51@gmail.com

Article Info: Received: September 10, 2024; Revised: September 18, 2024; Accepted: September 24, 2024

Abstrak: The objective of this study is to examine the function of Islamic finance in fostering macroeconomic stability in Indonesia. Specifically, it will scrutinize the stability of Islamic banks, its effects on micro, small, and medium enterprises (MSMEs), and its impact on economic growth and inflation. Employing a qualitative research approach, data were gathered by means of document analysis, encompassing books, scholarly publications, and institutional reports. The results demonstrate that Islamic banks, which employ profit-sharing and asset-backed financing structures, have higher levels of stability in comparison to conventional banks, therefore mitigating the likelihood of financial catastrophes. Islamic finance has profoundly facilitated the expansion of MSMEs by offering cost-effective, interest-free lending, therefore augmenting their productivity and economic contributions. Furthermore, Islamic finance promotes consistent economic expansion by prioritizing investments in tangible assets in industry areas such as agriculture and manufacturing. Although it suppresses speculative activity, its effect on inflation is inconclusive, as further growth of micro, small, and medium enterprises (MSMEs) may have upward influence on pricing. In conclusion, the study highlights that Islamic finance contributes to Indonesia's macroeconomic stability by strengthening Islamic banks, promoting MSME development, and fostering balanced economic growth. The data shows a consistent rise in the contribution of MSMEs to Indonesia's GDP from 57.08% in 2017 to 61.90% in 2022, underscoring their increasing significance in the national economy. This upward trend highlights the growing role of MSMEs in economic development.
Kata Kunci: Islamic Financing, Macroeconomic Stability

Abstrak: Tujuan dari penelitian ini adalah untuk mengkaji fungsi keuangan Islam dalam mendorong stabilitas ekonomi makro di Indonesia. Secara khusus, penelitian ini akan meneliti stabilitas bank Islam, dampaknya terhadap usaha mikro, kecil, dan menengah (UMKM), dan dampaknya terhadap pertumbuhan ekonomi dan inflasi. Dengan menggunakan pendekatan

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penelitian kualitatif, data dikumpulkan melalui analisis dokumen, yang mencakup buku, publikasi ilmiah, dan laporan kelembagaan. Hasilnya menunjukkan bahwa bank Islam, yang menggunakan struktur pembiayaan bagi hasil dan berbasis aset, memiliki tingkat stabilitas yang lebih tinggi dibandingkan dengan bank konvensional, sehingga mengurangi kemungkinan terjadinya bencana keuangan. Keuangan Islam telah sangat memfasilitasi perluasan UMKM dengan menawarkan pinjaman yang hemat biaya dan bebas bunga, sehingga meningkatkan produktivitas dan kontribusi ekonomi mereka. Lebih jauh, keuangan Islam mendorong perluasan ekonomi yang konsisten dengan memprioritaskan investasi pada aset berwujud di bidang industri seperti pertanian dan manufaktur. Meskipun menekan aktivitas spekulatif, dampaknya terhadap inflasi tidak meyakinkan, karena pertumbuhan lebih lanjut dari usaha mikro, kecil, dan menengah (UMKM) dapat memengaruhi harga ke atas. Sebagai kesimpulan, penelitian ini menyoroti bahwa keuangan Islam berkontribusi terhadap stabilitas makroekonomi Indonesia dengan memperkuat perbankan Islam, mendorong pengembangan UMKM, dan mendorong pertumbuhan ekonomi yang seimbang. Data tersebut menunjukkan adanya peningkatan yang konsisten dalam kontribusi UMKM terhadap PDB Indonesia dari 57,08% pada tahun 2017 menjadi 61,90% pada tahun 2022, yang menggarisbawahi semakin pentingnya UMKM dalam perekonomian nasional. Tren peningkatan ini menyoroti semakin besarnya peran UMKM dalam pembangunan ekonomi.
Kata kunci: Pembiayaan Islam, Stabilitas Makroekonomi

INTRODUCTION

The maintenance of macroeconomic stability is crucial for ensuring steady and enduring economic growth. In order to preserve this stability, Indonesia has undertaken fiscal and monetary measures. The field of Islamic finance has gained prominence in tandem with the growing public consciousness of Islamic economic concepts. Islamic financing, by prioritizing the funding of the real sector and refraining from usury and speculation, is regarded as a viable substitute for the traditional financial system and contributes to greater economic stability.

Maintaining macroeconomic stability, encompassing factors such as exchange rate stability, inflation, unemployment rate, and GDP growth, is crucial for sustaining a nation's economic growth. These metrics serve as a measure of the economic well-being and assist policymakers in formulating strategic approaches to maintain a robust economy. Achieving macroeconomic stability is crucial for establishing a favorable investment climate. Finally, this will enhance the well-being of the society.

As Islamic finance plays an increasingly significant role in the Indonesian economy, it is crucial to conduct study on its effect on macroeconomic stability. To promote greater involvement of Islamic finance in the domestic economy, the Indonesian government and financial authorities have enhanced the regulatory environment. While the impact of Islamic finance on economic growth has been extensively examined, its precise influence on macroeconomic stability remains incompletely assessed. Therefore, the aim of this study is to conduct a thorough examination of the impact of Islamic finance on the macroeconomic stability of Indonesia.

Empirical data strongly indicates that Islamic finance has the potential to improve macroeconomic stability. However, there remain several areas that have not been extensively examined. One crucial aspect is the influence of Islamic finance on several measures of macroeconomic stability. Furthermore, there remains a scarcity of comparative research on Islamic and conventional finance, particularly in the field of macroeconomics. The objective of this study is to conduct a comprehensive examination of the correlation between Islamic finance and macroeconomic stability.

Through a variety of methods and effects on financial stability, Islamic financing has demonstrated promise in improving macroeconomic stability. Statistical evidence suggests that Islamic banks have a beneficial impact on financial stability, frequently outperforming traditional banks in this aspect (Rashid et al., 2017). Empirical evidence suggests that Islamic banks tend to exhibit greater short-term stability in comparison to conventional banks, but potentially displaying lower long-term stability (Rihab Ben Slimen et al., 2022).

Academic research has also emphasized the significance of macroeconomic indicators in exerting an impact on the financial stability of banks. Gross domestic product and inflation exert substantial influence on the financial stability of banks, indicating that implementing preventive measures could amplify the beneficial effects while reducing the adverse ones (Rashid et al., 2017). Moreover, there exists a correlation between macroeconomic factors such as economic growth, public debt, and foreign direct investment with the performance of Islamic banks. Specifically, the requirements for external financial resources imposed by foreign direct investments have a negative impact on the performance of Islamic banks (Al Sharif, 2023).

The empirical analysis of the influence of Islamic financing on economic growth and financial stability has been conducted in several geographical areas. Specifically, Islamic finance has a substantial influence on economic growth and financial stability in the ASEAN-4 countries. However, the effects of individual elements such as Islamic stock indexes and

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Sharia banking assets differ (Hanif & Hanafi, 2023). Furthermore, the moderating role of institutional frameworks in the relationship between macroeconomic stability and the growth of global Islamic finance, particularly the sukuk market, has been established (Ismail & Basyariah, 2022).

In general, the empirical data indicates that Islamic finance has a role in maintaining financial stability and promoting economic growth. This is driven by both internal forces within Islamic banking and external macroeconomic variables. This contribution is crucial for policymakers and financial organizations seeking to utilize Islamic financing to achieve wider economic stability and expansion.

Emerging research in Islamic finance reveals a complex influence on macroeconomic stability and growth, with particular advancements emphasizing the significance of different Islamic financial instruments and banking assets. Research conducted by Hanif, Hanafi et al. (2023) revealed that Islamic stock indices had no discernible effect on economic growth. However, they did contribute to the improvement of financial stability in the ASEAN-4 countries. Conversely, Sharia banking assets greatly enhanced economic growth but had no discernible impact on financial stability. These findings indicate that different elements of Islamic finance have varying effects on economic indicators.

Moreover, Sharif (2023) showed that there is a generally beneficial relationship between macroeconomic factors and the performance of Islamic banks. However, foreign direct investments had a contraactive impact. This observation highlights the intricate interplay between external economic variables and the operating success of Islamic banking.

An investigation conducted by Slimen, Belhaj et al. (2022) in the Gulf Cooperation Council region revealed that Islamic banks provide superior short-term financial stability in comparison to conventional banks. However, they exhibit lower long-term stability. These findings indicate fundamental disparities in the factors that determine financial stability between Islamic and conventional banking systems. A study conducted by (El Khatib & Ferreira Savoia, (2024) Khatib revealed that specific elements such as governance and bank concentration had a detrimental effect on the financial stability of Islamic banks. However, enhancements in capital adequacy and liquidity were shown to be advantageous. These findings indicate potential areas for Islamic banks to improve their stability.

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In conclusion, the research conducted by Muhammad, Sunni et al. (2024) emphasized the impact of internet users and macroeconomic variables on the Islamic Finance Index in Indonesia and Malaysia. The study revealed substantial long-term correlations and identified contemporary digital effects as key drivers of Islamic finance expansion. The aforementioned results depict the dynamic nature of Islamic finance, characterized by its diverse effects on several economic dimensions and shaped by both conventional and modern economic factors.

In order to further comprehend the relationship between Islamic finance and macroeconomic stability, it is necessary to pose some crucial questions. Firstly, what the influence of Islamic finance on the macroeconomic stability of Indonesia. The objective of this study is to investigate the role of Islamic financing in enhancing stability relative to the traditional financial system, and to examine the interplay of these aspects within the context of economic stability. This phenomenon can be attributed to the coexistence of conventional and Islamic finance inside the dynamic financial system of Indonesia.

The influence of Sharia financing on macroeconomic stability in Indonesia is complex, affecting several economic sectors and the stability of the financial system. Sharia finance, distinguished by its strict adherence to Islamic rules, has a substantial impact on the economic environment of Indonesia, namely by influencing banking stability, MSME development, and overall economic growth. The subsequent sections comprehensively examine these elements, emphasizing the contributions and obstacles of Sharia funding in Indonesia.

Nevertheless, the existing evidence on the impact of Islamic finance on macroeconomic stability in Indonesia remains somewhat scarce. The predominant focus of contemporary study is on the impact of Islamic finance on the general economic growth or its comparison with conventional systems. The present study centres on the impact of Islamic finance on several measures of macroeconomic stability. In essence, this study perceives Islamic finance not only as an integral component of the financial system, but also as a factor that influences macroeconomic stability. This study is distinctive since it employs a comprehensive analysis to quantify the impact of Islamic finance on the macroeconomic stability of Indonesia. This study employs a qualitative methodology by simultaneously assessing multiple economic indicators, in contrast to prior research that generally adopts a descriptive or single-focused approach. Thus, it is anticipated that this study would provide novel concepts to the Islamic

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economics literature and assist policymakers in developing more effective and enduring financial strategies.

METHOD

The present work employs a qualitative research methodology to investigate and evaluate data derived from several documentary sources, including books, scholarly journals, and reports. The qualitative approach facilitates a more profound comprehension of the topic by explicating the significance embedded in textual material. The methodology employed for data collection was document analysis, which entailed a methodical examination of pertinent information. The sources encompassed seminal literature that provide historical background and theoretical frameworks, scholarly journal articles that provide current research and ongoing debates, and institutional reports that offer practical insights and case studies.

The selection of books was based on their pertinence to the research objective, providing crucial background and theoretical information. Empirical research and theoretical viewpoints were among the criteria used to select academic journal articles from databases such as Scopus and Google Scholar. Moreover, reports from research institutes and other organizations were examined to investigate practical uses of the subject matter. The wide array of documented sources offered a balanced perspective on the topic, guaranteeing thorough coverage.

The material underwent thematic analysis, a systematic approach that discovers, examines, and presents repeating patterns or themes embedded in the documentation. Upon careful examination, the data were systematically analyzed to identify important trends, which were further categorized into more comprehensive groups for interpretation. The aforementioned procedure facilitated a rigorous and comprehensive comprehension of the fundamental ideas and their consequences. For the purpose of ensuring the accuracy and dependability of the results, triangulation was used by cross-referencing data obtained from several sources. Implementing this approach facilitated the verification of the coherence of results across several forms of documentation, therefore augmenting the trustworthiness of the study. Through the integration of diverse data sources and meticulous analysis, this research endeavors to provide significant insights into the examined subject.

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RESULTS AND DISCUSSION

The following section outlines the results of the research on the impact of Islamic finance on the overall economic stability of Indonesia. This study specifically examines three main aspects: the stability of Islamic banks, the influence of Islamic finance on micro, small, and medium companies (MSMEs), and its implications for economic growth and inflation. The findings emphasize that the distinctive financial frameworks of Islamic banks, which are founded on risk-sharing and ethical values, not only ensure stability in the financial system but also promote the development of MSMEs. In addition, the discussion delves into the impact of Islamic finance on Indonesia's general economic growth and inflation dynamics, providing valuable insights into its wider economic consequences.

Stability of Islamic Banks

An examination of Islamic finance in Indonesia reveals that Islamic banks have shown superior ability to sustain macroeconomic stability in comparison to their conventional counterparts. The stability of Islamic banks can be ascribed to their use of profit-sharing assumptions and asset-backed financing structures, which effectively mitigate their vulnerability to speculative activity and high-risk investments. In contrast to traditional banks that primarily depend on interest-based revenue, Islamic banks function based on risk-sharing arrangements that encourage financial caution and stability. Consequently, Islamic banks in Indonesia have demonstrated reduced rates of default and more robust capital reserves, especially during times of economic instability. Such resilience enhances the general stability of the financial sector, therefore mitigating the likelihood of systemic crises.

Islamic financing exerts a substantial impact on both the macroeconomic stability and the stability of Islamic banks in Indonesia. The interaction of Islamic financial principles, macroeconomic variables, and the operational dynamics of Islamic banks generates an intricate and influential setting that affects both the overall economy and the financial institutions (Abbas & Frihatni, 2020).

An important determinant of the stability of Islamic banks in Indonesia is the maqasid sharia, which seeks to accomplish goals like as education, justice, and welfare (M. Agustina et al., 2022). Nevertheless, the introduction of maqasid sharia has demonstrated an adverse effect on the stability of banks, as seen by a decline in the Z-score, which serves as an indicator of bank stability, during the duration of the study (Angraini et al., 2020). The stability of Islamic banks is positively influenced by factors such as capital adequacy and bank size, but negatively influenced by GDP and the maqasid index (Arifin, 2021). This implies a need for enhanced management and financing quality within Islamic banks (Analia et al. 2024).

Research conducted by Sakinah, Kasri et al. (2022) in Indonesia revealed that Islamic finance, encompassing Islamic banking, capital markets, and Sukuk, has a substantial influence on the country's GDP in both the near and far future. Indeed, this highlights the increasing significance of a wide range of Islamic financial products inside the economic frameworks of nations (Ascarya et al., 2022).

The stability of Islamic banks in Indonesia is influenced by many crucial elements, such as the principles of maqasid sharia, macroeconomic indicators, operational effectiveness, and regulatory obstacles. The influence of these elements extends beyond the stability of the banks themselves and has wider consequences for the macroeconomic stability of Indonesia. Therefore, it is crucial for policymakers and players in the Islamic banking sector to comprehend the effects of these factors (Analia et al., 2024).

The objectives of Islamic law, referred to as maqasid sharia, are of pivotal importance in establishing the stability of Islamic banks. The maqasid index, which assesses the extent to which banks meet these objectives, has been shown to have an adverse effect on bank stability as a result of inadequate management and financing characteristics, which hinder the attainment of goals such as education, justice, and welfare (Asnawi et al., 2020). In contrast, determinants such as the size of the bank and its capital adequacy ratio (CAR) have a positive impact on stability, indicating that bigger banks with enough capital exhibit greater stability (Analia et al., 2024).

Macroeconomic factors such as inflation have a substantial impact on the funding of the MSME sector in Islamic banks, ultimately affecting both the short-term and long-term stability. Furthermore, other macroeconomic indicators, such as GDP and exchange rates, are of utmost importance(Ulina & Majid, 2020). Gross Domestic Product (GDP) has a beneficial effect on deposits in Islamic banks in both the short and long run. However, the stability of these banks is also affected, albeit to a smaller degree compared to conventional banks, by faulty loans(Harini et al., 2024).

Effective management of operational efficiency and risk is crucial for ensuring the financial soundness of Islamic institutions. Optimising these aspects can augment profitability

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and stability. Furthermore, there exists a favorable correlation between product diversification, service quality, and risk management with money market stability. This underscores the significance of implementing comprehensive methods to uphold financial stability(Khan et al., 2024).

Regulatory issues, with their intricate and ever-changing nature, can present substantial obstacles to the long-term viability of Islamic banks. Revision of rules is essential to facilitate the expansion of the Islamic banking sector and guarantee compliance with sharia principles. Although Islamic banks in Indonesia typically demonstrate a greater likelihood of stability in comparison to conventional banks, they encounter challenges in adequately recovering from crises. This emphasises the need of implementing focused measures to strengthen their ability to recover and participate to the general economic stability of the nation(Panjaitan & Nurbaiti, 2024).

Impact on MSMEs

The influence of Islamic finance on the expansion and long-term viability of micro, small, and medium enterprises (MSMEs) in Indonesia has been substantial. Islamic financial facilities like murabaha (cost-plus financing) and musharaka (partnership-based financing) have enabled MSMEs to obtain cost-effective loans without the need to pay exorbitant interest rates. This financing strategy is in accordance with Islamic ethical ideals, which promotes inclusive economic development. Micro, Small, and Medium Enterprises (MSMEs), which are the fundamental support of the Indonesian economy, leverage the emphasis of Islamic banks on tangible economic operations and fair wealth sharing. This study demonstrates that Islamic finance has effectively enabled the growth of MSMEs, enhanced their efficiency, and amplified their impact on job and income creation across multiple industries.

Sharia finance plays a crucial role in facilitating the expansion of Micro, Small, and Medium Enterprises (MSMEs) in Indonesia. It offers vital financial resources and investment prospects, promoting sustained development and economic empowerment, especially in rural regions (Fidat & Rolianah, 2023). Enhanced performance and understanding of Sharia financing alternatives, which are essential for sustainable growth, clearly demonstrate the beneficial influence of Sharia finance on MSMEs (Hsb et al. 2024).

Islamic bank finance has emerged as a significant option for Micro, Small, and Medium Enterprises (MSMEs), offering ethical and Sharia-compliant financial solutions. In addition to

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satisfying the financial requirements of MSMEs, this strategy also corresponds with the religious and cultural principles of many entrepreneurs in regions with a Muslim majority (A. Agustina, 2023). Recent research emphasises that the adoption of Islamic finance is influenced by several considerations, which can have a substantial impact on the performance of MSMEs (Janah & Rintisari, 2024).

A report by the Ministry of Cooperatives, Small and Medium Enterprises highlighted the substantial contribution of MSMEs to the economic recovery of the country. There are currently 64.2 million MSMEs in Indonesia, which account for 61% of the country's GDP. Medium and Small Enterprises (MSMEs) can employ 97% of the entire national population, which amounts to almost 119.6 million Indonesians.

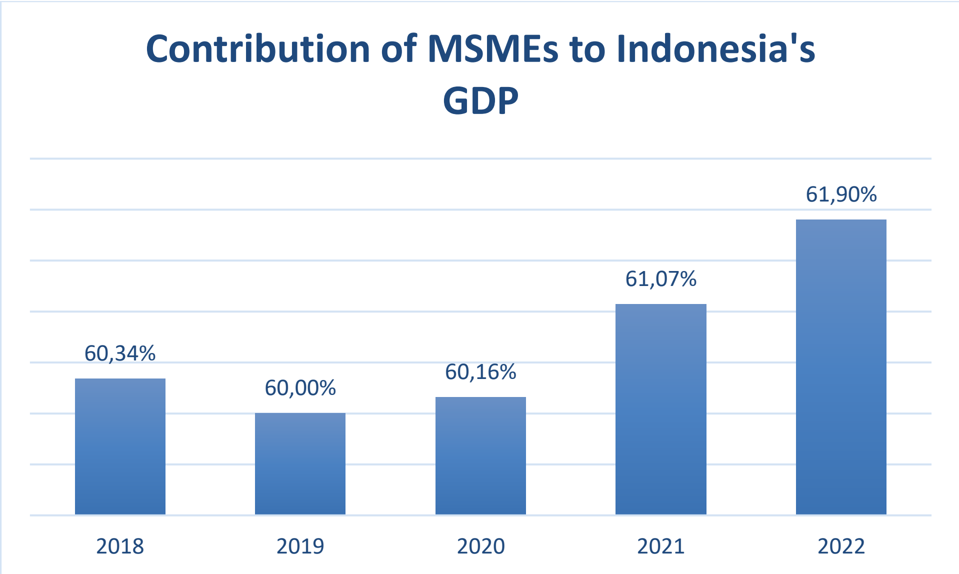

Figure. Contribution of MSMEs to Indonesia's GDP

Source: Ministry of Cooperatives, Small and Medium Enterprises

The Adoption of Islamic Financing: An Analysis of Factors Among MSMEs, the inclination to use Islamic Debt Financing (IDF) is significantly influenced by entrepreneurial motivation and attitudes(Nisa, 2024). Financial literacy, risk perception, and cost perception are identified as influential elements that affect this desire (Rhoudri & Ougoujil, 2024). Entrepreneurial accomplishment motivation acts as a mediating factor in this relationship. The level of Islamic religious devotion greatly moderates these dynamics. Although Islamic financial literacy alone does not mitigate this relationship, the adoption of Islamic fintech

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financing on is primarily driven by its perceived usefulness and convenience of use (Kartika & Budianto, 2024).

Murabaha finance, like other Islamic financial solutions, has a beneficial effect on the financial performance of MSMEs by improving their profitability and operational efficiency. The implementation of Sharia People's Business Credit (KUR) financing in Indonesia has demonstrated its ability to enhance the financial performance of Micro, Small, and Medium Enterprises (MSMEs) and promote local economic empowerment (Saifurrahman & Kassim, 2024). Furthermore, in Nigeria, Islamic finance promotes sustainable micro, small, and medium enterprise (MSME) financing by tackling challenges such as insufficient capital and unattainable lending facilities(Rhoudri & Ougoujil, 2024).

The function of Islamic financial institutions, namely Islamic Rural Banks and Baitul Maal wat Tamwil (BMT), is crucial in delivering financial services and consultancy, so exerting a direct impact on the revenue and development of Micro, Small, and Medium Enterprises (MSMEs) (Sandy & Armina, 2023). Furthermore, Sharia-compliant financial technology, namely crowdfunding, presents a feasible avenue for micro, small, and medium enterprises (MSMEs), in accordance with Islamic values and enabling ethical investment prospects (Saratian et al., 2024).

Between the years 2018 and 2022, the productivity of MSMEs in Indonesia is positively influenced by the working capital and investment finance provided by Islamic banks. The analysis incorporates two control variables: labor, which yields statistically significant outcomes on MSME productivity, and internet users, which yields statistically negligible outcomes on the same metric. Collectively, the productivity of Indonesian MSMEs between 2018-2022 is significantly influenced by the following factors: internet users, labor, financing for Sharia-compliant working capital, and Sharia investment financing. The research findings indicate that Islamic banking financing has a substantial positive impact on MSME productivity. Furthermore, Islamic investment financing has been shown to be more effective in enhancing MSME productivity compared to Islamic working capital (Supriani et al., 2024).

Small, Medium, and Micro Enterprises (MSMEs) are a fundamental component of economic operations in society. According to quality standards, MSMEs have a dominant position in the business sector in Indonesia, accounting for 99.9%. MSMEs, accounting for up to 90%, also dominate the global economy. Its growth consistently experiences a significant increase annually (Wahyuni et al., 2019). Minimal capital requirements of MSMEs enable these enterprises to survive and sustain growth. According to the East Java Central Statistics Agency (2017), the number of MSMEs in Indonesia was 55.2 million in 2015 and has been in steady increase throughout the years. There exists a direct correlation between the expansion of MSMEs and the rise in MSME contributions to state revenues. In 2016, MSMEs made a contribution of IDR 7,009,283 billion (59.84% annually) to Indonesia's National Gross Domestic Product (GDP). According to the Ministry of Cooperatives and Small and Medium Enterprises of the Republic of Indonesia (2017), the value of the funds rose to Rp 7,704,635.9 billion, representing a growth of 60%. These findings validate that MSMEs are the primary economic sector that makes the greatest impact on GDP and is highly important to foster growth (S. Alam & Ramadhani, 2023)

The current level of utilisation of Islamic financial products is somewhat low, as only a small proportion of MSMEs actively participate in these services, despite the existing awareness of them. However, in locations such as Probolinggo, Indonesia, the increase in Islamic financial inclusion and literacy has greatly improved the productivity of micro, small, and medium enterprises (MSMEs) (Khalidin et al., 2023). Although Islamic financing provides several advantages for MSMEs, obstacles such as low rates of utilization and the necessity for enhanced financial literacy continue to exist. By implementing focused education and improving the availability of Islamic financial instruments, it is possible to enhance the empowerment of MSMEs and make a significant contribution to overall economic growth.

Economic Growth and Inflation

Islamic finance has contributed to the promotion of consistent economic growth in Indonesia. Islamic financial institutions have enhanced the stability of economic growth by prioritizing investments in tangible assets and minimising speculative transactions. The prioritization of funding productive industries such as agriculture, industry, and services has contributed to the maintenance of long-term economic expansion. Nevertheless, the research also observes that Islamic finance, although achieving stability in many domains, has had varied impacts on inflation. Although it mitigates speculative bubbles that usually result in inflationary pressures, the growth of MSMEs and elevated consumption in specific industries could temporarily drive prices upwards. Yet, the overall effect of Islamic finance on inflation is still modest and controllable within Indonesia's broader monetary policy framework.

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The Islamic financial sector, encompassing banking and sukuk, has a beneficial impact on the economic development of Indonesia. Nevertheless, the influence differs among various financial instruments, and Islamic mutual funds exhibit a predominantly adverse impact (Azwar et al. 2024) (Hartanto & Samputra, 2023). The Impact of Sharia Monetary Policy tools, such as the Bank Indonesia Sharia Deposit Facility, on Economic Growth and Inflation is substantial, underscoring the importance of meticulous assessment of these tools to maximize their effectiveness (Sadeghi et al., 2023)(Winarto & Beik 2024).

The impact of Islamic finance on economic growth and inflation is substantial, particularly in countries such as Indonesia, where Islamic financial instruments are becoming more incorporated into the economic framework. The interplay of Islamic finance, economic growth, and inflation is intricate, encompassing a range of monetary policy instruments and financial instruments that conform to Sharia norms .(Saputra & Zulpahmi, 2023)

The provision of Islamic finance, namely through Islamic banking and sukuk (Islamic bonds), has demonstrated a beneficial influence on economic productivity. Research by Soumena et al., (2024) findings demonstrate that these instruments make a substantial contribution to the economic growth of Indonesia, therefore indicating their efficacy in fostering sustainable development. The interplay between Islamic bank funding, MSMEs, and inflation in West Java has had a substantial influence on the economic growth of the region, highlighting the importance of Islamic financial institutions in regional development (T. Alam et al., 2023). Furthermore, Islamic microfinance institutions also contribute to economic development, while traditional elements such as interest rates continue to have a significant impact in both the immediate and extended periods.

Islamic monetary policy, predicated on principles of equity and the proscription of usury, presents different means of managing inflation (Nainggolan, 2023). Proposed measures to ensure price stability and advance economic fairness include the implementation of commodity-based currencies and the prohibition of interest (Rohmana & Utami, 2023). The Bank Indonesia Sharia Deposit Facility (FASBIS) and the Islamic Interbank Money Market (PUAS) exert substantial impact on inflation, both in the immediate and extended periods, thereby demonstrating the capacity of Islamic financial instruments to shape inflation dynamics. The objective of Islamic monetary policy is to establish economic stability and

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efficiently manage inflation by prioritizing real sector investments and profit-sharing principles (Hidayat, 2024).

Islamic financing is instrumental in the promotion of macroeconomic stability in Indonesia by adhering to Sharia principles, which forbid speculative activities and interest. This type of financing promotes financial inclusion, particularly among individuals who refrain from using traditional institutions due to religious beliefs (Nasir, 2022). Consequently, it facilitates balanced growth and integrates a broader segment of the population into the economic system (Othman, 2021). Islamic finance promotes economic diversification and reduces dependence on volatile sectors by supporting sectors such as small and medium enterprises (SMEs) and infrastructure through profit-sharing and risk-sharing contracts, thereby fostering more sustainable development (Aryati, 2023). Its risk-sharing feature, which involves the sharing of investment risks between financiers and entrepreneurs, encourages prudent financial behaviors that can safeguard the economy from sudden disruptions (Kasri, 2022). Furthermore, Islamic finance can assist in inflation control due to its asset-backed nature and its prohibition of debt multiplication (Komaludin, 2019). The emphasis on social welfare and equitable wealth distribution through mechanisms such as zakat (almsgiving) also contributes to overall economic stability, enhances social cohesion, and reduces income inequality (Zulkhibri, 2019). As a result, the incorporation of Islamic financing not only enhances Indonesia's financial system but also provides resilience against global economic fluctuations by virtue of its ethical and sustainable practices.

Although Islamic financing has demonstrated promise in promoting economic growth and controlling inflation, there are still obstacles to overcome, including the requirement for uniformity among various nations and the need for improved interaction with the global financial system. Moreover, the influence of traditional economic variables such as population growth and foreign investment on economic growth may not completely correspond with Islamic economic principles, indicating an intricate interplay among these factors. Overall, Islamic finance presents a promising structure for economic growth, but its complete potential necessitates meticulous execution and legislative backing.

CONCLUSION

The distinctive financial arrangements of Islamic financing in Indonesia have been crucial in preserving macroeconomic stability. Islamic banks, by virtue of their profit-sharing

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DOI: 10.22236/agregat_vol8.i2/16299
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and asset-backed financing designs, have demonstrated superior resilience in comparison to conventional banks. This is attributed to their avoidance of speculative activities and hazardous investments, which has led to the establishment of robust capital buffers and reduced default rates. This stability has had a beneficial effect on micro, small, and medium enterprises (MSMEs), enabling them to access cost-effective, interest-free finance through financial instruments like as murabaha and musharaka, which are in line with Islamic ethical standards. As a result of this support, MSMEs have expanded, leading to increased production, employment, and revenue generation. Furthermore, Islamic finance has facilitated sustainable economic expansion by prioritizing productive industries like agriculture and manufacturing, while its impact on inflation is inconclusive. Although it serves to mitigate speculative bubbles, the growth of MSMEs and heightened consumption might lead to an upward shift in pricing. In general, Islamic finance enhances Indonesia's macroeconomic stability by fortifying the banking industry, bolstering MSMEs, and fostering equitable economic development.

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AGREGAT: Jurnal Ekonomi dan Bisnis
Volume 8 (No 2), 2024
http://journal.uhamka.ac.id/index.php/agregat/
p-ISSN: 2549-5658 e-ISSN: 2549-7243
DOI: 10.22236/agregat_vol8.i2/16299
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