EKONOMI ISLAM
Volume 16, Number 1, May 2025, 194 - 211
P-ISSN: 2087-7056, E-ISSN: 2527-7081
http://journal.uhamka.ac.id/index.php/jei

VECTOR ERROR CORRECTION MODEL (VECM) APPROACH IN ANALYZING THE DYNAMIC RELATIONSHIP BETWEEN GROSS DOMESTIC PRODUCT (GDP) AND ISLAMIC BANK FINANCING IN INDONESIA

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Abstract
Research aims: This study investigates the connection between Islamic bank financing and the Gross Domestic Product (GDP) of Indonesia.
Design/Methodology/Approach: Using secondary time-series data (2015 – 2023), this study employs the Vector Error Correction Model (VECM) within a quantitative framework to investigate short-run and long-run dynamics between the two variables.
Research findings: This study reveals that Islamic financing is a key factor in fostering long-term economic growth, although its influence in the short term shows a fluctuating pattern. The Granger test indicates bidirectional causality, while the IRF and VD analyses show an initial positive impact of Islamic financing on GDP that diminishes over time.
Theoretical Contribution/Originality: This study develops the theoretical framework of Islamic banking by demonstrating that financing is directed toward the real sector based on principles of justice (free of interest and speculation) and isolated from non-bank variables, such that funding can foster pure economic growth.
Practitioners/Policy Implications: To achieve the real-world impact of Islamic financing on the national economy, close collaboration between financial regulators, academics, industry stakeholders, and Islamic social organizations is essential.
Research Limitations/Implications: The overall scope of the data used remains limited, particularly regarding the exclusion of external variables such as global economic dynamics, the level of financial inclusion, and fiscal policies, which may implicitly influence the research outcomes.
Keyword: GDP, Islamic Financing, Islamic Economics, VECM

Introduction

As global economic uncertainty intensifies after the COVID-19 pandemic, achieving sustainable economic growth has become a central focus for numerous nations. Economic growth is not only a macroeconomic

indicator but is also closely related to poverty reduction, job creation, and the long-term welfare of a nation (Purnomo & Istiqomah, 2019). The need for a resilient and inclusive financial system has become increasingly urgent in economic recovery and adaptation.

Indonesia, as one of the largest developing market economies in Southeast Asia, has demonstrated relatively robust economic performance over the past decade, with an average Gross Domestic Product (GDP) growth exceeding 5% before the pandemic (BPS, 2019). However, fluctuations in global commodity prices, external shocks, and internal structural challenges have caused volatility in economic growth rates (Rudiawan & Meirinaldi, 2019). This situation has prompted policymakers and researchers to seek more stable and inclusive financing alternatives to support sustainable economic development.

As a primary catalyst for economic growth, investment contributes by increasing productive capacity and promoting technological progress (Putra & Rahayuningsih, 2025). In this regard, the availability of capital, particularly through banking institutions, plays a crucial role. An efficient process of financial intermediation between those with funds and those requiring financing is essential to ensure that funds are allocated to productive sectors (Nasrulloh et al., 2024). Therefore, developing a healthy and inclusive financial system is key to supporting national development objectives.

Islamic banking has gained prominence within the financial sector, notably in countries with a large Muslim demographic. On a global scale, Islamic finance has witnessed notable expansion by providing financial solutions that comply with Sharia law. In 2021, global Islamic banking assets reached over USD 2.5 trillion, according to the Islamic Financial Services Board (IFSB, 2021), with much of these assets concentrated in Saudi Arabia, Malaysia, and the United Arab Emirates. Various studies in these countries indicate that Islamic financing instruments have great potential in supporting economic growth, financial stability, and social welfare (Kolinets et al., 2021; Yakubu et al., 2025). Despite being home to the world's largest Muslim population and experiencing rapid growth in its Islamic banking industry, empirical research in Indonesia remains relatively scarce.

Islamic banking in Indonesia has shown significant progress over the past decade, with total assets increasing from approximately Rp200 trillion in 2010 to over Rp800 trillion in 2023 (OJK, 2024). Islamic banking primarily concentrates on financing operations, utilizing contracts like *murabahah*, *ijarah*, and *musyarakah*, which are predominantly aimed at supporting productive sectors such as micro, small, and medium enterprises (MSMEs) (Mujaddid & Sabila, 2018). Although Islamic banking in Indonesia has grown

rapidly, its market share is still relatively modest compared to conventional banks. This condition prompts further inquiry into its impact on the country's macroeconomic indicators, especially GDP growth.

Theoretically, Islamic finance is founded on the principles of *maslahah* (public interest), *adl wa ihsan* (justice and goodness), and profit-sharing (risk-sharing), intended to align financial practices with broader ethical and social norms (Kamali, 2016). These principles promote financial inclusion, prevent excessive speculation, and encourage just development. Thus, the expansion of Islamic bank financing should theoretically positively impact economic growth since funds are channelled to honest and productive sectors without burdening the economy with an exploitative interest system (Khan & Haneef, 2022). However, empirical evidence is required to determine how much this relationship holds within the Indonesian context.

Building on the previous background, by employing the Vector Error Correction Model (VECM), this study analyzes the dynamic relationship between Islamic bank financing and Indonesia's economic growth. The analysis evaluates short-term and long-term interactions between the variables and identifies potential causal links. By leveraging a rigorous time-series econometric method, this research enhances the existing body of knowledge in Islamic finance and deepens insights into macroeconomic dynamics. In addition, the study's outcomes provide valuable implications for policymakers, financial institutions, and various stakeholders with respect to the important role Islamic bank financing plays in advancing inclusive and sustainable economic progress in Indonesia.

Literature Review

1. Gross Domestic Product (GDP)

The sustained increase in Gross Domestic Product (GDP), representing the total value of goods and services produced within a nation over time, serves as a primary indicator for assessing a country's development progress and plays a vital role in guiding national economic policy (Lubis et al., 2023).

Various factors such as investment, consumption, government expenditure, and foreign trade contribute to economic growth, as explained in economic theory. Adam Smith emphasized the importance of capital accumulation, while Schumpeter highlighted the role of innovation in driving growth. Conversely, Keynes advocated increased government spending as an economic stimulus (Mulyadi & Suryanto, 2022). Real GDP growth, calculated based on constant prices, is more

accurate because it reflects genuine changes in the volume of goods and services produced rather than merely price fluctuations.

Empirically, Indonesia's economic growth exhibits a positive trend. In 2022, economic growth reached 5.31%, driven by increased production activity, rising household consumption, and domestic and foreign investment (Apriyana et al., 2023).

2. Islamic Financing

The practice of Islamic financing in banks means directing funds to the real economy, following the guidelines of Islamic Sharia. According to Law No. 10 of 1998, Islamic financing is defined as the provision of funds based on contracts that comply with Islamic law, with profit-sharing, leasing, or profit margin returns. Therefore, Islamic banking institutions must ensure that every aspect of their operations is consistent with Islamic law and avoid practices contradicting these sacred guidelines (Nada et al., 2023).

In practice, Islamic bank financing encompasses two central schemes: (1) profit-sharing schemes such as *mudharabah* and *musyarakah*, and (2) sale or leasing schemes such as *murabahah* and *ijarah* (Antonio, 2010; Putri, 2021). *Murabahah*-based financing products dominate the Indonesian Islamic banking market due to their transparent mechanism for determining profit margins, which is easily understood by customers (Zulaeha & Umam, 2023).

Islamic banks drive economic development by directing financial resources toward productive areas like micro, small, and medium enterprises (MSMEs) and infrastructure projects. The disbursement of Islamic financing to the real sector contributes to value creation and employment generation, while advancing financial inclusion aligned with the principles of fairness and long-term sustainability (Winarto & Falah, 2020).

3. Empirical Evidence and Research Gaps

Several researchers have explored how Islamic financing relates to economic growth across different nations. Findings by Kolinets et al. (2021) and Prastowo (2018) reveal that Islamic finance does not contribute equally to GDP across all sectors—only specific areas, like Islamic banking, show a notable influence. These outcomes indicate that a closer look is required to understand the shifting connection between Islamic finance and economic growth across both immediate and extended periods.

Sakinah et al. (2022) combined variables from the non-bank Islamic financial sector and discovered differential influences on GDP in the

short and long run. However, many previous studies have employed simple regression methods or panel data analyses that cannot simultaneously capture these short-run and long-run dynamics. Moreover, most studies amalgamate banking and non-banking variables, making it difficult to isolate the specific impact of Islamic bank financing.

Thus, empirical studies focusing on the isolated effects of Islamic bank financing on economic growth in developing countries like Indonesia are still limited. To bridge this research gap, this paper uses a Vector Error Correction Model (VECM) to analyze the relationships between these variables over both short and long horizons.

4. Conceptualization and Hypotheses

This study's conceptual framework, based on a literature review, directly links Islamic bank financing to GDP-measured economic growth. To maintain a clear focus on this direct influence, the framework intentionally omits moderating or mediating variables. This framework is visually represented in the subsequent figure.

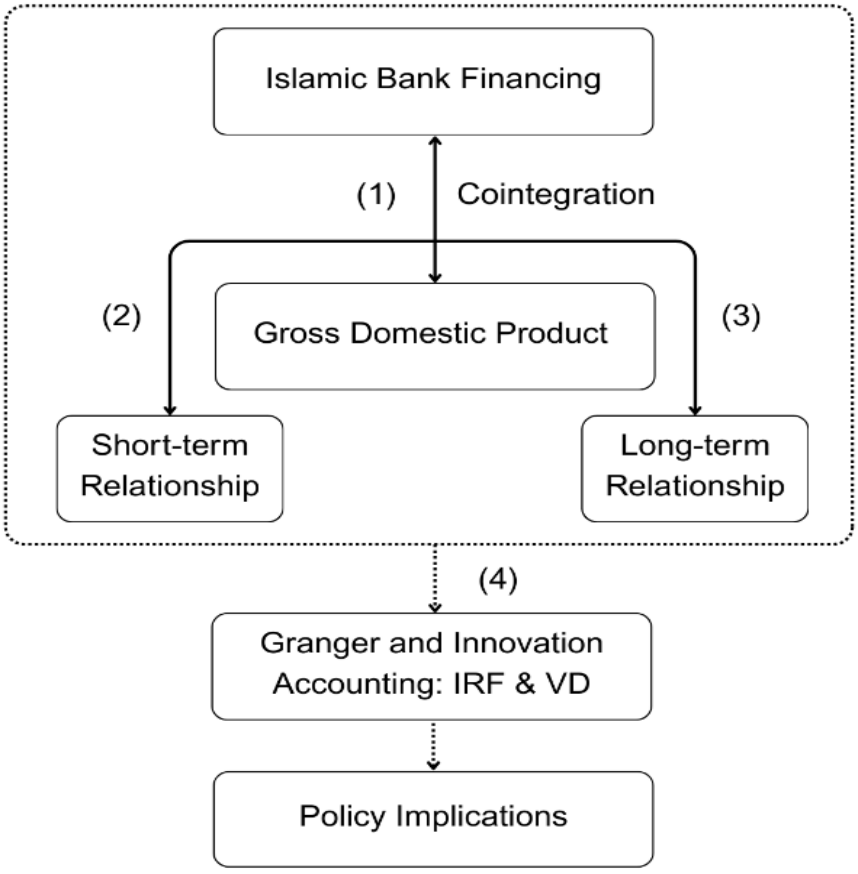


Figure 1. Conceptual Framework

The following hypotheses are formulated:

1) There is a dynamic relationship between Islamic bank financing and GDP.
2) Over an extended period, Islamic bank financing positively influences Indonesia's economic growth as measured by GDP.
3) Islamic bank financing and economic growth (GDP) demonstrate a notable dynamic relationship in the short term.
4) There is a dynamic response of Islamic bank financing to GDP over a specific period.

With a formulation of a specific and measurable conceptual framework and hypotheses, this study is intended to make theoretical contributions to the literature on Islamic finance and deliver practical recommendations for shaping Islamic economic policies in Indonesia.

Research Methodology

This study investigates the link between Islamic financing and Indonesia's economic growth, measured by Gross Domestic Product (GDP). A quantitative method relies on quarterly time-series data from Q1 2015 to Q4 2023. Real GDP figures (in constant prices) from BPS represent national economic output, while the total Islamic financing disbursed by Islamic banks, sourced from OJK, is the key indicator of Islamic finance performance. These two variables were selected due to the availability of consistent quarterly data and their relevance to policymaking in the context of macroeconomic growth. Focusing on these indicators enables a clear and focused analysis of their direct relationship. The Vector Error Correction Model (VECM) is the primary analytical method, accurately capturing short-term dynamics and long-term equilibrium among cointegrated variables.

The primary analytical tool used in this study is the Vector Error Correction Model (VECM). This model is chosen because it can capture short-run fluctuations and long-term relationships among cointegrated variables, thus providing important information for long-term strategic planning. The use of VECM enables the study to predict how the relationship between Islamic financing and economic growth will evolve over the coming five to ten years. These projections are crucial for Islamic banks and financial institutions in crafting more precise and risk-aware strategies—such as identifying which financing sectors to prioritize or scale back, and developing financing models more responsive to macroeconomic conditions shifts (Rachmat, 2023).

The analysis stages in the VECM involve performing a stationarity test (Augmented Dickey-Fuller/ADF) to ensure that the data for each variable is

stationary and free from spurious regression. Next, determining the optimal lag length is achieved by using information criteria (based on the values of FPE, AIC, SC, and HQ) to ensure that the model can capture the relevant dynamics without issues of residual autocorrelation. Following this, to check for the existence of a long-term equilibrium among the variables, the Johansen cointegration test is employed. When cointegration is established, the estimation of the VECM is conducted to explore the error correction term and the short-term adjustments leading to equilibrium. To identify the direction of causality between Islamic financing and economic growth, the Granger causality test is also employed. The Impulse Response Function (IRF) analysis is also applied to examine how each variable responds to shocks within the system. Finally, Variance Decomposition (VD) analysis is conducted to quantify the relative influence of each variable on the forecast error variance of the others (Fatimah & Putra, 2025).

The strengths of the VECM lie in its ability to model both long-run and short-run relationships, overcome spurious regression, and analyze causality and dynamic responses. However, the VECM also has limitations, such as its sensitivity to the lag length selection, the need for a sufficiently long time series, the complexity involved in interpreting short-run coefficients, and the assumption of cointegration among variables. Understanding these strengths and limitations is essential for comprehensively analyzing the analysis results (Basuki & Prawoto, 2019).

Results and Discussions

1. Data Stationarity Test (Root Test)

The outcomes of the Augmented Dickey-Fuller (ADF) unit root test are shown in Table 1, which determined whether the data were stationary. A variable is deemed stationary if its p-value is below 0.05.

Table 1
Unit Root Test Result

Variables	Data Level		Data 1st Difference	
	ADF	Prob.	ADF	Prob.
GDP	0.065731	0.9583	-5.229117	0.0001
Islamic Financing	-1.350470	0.5916	-3.028319	0.0444

Source: Eviews 10, data processed (2024)

The stationarity test results show that GDP and Islamic Financing are non-stationary at their levels, as indicated by ADF p-values > 0.05. However, after first differencing, both variables become stationary. The ADF statistic for GDP is -5.229117 with a p-value of 0.0001, allowing us

to reject the null hypothesis of a unit root and confirming stationarity at the 1% level. Similarly, Islamic Financing has an ADF value of -3.028319 with a p-value of 0.0444, indicating stationarity at the 5% level. These results confirm that both variables are appropriate for VECM analysis, which requires data to be stationary to produce reliable estimates.

2. Optimal Lag Determination

The VAR model's optimal lag length was determined by minimizing the FPE, AIC, SC, and HQ criteria.

Table 2
Lag Test Result

Lag	LogL	LR	FPE	AIC	SC	HQ
0	-767.3492	NA	2.62e+18	48.08432	48.17593	48.11469
1	-760.8343	11.80816	2.24e+18	47.92714	48.20197	48.01824
2	-753.6441	12.13347	1.84e+18	47.72776	48.18580	47.87958
3	-722.6506	48.42731*	3.44e+17*	46.04066*	46.68192*	46.25322*

Source: Eviews 10, data processed (2024)

The optimal lag test results indicate that lag 3 is the best choice based on the most minor information criteria. The lowest FPE value at lag 3 (3.44e+17) suggests that the model with three lags provides more accurate predictions with lower error. In addition, the significant LR value (48.42731) at lag 3 indicates that including this lag substantially improves the model. Thus, to gain a richer understanding of the dynamic nexus between GDP and Islamic finance, a lag of 3 will be employed in the VECM analysis.

3. VAR Model Stability Test

The stability test results indicate that all the model's roots lie within the unit circle, signifying that the model is stable or has values less than 1. The modulus of each root can be observed in the Table 3.

Table 3
Stability Test Results

Root	Modulus
-0.118991 - 0.707086i	0.717028
-0.118991 + 0.707086i	0.717028
-0.600408	0.600408
0.446610	0.446610

Source: Eviews 10, data processed (2024)

The VAR model stability test demonstrates that all characteristic root modulus values are less than 1. Therefore, the model is considered stable, and the estimation results can be interpreted reliably.

4. Cointegration Test

Cointegration signifying a long-run relationship between the variables, is confirmed in Table 4's trace statistic results if the statistic surpasses the critical value at the 5% significance level.

Table 4
Cointegration Test Results

Hypothesized No. of CE(s)	Eigenvalue	Trace Statistic	0,05 Critical Value	Prob.**
None *	0.926877	90.99579	15.49471	0.0000
At most 1 *	0.203883	7.296279	3.841466	0.0069

Source: Eviews 10, data processed (2024)

The cointegration test results reveal two significant long-term relationships between GDP and Islamic Financing. For the "None" hypothesis, the trace statistic is 90.99579, well above the critical value of 15.49471, with a p-value of 0.0000. This leads to rejecting the null hypothesis, confirming a long-run relationship. Similarly, under the "At most 1" hypothesis, the trace statistic is 7.296279 with a p-value of 0.0069, indicating a second significant cointegration relationship. These results suggest that, despite short-term fluctuations, GDP and Islamic Financing are bound by a long-term equilibrium—an essential foundation for further analysis using the VECM approach.

5. Granger Causality Test

The Granger causality test was conducted to explore possible causal links between the variables. A causal relationship is considered statistically significant if the p-value is less than 5%. Table 5 presents the detailed results of the test.

Table 5
Granger Causality Test Results

Null Hypothesis:	Obs	F-Stat.	Prob.	Decision	Conclusion
GDP does not Granger Cause ISLAMIC_FINANCING	33	7.57069	0.0008	H_0 rejected	Causality Two-Way
ISLAMIC_FINANCING does not Granger Cause GDP		5.16955	0.0062	H_0 rejected	

Source: Eviews 10, data processed (2024)

Based on the Granger causality test, we reject both hypotheses of unidirectional causality between GDP and Islamic Financing. The significant F-statistic (7.57069) and corresponding p-value (0.0008) lead to the conclusion that GDP Granger-causes Islamic Financing. Similarly, the significant F-statistic (5.16955) and p-value (0.0062) prompt the rejection of the hypothesis that Islamic Financing does not Granger-cause GDP, indicating a causal effect in the reverse direction. These results confirm a mutual influence between the two variables, highlighting a dynamic interaction that should be accounted for in economic policymaking and financial planning.

6. VECM Model Estimation

Tables 6 and 7 present the results of the VECM estimation. In the tables, the upper sections present the short-term interactions between GDP and Islamic Financing, while the lower sections represent the long-term equilibrium relationship between these two variables.

Table 6
Short Term VECM Estimation Results

Variables	Coefficient	T-Statistic	Conclusion
CointEq1	-0.001388	[-0.07265]	Not Significant
D(GDP(-1))	0.106171	[0.55900]	Not Significant
D(GDP(-2))	0.195528	[1.05378]	Not Significant
D(ISLAMIC_FINANCING(-1)	-5.597536	[-1.41381]	Not Significant
D(ISLAMIC_FINANCING(-2))	-5.089847	[-2.01428]	Significant

Source: Eviews 10, data processed (2024)

The short-run VECM estimation results show that most variables are not statistically significant, except for D(ISLAMIC_FINANCING(-2)), which has a coefficient of -5.089847 and a t-statistic of -2.01428—indicating a substantial effect at the 5% level. This means that Islamic Financing from two periods earlier has a meaningful influence on the short-term behavior of GDP. Meanwhile, the coefficients for D(GDP(-1)) and D(GDP(-2)) are positive but not statistically significant, suggesting that GDP has a limited short-run effect on Islamic Financing. These results imply that the interaction between the two variables is more impactful over the long than in the short term.

Table 7
Long Term VECM Estimation Results

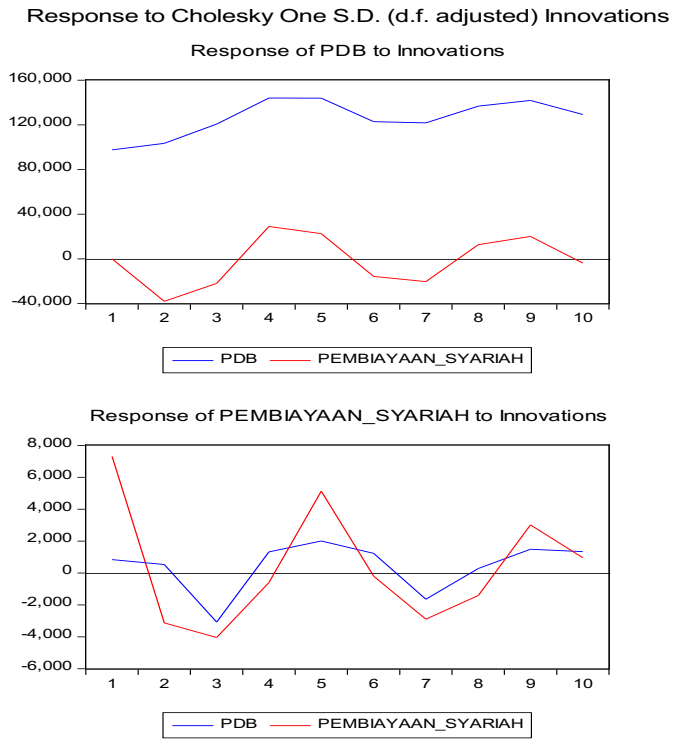
Variable	Coefficient	T-Statistic	Conclusion
ISLAMIC_FINANCING(-1)	-285.0394	[-8.16511]	Significant

Source: Eviews 10, data processed (2024)

The long-run Vector Error Correction Model (VECM) estimation results reveal a statistically significant negative relationship between the lagged value of Islamic Financing (ISLAMIC_FINANCING (-1)) and GDP at the 1% significance level. The coefficient of -285.0394 with a T-statistic of -8.16511 indicates that, in the long run, an increase in Islamic Financing is associated with a decrease in GDP. This finding suggests that the growth of Islamic Financing may not inherently lead to positive long-term economic expansion.

7. Impulse Response Function

By analyzing the Impulse Response Function (IRF), we can observe how endogenous variables behave when other variables experience sudden disturbances over a particular time frame. This analysis helps reveal the dynamic behaviour and interactions within the system. The IRF results illustrate how variables respond to disturbances, providing insight into causal linkages and the nature of their interdependence within the model.



Source: Eviews 10, data processed (2024)

Figure 2. Impulse Response Function Graph

The IRF graph shows that GDP's response to a positive innovation in Islamic Financing is positive and stable, with a significant

increase from period 1 through period 4 before reaching equilibrium in period 5. This indicates that Islamic Financing can provide a substantial initial boost to GDP growth. Conversely, GDP's response to shocks in Islamic Financing tends to be smaller and more volatile, indicating a limited short-run impact. In contrast, the reaction of Islamic Financing to GDP shocks exhibits a fluctuating pattern with an initially strong reaction that then declines and stabilizes near zero in subsequent periods. This reflects an inconsistent dynamic relationship between the two variables, where the short-run impact of Islamic Financing on GDP is more prominent than its long-run effect.

8. Variance Decomposition

Variance Decomposition (VD) illustrates the relative contribution of various variables to GDP variability over specific periods. The data below reveal how the roles of each variable evolve.

Table 8
Variance Decomposition Results

Variance Decomposition of PDB			
Period	**S.E.**	**GDP**	**Islamic_Financing**
1	97542.49	100.0000	0.000000
2	147139.9	93.32828	6.671718
3	191534.1	94.74464	5.255355
4	241361.5	95.25135	4.748652
5	281904.5	95.87717	4.122825
6	307904.8	96.28330	3.716696
7	331732.7	96.41984	3.580157
8	359035.3	96.81851	3.181489
9	386573.7	96.98528	3.014722
10	407607.3	97.27963	2.720372

Source: Eviews 10, data processed 2024

The variance decomposition results illustrate that in the initial period, GDP's variability is solely explained by itself (100%). Subsequently, Islamic Financing begins to contribute (6.67% in period 2), alongside a still dominant self-influence of GDP (93.33%). A trend emerges where the contribution of Islamic Financing to GDP variability gradually declines over time (reaching 2.72% by period 10), while the self-influence of GDP increases (reaching 97.28% by period 10). This implies that while Islamic Financing has a notable short-term impact on GDP variability, its significance diminishes in the long run, where GDP's own dynamics become the primary driver of its fluctuations.

The Effect of Islamic Financing on GDP

The VECM estimation outcomes affirm a notable and evolving relationship between Islamic Financing and GDP across both short-term and long-term horizons. This corroborates earlier studies, such as those by Sumiyati et al. (2020) and Diniyah (2023), that underscore the importance of Islamic financing in fostering macroeconomic growth. Similarly, research by Prastowo (2018) affirms the positive influence of Islamic financing on economic development in various countries, including Indonesia, Malaysia, and Pakistan.

For shorter timeframes, most of the connections between the variables are not statistically significant. A key exception is Islamic financing with a two-period lag, which exerts a significantly adverse effect on GDP. This suggests that changes in financing two periods prior directly impact GDP fluctuations, potentially due to a financing transmission mechanism that requires time. However, the weak significance of other short-term relationships implies that the role of Islamic financing will manifest more cumulatively over the long term.

The existence of a long-run cointegration relationship between Islamic financing and GDP signifies a structural equilibrium in the long term. However, the significantly negative coefficient associated with Islamic financing in this long-run relationship suggests that its contribution to economic growth is currently not at its peak. This may be due to inefficiencies in channelling funding to productive sectors or an overreliance on the financial industry without corresponding structural transformation in the real economy. These results support the findings of Santoso and Nurzaman (2020), which state that the effectiveness of Islamic financing heavily depends on the direction of investments and their alignment with sectors that drive economic productivity. Moreover, the study by Yakubu et al. (2025), which involved 12 countries including Brunei, Indonesia, and Saudi Arabia, confirms that although the impact of Islamic financing is more substantial in the early stages, its long-term effect on economic growth becomes increasingly pronounced over time.

The Granger causality tests further support the existence of a bidirectional link between Islamic financing and economic growth. This implies that the growth of GDP propels the development of the Islamic finance industry, while simultaneously, Islamic financing plays a role in boosting economic output, reflecting an interdependent and endogenous connection.

Impulse Response Function (IRF) analysis reveals that shocks to Islamic financing initially yield a positive response in GDP; however, that

effect diminishes over the long term. According to the Variance Decomposition (VD) results, the extent to which Islamic financing explains changes in GDP appears to decrease as time progresses. This decline suggests that economic growth cannot rely solely on funding of; it requires strengthening fundamental factors such as productivity, innovation, and real-sector efficiency. In other words, Islamic financing serves as an initial trigger rather than the main driver in the long run.

From a social perspective, the declining contribution of Islamic financing suggests that public access to Islamic financial products is limited, and the level of understanding regarding Islamic finance is low. If business actors, especially MSMEs, do not experience significant benefits from Islamic financing, confidence in the system may wane. Therefore, intensive education, outreach, and training for entrepreneurs are necessary to enable them to optimally utilize financing facilities.

These findings underscore the importance of reforming the Islamic financing system from a policy perspective. Policies must promote integration between the Islamic and conventional financial systems, incentivise Islamic financial institutions to channel financing to productive sectors, and create an environment conducive to product innovation. Arafah (2022) noted that the initial positive GDP response to Islamic financing reflects the system's potential to rapidly stimulate the real sector. Yet, a long-term strategy is necessary to ensure sustainable growth.

Variance Decomposition (VD) findings also emphasize the importance of diversifying Islamic economic instruments. Khotimah and Layaman (2024) stress that the development of the Islamic economy should not rely solely on bank financing but must be expanded through strengthening the Islamic capital market, sukuk, and waqf funds. Such diversification, if executed synergistically by financial institutions and regulators, will broaden the reach and sustainability of the contribution made by Islamic financing.

Furthermore, the implementation of Islamic values in productive economic development is crucial. One strategy that can be adopted is the development of sectors based on productive waqf, productive zakat, and other Islamic social finance initiatives. This approach will ensure that each financing channel is directed toward industries with a high multiplier effect that are inclusive (Rizal, 2022). Consequently, the impact of funding Islamic on GDP is expected to become more sustainable and evenly distributed across all segments of society (Isman & Siti Chuzaemah, 2024).

Conclusion

This study highlights the critical importance of Islamic financing in supporting the growth of the national economy. The dynamic and reciprocal link between Islamic financing and GDP demonstrates that the Islamic financial system serves as a source of funds and a strategic instrument for driving economic development that is both inclusive and sustainable. These findings reinforce the position of Islamic financing within the national monetary architecture, underpinned by ethical foundations and principles of justice that align with the objectives of Islamic economics. Theoretically, these results expand the literature on Islamic finance's contribution to macroeconomic growth, and practically, they emphasize the urgent need to integrate it into long-term development planning.

However, the effectiveness of Islamic financing tends to diminish over the long term if strategies for diversification and the strengthening of the real sector do not accompany it. Therefore, policy reforms are needed to connect Islamic financing with national priority programs, such as developing MSMEs, green infrastructure, and productive waqf-based sectors. The government and relevant authorities should provide fiscal and non-fiscal incentives to encourage Islamic financial institutions to innovate and extend their financing reach to segments that have not yet been optimally served.

For regulators, several strategic steps can be taken, including expanding Islamic financing guarantee schemes for MSMEs, simplifying the regulatory approval process for new financing products, and creating a research-based innovation ecosystem to enhance the competitiveness of the Islamic financial industry. In addition, a priority should be placed on improving Islamic financial literacy through training specifically designed for the needs of business actors to encourage greater public adoption of Islamic financial products. Crucially, synergy between financial authorities, academics, industry stakeholders, and Islamic social organizations is vital for achieving the significant impact of Islamic financing on the national economy.

This study has several limitations that should be noted. First, data from 2024 could not be included in the analysis due to data limitations and incompleteness when the research was conducted. Second, the overall scope of the data used remains limited, particularly regarding the exclusion of external variables such as global economic dynamics, the level of financial inclusion, and fiscal policies, which may implicitly influence the research outcomes. Therefore, future studies are advised to employ a more comprehensive multivariate approach, including cross-country or sectoral

panel data, to enrich the analysis. Furthermore, a significant avenue for future research lies in exploring the impact of Islamic financing on the real sector, including MSMEs and the halal industry, as well as investigating the Islamic financial index as a potential mediating factor. This would significantly enhance our comprehension of the Islamic financial system's real contribution to economic development.

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