

# **CHAPTER I**

## **INTRODUCTION**

### **1.1 Background**

Capital market defined as a market for any long-term financial instruments (securities) which can be traded, in term of bonds or equities, either issued by government, public authorities or private company. Most countries around the world has capital market, it is because capital market drives the economic and financial condition in a country (Husnan, 1998). Capital market also as an indicator of economic growth. The volatility of index in a country can be read as a reflection of economic situation in that country. Beside that, capital market plays role as an investment tool that is useful for economic development. According to Widoatmodjo (2009), it is integrated with the function of capital market such as; first, capital market serves as an alternative for a company's capital resources. The capital gained from the public offering can be used for the company's business development, expansion, and reinvestment. Second, Capital Market serves as an alternative for public investment. People could invest their money according to their preferred returns and risk characteristics of each instrument such as stocks, bonds, mutual funds and securities. Capital market becomes a modern indicator of a country. It means, a country can be categorized as modern country if their capital market is developed.

The development of capital market influenced by the supply and demand of long-term funds which is transferable. Securities supply means that many companies will issued profitable securities. Securities demand means that there are investors who have a lot of funds to buy the securities. Stable economic

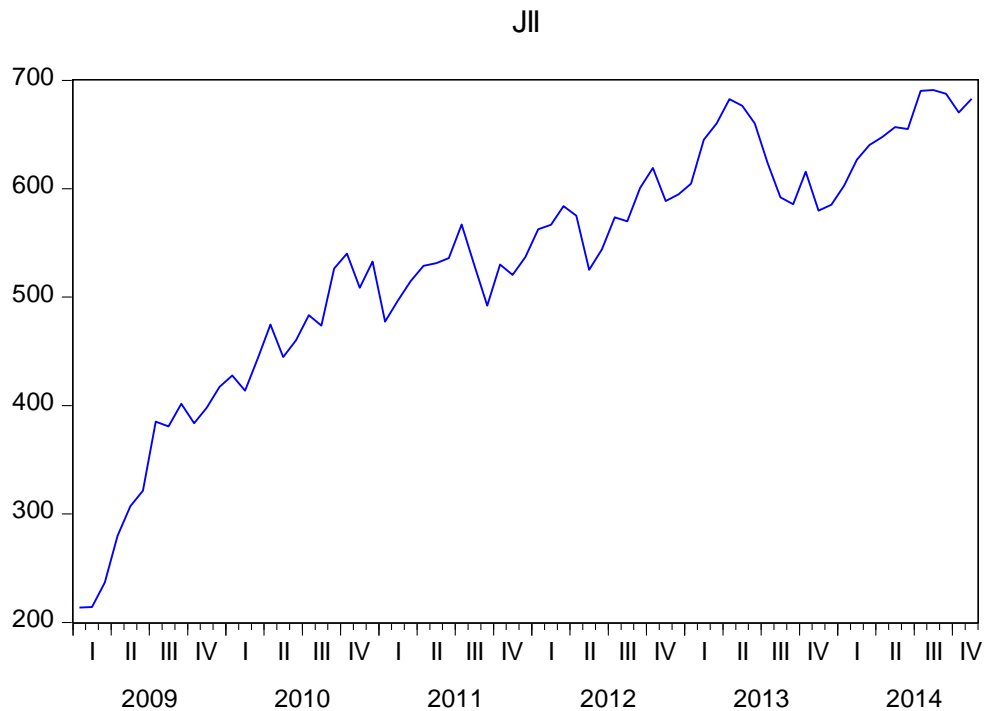
condition and political condition is one of the requirement in business development. Business development will cause demand of funds (short-term or long-term) increase. The increasing of fund will support the development of capital market. Legal security and rules problems often be a problems barrier in developing countries. The rule which protect the investor from emiten abuse must be stand. The institution which support the capital market such as stock exchange commision (BAPEPAM) which give the permission for the emiten, stock exchange, broker, underwriter, accountant and notary public must had exist and can work professionally to support the operation of capital market.

The Indonesia Exchange (IDX) market capitalization ratio to GDP becomes an indicator of Indonesia capital market growth. The Indonesia Exchange's market capitalization in 2009 is significantly increased around 87,59% from 1.076,50 in 2008 to 2.091,38 trillion. In 2010 IDX market capitalization was increased approximately 46,13% from 2.091,38 trillion in 2009 to 3.247,10 trillion in 2010. In 2011, IDX market capitalization also increased slightly to 3,20% from 3.247,10 trillion in 2010 to 3.821,99 trillion in the end of 2011. In 2012, IDX market capitalization increased to 7,98% from 3.821,99 trillion in 2011 to 4.127 trillion in 2012. Furthermore, IDX market capitalization continously increased to 3,56% from 4.127 trillion in 2012 to 4.274,17 trillion in 2013. (BAPEPAM)

The growth of middle-up income of Muslims in around the world cause the increasing of islamic financial market demand. Islamic financial market becomes an alternative for financing and *Halal* investment instrument (Setiawan, 2005). The rise of islamic financial market attracts many investors and financial

institution to develop islamic financial instrument. It is because islamic economic system offering fair and justice in the economy. Not only Muslim countries which developing the Islamic economic system, but also non Muslim countries have high interest to take the opportunity in Muslim market which is more than 28,26% from the total population around the world (Muslim Population). Islamic capital market offers investment regarding to Islamic investment principles. The difference between conventional investment and islamic investment such as, the conventional investment defines investment as the total income subtracted by total consumption and saving for maximizing returns. Then, the islamic investment explains investment as a part of wealth that consists of return and social value (Karim, 2007).

The increasing of Islamic Economic and Finance development in Indonesia, make Indonesian Stock Exchange interest to develop their product in Shariah-compliant. In 3 July 2000, PT. Bursa Efek Indonesia in cooperation with PT. Danareksa Investment Management (DIM) established stocks index based on Shariah-compliant which is Jakarta Islamic Index (JII). This index is expected to be the barometer of Shariah-compliant stocks and further develop of Islamic Capital Market in Indonesia. Jakarta Islamix Index (JII) consists of top 30 stocks in several main sectors including agriculture, mining, chemical, consumption, property, infrastructure, utility, transportation and trades which passed from output screening mechanism based on *shariah* criteria.



**Figure 1.1: The pattern movement of Jakarta Islamic Index (JII)**

Along this 6 years since 2009 until 2014, Jakarta Islamic Index has experienced excellent performance. In the first quarter of 2009, JII only reach 213 points and in the last quarter of 2009 JII reach 417 points. It show that in one year the index increasing significantly. In the last quarter of 2013, JII reach 585 points, it is decreasing from the quarter 2 in 2013 which can reach 680 points. This situation happened because of Rupiah depreciate to Dollar in the last quarter of 2013. Jakarta Islamic Index (JII) is increasing from the first quarter of 2014 and has the highest points, 690 points in the third quarter of 2014.

According to Robert ang (1997), the volatility of index influence by many factors such as the changing of interest rate, global economic situation, condition of politic in a country and domestic economic condition. Beside these factors, the investor behavior will also give impact to the movement of stock index.

The global Islamic stock market which used as a proxy is Dow Jones Islamic Market Index. In 1999, Dow Jones established the Shari'ah-compliant indexes which called Dow Jones Islamic Market Indexes. The Dow Jones Islamic Market Index (DJIM) was the first attempt by any global index provider to create a measurement tool for Shari'ah-compliant investors and to reduce the research costs of ascertaining and measuring Shari'ah-compliance by creating a global universe of Shari'ah-screen companies approved by a Shari'ah supervisory board. As the first such index and due to its unique characteristics, the DJIM has become the initial standard of Shari'ah-compliant investing in Muslim countries, offering incentive for companies to meet the standards of Dow Jones Indexes' DJIM methodology screens to be included in a high-profile Shari'ah-complaint index. So, today Dow Jones Islamic Market Indexes becomes the Global Index reference for the Islamic Capital Market around the world.

In Asia regional index, Islamic capital market in Malaysia is one of the most popular reference for Islamic capital market. On 22 January 2007, FTSE Bursa Malaysia Hijrah Shariah Index (FHSI) was launched in response to increasing interest in Shariah-compliant investment. This index was the joint initiative between FTSE, Bursa Malaysia and Yasaar Ltd, the leading global Shariah consultancy. FTSE Bursa Malaysia Hijrah Shariah consists of 30 companies which had pass the screening methodology from Malaysia Shariah Advisory Council (SAC).

In the preparation of Asean Economic Community (AEC) 2015, industry in Indonesia is growing up. The company active to do export and import. One of the most important things to make the export and import work is the currency as a

tool of transaction. The currency that commonly used in international trade is US Dollar. For the company who do export and import actively, the stability of exchange rate between US Dollar to Rupiah is an important things. Because, when the value of Rupiah depreciation to US Dollar, it will cause the increasing price of imported goods. If the raw materials use imported goods, automatically it will increase the production cost. The increasing of production cost will reduce the company profit. The decreasing of company profit will impact to the decreasing of investor buying interest to the company. In general, it will give impact to the weakness of stock market in the country.

Regarding to other investements, islamic stocks market investment also faces the possibility of generating both risks and returns. Jakarta Islamic Index will not be free from risk as well. Islam does not merely treat investment for profit maximization, but also consists of worshiping spirit. In more practice, risk relates to price fluctuation for several stocks or sectors. It happened because of investor responds' on the changing of expected rate of return (Syukma, 2011).

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

There are some researches on the influence of macroeconomic variable on stock returns in several countries with various results. According to Hussin

(2012), stock return in Kuala Lumpur Syariah Index was negatively influenced by foreign exchange rate (USD to MYR) and money supply (M3). In addition, Industrial Price Index (IPI) and Consumer Price Index (CPI) had positive influence on stock returns. Meanwhile, the Islamic Inter Bank Rate (IIR) had negative influence but no significant influence on stock return. Otherwise according to Hasanzadeh, A., & Kianvand, M. (2012), return on stock in Iran's Stock Market was negatively influenced by gold prices, exchange rate and the private sector investment in housing sector. Meanwhile, Iran's Stock Market was positively influenced by other macroeconomic variable such as growth rate of GDP and money supply. Vejzagic, M., & Zarafat, H. (2013) also described return on stock in FTSE Bursa Malaysia Hijrah Shariah Index was negatively influenced by exchange rate and interest rate. Meanwhile money supply had positive influence on it and CPI had been statistically proven insignificant. In Lahore Stock Market according to Sohail, N., & Husain, Z. (2009), return on stock was negatively influenced by costumer price index. While, industrial production index, exchange rate amd money supply was positively influenced return on stock in the long-run. According to M. Syafii Antonio, H.H (2013), Jakarta Islamic Index was negatively influenced by FED Rate. Furthermore, in short-term world oil price, exchange rate, consumer price index had effects on the movements of the Jakarta Islamic Index (JII). While in the long-term, global macroeconomic variable such as the Dow Jones Index do not significantly influence JII movements. According to Syukma (2011), Jakarta Islamic Index coal stock returns were negatively influenced by consumer price index and the exchange rate. In addition, industrial production index and composite stock price index had positive influence to JII

coal stock returns. While, money supply and interest rate of SBI did not affect JII coal stock returns.

As Dow Jones Islamic Index, FTSE Bursa Malaysia Hijrah Shariah Index and domestic macroeconomic variables such as exchange rate, consumer price index, money supply and BI rate are likely having different influence on Jakarta Islamic Index, these factors then are interesting to be analyzed. Hence, this study entitled **“The Analysis of Inter-influence among Global Islamic Index, Regional Islamic Index, Macroeconomics Variables and Indonesia Islamic Index” (Case of Jakarta Islamic Index, Period 2010 – 2014)** is going to investigate the relationship among Dow Jones Islamic Index (DJIM) as a Global Islamic Index, FTSE Bursa Malaysia Hijrah Shariah Index (FHSI) as a Regional Islamic Index, exchange rate (EXRATE), consumer price index (CPI), money supply (M2), BI rate (BIR) and Jakarta Islamic Index (JII) as an Indonesia Islamic Index. This study using monthly time series data from index closing price of JII, DJIM and FHSI. As macroeconomics variables, this study use exchange rate, consumer price index, money supply and BI rate monthly time series data which posted by Bank Indonesia and Indonesian Statistical Department every month.

To examine these relationship, this study use cointegration analysis where two or more non-stationary variables will cointegrated if the combinations are linear with the time series. A cointegration relationship can be seen as a long-run equilibrium. Then, to see the short-run relationship among these variables used Vector Error Correction Model (VECM).



## **1.2 Research Limitation**

There are a lot of factors that may influence Islamic stock market volatility in Jakarta Islamic Index. However, the relationship among Dow Jones Islamic Market Index, FTSE Bursa Malaysia Hijrah Shariah Index, exchange rate, consumer price index, money supply, BI rate and Jakarta Islamic Index Period 2010-2014 is interesting to be examined. Study limitations aim to restrict the analysis problems that may occurred. Therefore, this study is restricted to the following limitations:

1. Focus on Jakarta Islamic Index during research period.
2. The stock returns refer to the changes of stock price movement of the Jakarta
3. The study period is from January 2010 – December 2014, monthly time series data.

## **1.3 Research Question**

Based on the background that explained before, then the problem which is going to solve in this paper defined as:

1. How does the long-run relationship (cointegrated) among those variables such as, JII, DJIM, FHSI, EXRATE, CPI, M2 and BIR?
2. How does the causality and short-run relationship among those variables such as, JII, DJIM, FHSI, EXRATE, CPI, M2 and BIR?

## **1.4 Research Objectives**

Based on the research questions, thus the objectives of this paper are:

1. In order to know the long-run relationship (cointegrated) among JII, DJIM, FHSI, EXRATE, CPI, M2 and BIR.
2. In order to know the causality among those variables and the short-run relationship among JII, DJIM, FHSI, EXRATE, CPI, M2 and BIR.

### **1.5 Research Benefits**

This study contributes useful information for parties which are interested in developing of Indonesia Islamic capital market. The detailed of research objectives will explain below:

1. It can help explain the short-run and long-run relationship among Jakarta Islamic Index, Dow Jones Islamic Index, FTSE Bursa Malaysia Hijrah Shariah Index, exchange rate, consumer price index, money supply and BI rate.
2. It is expected to be an input for the investor to have deep understanding in macroeconomic factors which influence Islamic stock market volatility in Indonesia.
3. It is expected could be input analysis and comparison for the other researchers.

