

CHAPTER I

INTRODUCTION

1.1 Background

Investment can be split into investment in real sector and investment in financial sectors. Investment in real sector includes the activity of buying intangible asset such as land and building, meanwhile investment in financial sector includes the activity of buying and selling shares, bond, and other types of securities. Each of investment that expects return has difference risk. In real sectors the risk faced by the investor is the high cost of maintenance, while in financial sectors the risk faced by the investor is the instability of economic, uncertainty rules and the regulation (Mankiw, 2004). The existence of capital market in Indonesia in this case Indonesia Stock Exchange (IDX) has provided an alternative for the society to invest in financial sector. The investment activity which occurred in stock exchange, the risk can be reduced by purchasing stock in portfolio (Mankiw, 2004).

Indonesia economic crisis in 1998 gave an overview how the conventional financial sectors that based on interest system are vulnerable. While interestingly the Shariah financial sectors, shows high resistance to crisis and has been successfully passed it. This realization led the significantly increasing growth of shariah financial sectors, which is categorized into bank or non-bank financial service (Beik, 2012).

Indonesian economic stabilization continually increases the growth of investment in financial sector. In Islamic investment is considered as a *Muamalah* activity. Islam views investment as a mandatory thing to do in order to create productive assets and be advantageous to general community. It is forbidden in Islam to hoard the resource (Hanif, 2012).

يَوْمَ نَحْمَىٰ عَلَيْهَا فِي نَارِ جَهَنَّمَ فَتُكْوَىٰ بِهَا جِبَاهُهُمْ وَجُنُوبُهُمْ وَظُهُورُهُمْ هَذَا
مَا كُنْتُمْ تَكْتُمُونَ ﴿٣٥﴾

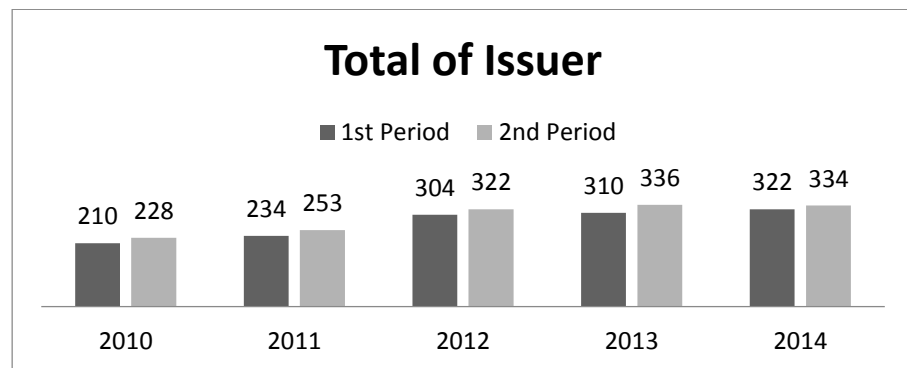
"On the Day when heat will be produced out of that (wealth) in the fire of Hell, and with it will be branded their foreheads, their flanks, and their backs - "This is the (treasure) which ye buried for yourselves: taste ye, then, the (treasures) ye buried!" (At-Taubah:35)

The command to investment is clearly stated in Islam. Because of that we need the instrument in financial sector based on shariah aspects to accommodate the high interested Indonesian Muslim in Indonesia to financial sectors. In 3rd July 2000, PT. Bursa Efek Indonesia in corporation with PT. Danareksa Investment Management (DIM) established stock index based on Shariah-compliant which is Jakarta Islamic Index. Jakarta Islamic Index (JII) consists of top thirty stocks in several main sectors (Darsono, 2015).

The total of issuers shariah stock market is more than two hundred and ten not only thirty stocks listed in JII. Therefore since November 2007, regulation of Bapepam-LK number IX.A13 has issued Sharia Securities List (DES) which contains list of Sharia Stock in Indonesia. With the DES, it is easier for public to

know what kind of shares are included in Sharia stock because as it is the only reference for Sharia securities in Indonesian (Bapepam, 2007).

The presences of Shariah Securities List (DES) followed by the launch of Indonesia Sharia Stock Index (ISSI) by IDX on May 12,2011. ISSI constituency consists of all Sharia Stock listed (IDX, 2014). The Indonesian Shariah Stock Index (ISSI) has been designed to be used as the basis of Shariah compliant investment products that meets the screening requirements of the shariah stock market (IDX, 2014).Although formed in mid-May 2011 the development of Islamic stocks in Indonesia Shariah Stock Index shows positive trends. Every year the growth of Islamic stocks shows an increase. The increasing growth of sharia stock is identified as an option to invest on Indonesia Shariah Stock Index. The table below showed the development of issuer Islamic stock in 2010 -2014.



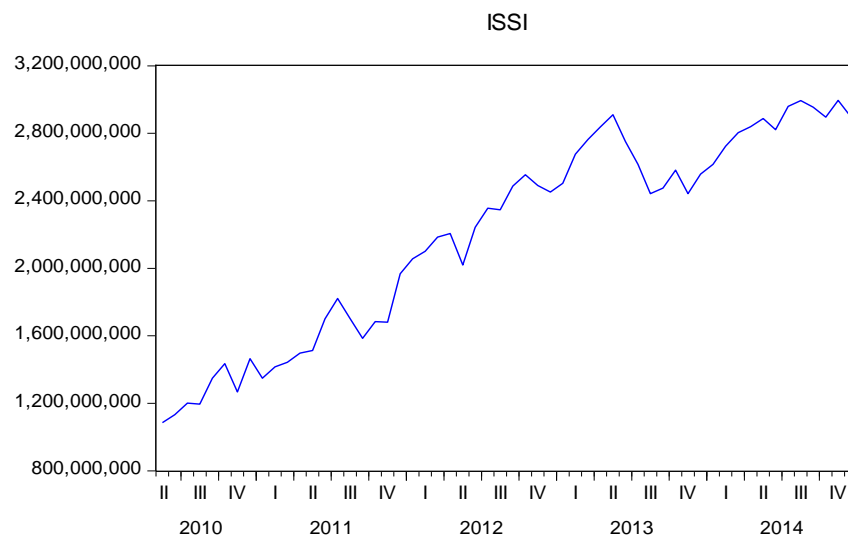
Source: Shariah Capital Market Statistics, 2014

Figure 1.1 The Development of Sharia Stock Issuer

Figure 1.1 shows the development of Islamic stock market issuers from 2010 to 2014. The Shariah capital market statistics are reviewed by OJK every semester. The total of issuer Islamic capital market in period one 2010 are 210

issuers, and the total of issuers in period two is 228. In 2011 the totals of issuer Islamic capital market in period one reached 234 companies. After the launch of ISSI by IDX on mid May 2011, the total of issuer reached 253 issuers on May 2011. It continuously increased on first period 2012 that amounted 304 issuers and 322 issuers in second period. In 2014 the total issuers in Islamic capital market reached 334 issuers. The establishment of ISSI provides significant influence on the growth of Islamic stocks in Indonesia (Shariah Capital Market Statistics, 2014).

Capitalization becomes the most important milestone in developing national economy (Panatagama, 2013). Figure 1.2 shows the movement capitalization of Shariah Securities List in 2010 – 2014.



Source: Shariah Securities List (2010 - 2014)

Figure 1.2 The pattern movement of Shariah Securities List

Figure 1.2 shows from 2010 record of capitalization value of Shariah Securities List (DES) it shows that in May-2010 the total capitalization of Shariah

Securities List (DES) is only Rp 1,084,853,495.00. In last quarter of 2010 Shariah Securities List (DES) showed a great performance by having the total capitalization Rp 1,463,811,596.00. The capitalization value of Shariah Securities List (DES) is increased become Rp 1,512,915,230.00 after Indonesia Shariah Stock Index (ISSI) official launch by IDX in May-2011 (DES, 2010).

In the business scope, macroeconomic factors influence the increase or decrease in the company's performance, directly and indirectly. The conditions of the capital markets as a leading indicator for the economy of a country are intertwined with the country's macroeconomic conditions (Yusof and Abdul Majid, 2007). Over the past few decades, the interaction of stock market and macroeconomic variables has been interesting case study, the relationship between macroeconomic variables and stock market in both developed and developing country (Gan *et al.*, 2006). Stock market is a suitable place for investor to invest their money to avoid the threat of inflation and the same time as indicator toward the development of the nation in term of economic (Khill & Lee 2000). This implies that macroeconomic forces influence investors' investment decision and motivated many researches to investigate the relationship between stock prices and macroeconomic variables (Rad, 2007). Money supply, Industrial Production Index, Consumer Price Index and exchange rate the main factors in macroeconomic.

Money supply, Industrial Production Index, Consumer Price Index, and exchange rate are the main factor in macroeconomic. Broad Money consists of foreign currency deposits. A rise in money supply increases liquidity in the economy thus making money available for consumption and investments. Industrial

Production Index (IPI) has been a very important macroeconomic indicator to monitor the progress and fluctuation of industrial sectors in the Indonesia Economy (Rosidi, 2000). In others words, Industrial Production Index is employed as the proxy to income, as major economic indicator. The index is commonly used as proxy for economic activity or national income primarily due to unavailability of real GDP or GNP measure on monthly basis (Kasri and Kassim, 2009). Inflation is also one of important macroeconomic variable with great effect both on real and financial sector. It reflects the aggregate increase in price and goods or service during a given period. The inflation rate is measured using changes in the general price level (CPI) and the producer price index or implicit gross domestic product deflator (Karim, 2008). Indonesia uses the floating exchange rate, where the value of floating exchange rate gives direct impact to the growth of economic in Indonesia. Because of the reason above Indonesia Shariah Stock Index as new index in Indonesia that has effect on macroeconomic needs to be examined to know its performance after its was launch in mid May 2011.

There are some researches on the influence of macroeconomic variable on stock returns in several countries with various results. According to Harun (2013), stock return in Jakarta Islamic Index was in the long-run positive relationship between exchange rate and industrial production, and negative on inflation rate and money supply. Meanwhile, Surur (2010) investigate the result Identified In the long run both IPI and ER are significant to JII. Industrial Production Index is positive; exchange rate is negative on JII. Otherwise, according to Hasanzadeh (2010) was stock returns in Teheran In long run stock prices show significantly positive to

money supply, significantly negative relation with nominal effective exchange rate. Acklin *et al* (2008) on Istanbul stock exchange the result identified In long run GDP, exchange rate and current account balance have significantly negative to ISE Causality test show unidirectional relationship between GDP and exchange rate to ISE. According to Vejzagic (2013) on FTSE Bursa Malaysia The result identified in the long run identifying money supply, exchange rate, and interest rate is significant positive to FTSE, meanwhile CPI is insignificant to FTSE. Otherwise, Hussin (2012) on KLSI The result identified in the long run relationship KLSI value are significant to IPI, CPI, M3, exchange rate meanwhile interest rate are not significant.

As conclusion there is necessity to examine what factors that influence investment in financial market, especially on Indonesia Shariah Stock Index. In this study use Vector Error Correction Model is used to examine the long-run and short-run effects of Indonesia Shariah Stock Index, thus understanding the nature of volatility patterns of financial asset. It also studied and what events can alter and determine the persistence of volatility overtime on Indonesia Shariah Stock Index to macroeconomic variable which is money supply, Industrial Production Index, Consumer Price Index, and exchange rate. The focus of this research is on Indonesia Shariah Stock Index variable that influences macroeconomic variable for the period of May 2011 to December 2014 (forty-four months in total). Hence, this paper entitled **“Analysis Effect of Macroeconomic Variable to Indonesia Shariah Stock Index (ISSI): An Approach Vector Error Correction Model”**

1.2 Problem Limitation

There are many factors that may influence the value of Indonesia Shariah Stock Index (ISSI). However, the influence of money supply, Consumer Price Index, Industrial Production Index, and exchange rate in period 2011 May – 2014 December to be examined. Study limitation aim to restrict the analysis problem may occur. This study restricted to the following limitation:

1. Indonesia Shariah Stock Index has just launched in 2011.
2. The study period is limited from May 2011, used monthly time series data.
3. The study case are limited of four independent variables are money supply (M2), Industrial Production Index (IPI), Consumer Price Index and exchange rate.

1.3 Research Question

Based on the explanations that have been described above the development of macroeconomic variable is one factor that can influence the development of the Islamic capital market. Therefore, the problems in this research are:

1. How does the effect of long-run and short-run relationship between money supply, Industrial Price Index, Consumer Price Index, and exchange rate influence Indonesian Shariah Stock Index?
2. How does the dynamic pattern between money supply, Industrial Price Index, Consumer Price Index, and exchange rate to Indonesian Shariah Stock Index?

3. How does the forecasting shock of macroeconomic variable money supply, Industrial Price Index, Consumer Price Index and exchange rate to Indonesian Shariah Stock Index

1.4 Research Objectives

The specific purpose of this research is to study of macroeconomic variables including money supply, Industrial Production Index, Consumer Price Index, and exchange rate on index value of Indonesia Shariah Stock Index. Based on research question, thus the objective of this paper is:

1. Analyze the long-run and short-run relationship between money supply, Industrial Price Index, Consumer Price Index and exchange rate to Indonesian Shariah Stock Index
2. Analyze the dynamic pattern of money supply, Industrial Price Index, Consumer Price Index and exchange rate to Indonesian Shariah Stock Index.
3. Analyze forecasting shock of macroeconomic variable money supply, Industrial Price Index, Consumer Price Index and exchange rate to Indonesian Shariah Stock Index.

1.5 Research Benefits

This study contributes useful information for parties are interested in developing Indonesia capital market in particular Indonesia exchange market. The focus benefits of this research are followings:

1. To Investor: It can be one of consideration, references, and judgment to choose their decision on stock investment especially Islamic capital market as investment planning in Indonesia.
2. Scholar and Academics: It is expected this study can be provide additional information for further research.

1.6 Research Plan

To understanding this research, the researcher will explain and divided this study into some of chapter in systematic and clearly, the systematic as follows:

Chapter I, Introduction in that chapter will explain the purpose and objective of this research, the background of this research and aims to explore the objects of research.

Chapter II, Literature Review this chapter include the theory related with this study, theory of Islamic capital market in Indonesia, theory of investment and soon, chapter two also include the previous research from the expert who was conduct similarly this research before with the difference object, chapter two include the hypothesis to conjecture the analysis of the study.

Chapter III, Data Research and Methodologychapter three explain in briefly the data which conduct in this research, and explain VECM methodology step to analysis in this study.

Chapter IV, Overview and Research Findings on Chapter four will explain the general description and overview the growth of ISSI and the macroeconomic variable in this chapter will explain in detail the result of analysis which conduct by VECM model.

Chapter V, Conclusion in this chapter will conclude the result of test in chapter four and recommendation for the next research and the policy in Economic Indonesia.