

Did Conventional Interest Rate Influence Islamic Total Deposits? Evidence From January 2007 Till January 2019

Abdul Razak Abdul Hadi¹, Hafezali Iqbal Hussain² & Zalina Zainudin¹

¹ University Kuala Lumpur Business School, Kuala Lumpur, Malaysia

² Taylor's University, Malaysia

Correspondence: Abdul Razak Abdul Hadi, University Kuala Lumpur Business School, Kuala Lumpur, Malaysia.

Received: April 30, 2019

Accepted: May 30, 2019

Online Published: June 10, 2019

doi:10.5430/ijfr.v10n5p11

URL: <https://doi.org/10.5430/ijfr.v10n5p11>

Abstract

This study is carried out to examine the influence of Malaysian conventional interest rate and narrow money supply (M1) upon the growth of Islamic total deposits (ITD) in Malaysia Islamic financial system. Even though it is a known fact that there is a clear separation between Islamic and conventional financial markets, the study is still pursued on the spirit of providing the latest empirical evidence. Since Malaysia is one of the biggest players in Islamic financial products, it is always the centre of attraction among the world investment community. Using 3-month Interbank rate (IBR) coupled with the deployment of Engle-Granger Cointegration Test (1987) as an estimation tool, the results from Error Correction model uncovers that ITD and IBR are not cointegrated. There is also an absence of short-run relationship between these two variables. On the contrary, this bi-variate cointegration test proves the presence of equilibrium relationship between ITD and M1 but fail to support the dynamic relation between them. From the analysis of dynamic interactions via impulse-response functions and variance decomposition, the study reveals that ITD is the most exogenous variable of all. As such, ITD is unquestionably a leading economic indicator.

Keywords: Islamic total deposits, 3-month interbank rate, Engle-Granger cointegration test, money supply and variance decomposition

1. Introduction

Malaysia is one of the major oil-producing countries in South East Asia and it is intriguing to investigate to what extent that changes in crude oil price over the past five years could affect Malaysia exchange rate. The fluctuation in crude oil prices since August 2014 has caused many oil-producing countries, particularly their governments to review their fiscal and monetary policy. The Asian Debt Crisis in 1997 was a major turning point that influenced the way Malaysian government managed its foreign currencies. At the onset of the event, the Central Bank of Malaysia did intervene in the foreign exchange market so as to stabilize RM. Nevertheless, this effort was futile as the currency speculative attack continued to be rife. The world has witnessed how Malaysia refused to subscribe the prescription given by International Monetary Fund (IMF) and decided to peg its Ringgit Malaysia (RM) to USD, coupled with massive domestic government borrowing (Bello & Aliyu 2016; Baharumshah *et al.*, 2009; Sivalingam & Kengatharan 2018). This study is pursued with the motivation to find out the causal-effect relationship between RM and movements of crude oil prices from January 1988 till October 2018. The RM/USD is the variable of interest, while crude oil price is assigned as the explanatory variable. The crude oil price has started to decline since September 2014 and it reached the bottom of USD37 per barrel in March 2016. Such a price swing detrimentally affects the oil and gas industry, particularly the revenue from export activities. This study is narrowed towards a number of pertinent issues within the international trade theory.

It has been argued that the soaring in the crude oil price has strengthened RM in tandem with the adjustment of base lending rate in the financial market. In the past, a rise in crude oil price led to increase in US Dollar exchange rate due to a change in current account deficit which depreciates the local currency (Bosupeng, 2018; Beckmann and Czudaj, 2013; Nazlioglu and Soytaş, 2011). Previous studies have recognized the significant relationship between crude oil price and major currencies such as US Dollar and Euro (Haseeb, Abidin, Hye & Hartani, 2018; B'áñassy-Qu'éré, Mignon, Penot, 2007). Johansen and Juselius (1990) acknowledge the presence of strong relationship between crude oil price and the currency rate such as USD/EURO rate. The relationship between crude oil price and currency also