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Amidst Global Uncertainty: Does Islamic Banking Increase Indonesia's Economic Growth?

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Abstract. Global economic uncertainty has caused shocks in various economic sectors in Indonesia. The establishment of Islamic banking in Indonesia is projected to address and mitigate the challenges posed by global economic uncertainty. Our study aims to to evaluate the financial performance of Islamic banking institutions by employing the RGEC methodology, encompassing variables such as risk profile, Good Corporate Governance (GCG), earning ratios, and capital ratios. The proposed hypotheses were assessed through panel data regression employing the Random Effect Model (REM) approach. The findings reveal that, partially, GCG, NOM, and CAR exhibit a significant negative influence on economic growth, while ROA demonstrates a significant positive impact on Indonesia's economic expansion. Conversely, NPF, and BOPO do not exhibit significant effects, but overall, the robust financial performance of Islamic banks is a pivotal factor in accelerating Indonesia's economic growth. This study emphasizes on Islamic banks in Indonesia, drawing data from twelve Islamic commercial banks, thus establishing a solid empirical basis for addressing global economic uncertainty and facilitating more valid generalizations pertinent to the Indonesian Islamic banking sector. It is imperative for the government and relevant entities to consistently ensure that Islamic banks effectively fulfill their intermediary role and expand their market share, thereby enhancing economic growth in Indonesia.

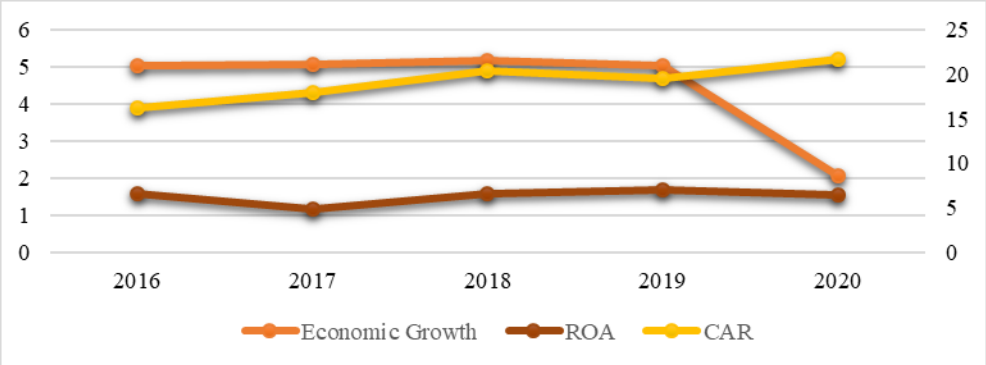
Abstrak. *Ketidakpastian ekonomi global telah menyebabkan guncangan di berbagai sektor ekonomi di Indonesia. Pendirian perbankan syariah di Indonesia diproyeksikan untuk mengatasi dan meredam tantangan yang ditimbulkan oleh ketidakpastian ekonomi global. Studi ini bertujuan untuk mengevaluasi kinerja keuangan Bank Umum Syariah dengan menggunakan metodologi RGEC, yang mencakup variabel-variabel seperti profil risiko, Tata Kelola Perusahaan yang Baik (GCG), rasio laba, dan rasio modal. Hipotesis yang diajukan dievaluasi melalui regresi data panel dengan pendekatan Model Efek Acak (REM). Temuan menunjukkan bahwa, secara parsial, GCG, NOM, dan CAR memiliki pengaruh negatif yang signifikan terhadap pertumbuhan ekonomi, sementara ROA menunjukkan dampak positif yang signifikan terhadap pertumbuhan ekonomi Indonesia. Sebaliknya, NPF dan BOPO tidak menunjukkan efek yang signifikan, namun secara keseluruhan, kinerja keuangan yang kuat dari bank syariah merupakan faktor kunci dalam*

mempercepat pertumbuhan ekonomi Indonesia. Studi ini berfokus pada Bank Umum Syariah di Indonesia, dengan data yang diambil dari 12 Bank Umum Syariah, sehingga membentuk dasar empiris yang kokoh untuk mengatasi ketidakpastian ekonomi global dan memfasilitasi generalisasi yang lebih valid terkait sektor perbankan Islam di Indonesia. Pemerintah dan entitas terkait perlu secara konsisten memastikan bahwa bank syariah dapat memenuhi peran perantara mereka dengan efektif dan memperluas pangsa pasar mereka, sehingga meningkatkan pertumbuhan ekonomi di Indonesia.

INTRODUCTION

Islamic banking as an institution trusted by the public as an intermediary institution, is not only necessary or useful for individuals and society as a whole. Additionally, Islamic banking is pivotal in fostering long-term economic growth. The financial contributions of the Islamic banking sector have substantially driven Indonesia's economic growth. The symbiotic relationship between Islamic financing and economic development not only stimulates economic expansion but also fosters the Islamic banking industry's progressive maturation in Indonesia. This interdependence highlights that Islamic banks have a crucial role in promoting economic stability and growth, while simultaneously advancing their operational scope and influence within the broader financial sector. A more developed Islamic banking sector can significantly enhance the availability of funds for productive activities, thereby generating real capital and making a positive contribution to economic growth. By providing greater financial resources for investment in various sectors, Islamic banks can stimulate economic development, foster job creation, and support the overall economic infrastructure, leading to sustainable growth and increased economic stability.

Robust financial performance can catalyze investment, yielding benefits for shareholders and the broader economy. The banking sector's performance is critical for economic growth because it aggregates surplus funds and lends to the undersupply units. Solow (1956) posits that an increase in savings is a fundamental mechanism for fostering economic growth. As savings rise, the capital available for investment correspondingly increases, thereby accelerating economic expansion. Furthermore, Islamic banking possesses the capacity to stimulate economic growth across various sectors, including agriculture, industry, and trade, while also contributing to the initial capital formation for investment projects. Consequently, financial services within the banking sector play a pivotal role in fostering the growth and development of the national economy.

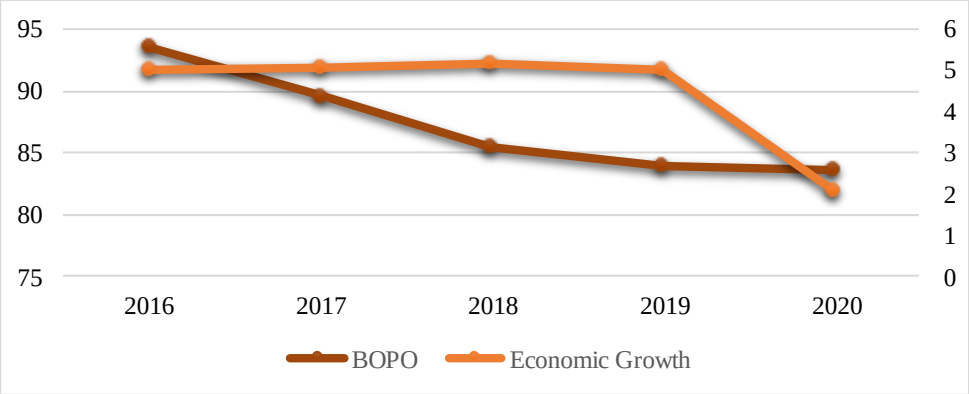


Source: Financial Services Authority, 2020.

Figure 1 Economic growth, Return on Asset (ROA), and Capital Adequacy Ratio (CAR) of Islamic banking in Indonesia (2016-2020)

However, throughout the past five years, there hasn't been a consistent link between the financial success of Islamic banking and Indonesia's economic growth. As depicted in the Figure 1, economic growth exhibited a modest upward trend even as the financial performance of Islamic banking, as measured by

Return on Assets (ROA), experienced a decline in 2017. In 2019, the ROA of Islamic banking increased but Indonesia's economic growth decreased, although not significantly. Meanwhile, the financial performance of Islamic banking through Capital Adequacy Ratio (CAR) increased in 2020 but economic growth decreased drastically that year.



Source: Financial Services Authority, 2020.

Figure 2 Economic growth and operating costs to operating income (BOPO) ratio of Islamic banking in Indonesia (2016-2020)

Meanwhile, the financial performance of Islamic banking through the Operating Costs to Operating Income (BOPO) ratio looks quite good where over the past 5 years it has continued to decline, which shows that bank efficiency is increasing but economic growth has slumped in 2020. This presents an intriguing opportunity for further study to explore the actual impact of financial performance, particularly within the Islamic banking sector, on economic growth in Indonesia during this period. This study utilizes the RGEC ratio to evaluate the performance of Islamic banking institutions. The RGEC ratio, mandated by Financial Services Authority Regulation Number 8/POJK.03/2014, represents a modern approach to performance assessment, replacing the CAMELS framework previously governed by Bank Indonesia Regulation Number 9/1/PBI/2007. Combining accounting for bank risk, capital, and profit with an essential element of bank governance or management—which is measured by sound corporate governance—is what the RGEC approach brings to the financial performance analysis of banks. Financing risk, also known as non-performing finance, is the risk that has the most impact on banks and is represented in the study's assessment of the risk profile.

The GCG composite value ratio serves as a quantitative metric for evaluating the implementation and effectiveness of Good Corporate Governance (GCG). Analyzing earnings entails carefully examining important financial measures, including return on equity (ROE), return on assets (ROA), and net operating margin (NOM). The Capital Adequacy Ratio (CAR) serves as the primary metric for assessing capital adequacy and stands as a critical indicator of the financial stability and soundness within the banking industry. These measurement parameters are derived from a number of earlier studies, including those by Ihsan and Kartika (2015), Jatmiko and Sholahuddin (2019) and Sholiha et al. (2020).

Considering the previous discussion, it is important to investigate how Islamic banking activities affect Indonesia's economic growth. While numerous studies have explored the relationship between Islamic banking and economic growth in various countries, there is a notable scarcity of research focused specifically on the Indonesian context. This study seeks to elucidate the nexus between Indonesia's economic growth and the financial performance of Islamic banks, as assessed through the comprehensive RGEC framework, encompassing Risk Profile, Good Corporate Governance, Earnings, and Capital on economic growth in Indonesia. Key variables under investigation include Non-Performing Financing (NPF),

Good Corporate Governance (GCG), Return on Assets (ROA), Net Operating Margin (NOM), Operating Costs to Operating Income (BOPO), and Capital Adequacy Ratio (CAR).

Prior academic research has been conducted on the link between banking sector performance and economic growth, each employing diverse methodologies and focusing on different contexts. For instance, Alam et al. (2021) investigated this relationship within India's conventional banking sector using panel data from 20 public banks spanning 2009-2019. Their study, which utilized the Pedroni and Kao cointegration tests, identified significant contributions from interest margin and return on assets to economic growth. In a related vein, Ledhem and Mekidiche (2020), examined Islamic banks across five countries, applying the CAMELS framework and GMM dynamic panel system. They concluded that only profitability, as indicated by return on equity (ROE), had a notable impact on economic growth. SenGupta (2020) study about the impact of non-performing loans on investment and economic growth and the role of political governance highlights that non-performing loans (NPLs) negatively impact investment and governance positively affects economic growth, it does not address how Islamic banking's unique characteristics might influence these dynamics.

The research conducted by Topaloğlu and Ege (2020), explored the financial performance and economic growth nexus within the European Union's banking sector from 1996 to 2017. Their analysis revealed a positive and significant correlation, with key contributions from ROA, ROE, and stock market capitalization. Conversely, Zahro and Dewi (2019) focused on both conventional and Islamic banks in Indonesia, finding that while ROA had a positive effect on economic growth in conventional banks, other financial performance metrics did not exhibit a significant impact. This discrepancy underscores the varying roles of different banking systems in fostering economic growth.

Further research on Islamic banking, including studies by Tabash (2019) and El Ayyubi et al. (2017) highlights the distinctive contributions of Islamic banks to economic growth. Tabash's study in the UAE demonstrated a positive relationship between indicators like ROA and ROE and economic growth. Meanwhile, El Ayyubi et al. (2017) found a significant bidirectional causality between Islamic financing and GDP in Indonesia, employing the Vector Error Correcting Model (VECM) method. These findings suggest that Islamic banks, through ethical practices and profit-sharing mechanisms, play a pivotal role in promoting economic stability and growth.

While prior research has explored various dimensions of financial performance in both conventional and Islamic banks, this study aims to deliver a detailed analysis utilizing multiple regression techniques to elucidate the distinctive contributions of Islamic banking. This study aspires to bridge the identified gap in the scholarly literature by using the RGEC approach to integrates four critical dimensions—risk management, governance, earnings performance, and capital adequacy—providing a holistic evaluation of banking performance. This method allows for a more nuanced understanding of how Islamic banks' unique risk profiles, governance practices, earnings quality, and capital structures contribute to economic stability and growth, particularly in the context of Indonesia's economic landscape.

The study also aims to give academic information, especially for scholars who are interested in the financial health dynamics of Islamic banking and how such dynamics affect the economy as a whole. Furthermore, the goal of this study is to provide stakeholders involved in formulating policies meant to promote Indonesia's economic growth with useful consequences and policy considerations.

There are five primary sections of this paper. The introduction offers a succinct synopsis of the issue statement, history, context, reasoning, and pertinent previous research in the area of Islamic finance. In the second section, empirical research and relevant literature are reviewed, leading to the formulation of hypotheses. The third section provides the methods used in this investigation. The data analysis and study

findings are presented in section four. Section five concludes the study, outlines the limits and possible directions for further research, and addresses the consequences of the results.

LITERATURE REVIEW

Economic Growth

Islamic banks are financial institutions primarily tasked with providing credit and other financial services within payment transactions. They are defined as institutions that conduct their operations, including monetary circulation, based on Sharia principles (Sudarsono, 2003). According to Law Number 21 of 2008 concerning Islamic Banking, Article 1, Paragraph 7, a sharia bank is defined as "a bank that conducts its business activities based on sharia principles." In this context, sharia principles refer to the tenets of Islamic law as delineated in the fatwas of the Indonesian Ulama Council (MUI). These principles encompass justice and balance (*'adl wa tawazun*), prosperity (*maslahah*), universality (*alamiyah*), and the prohibition of *gharar* (excessive uncertainty), *maysir* (gambling), riba, and oppression (*dholim*).

Economic growth denotes a sustained, long-term process characterized by a progressive increase in per capita output. It encapsulates the dynamic evolution of an economy over time, highlighting quantitative advancements from one period to the next. Defined as the augmentation of Gross Domestic Product (GDP), economic growth remains indifferent to fluctuations in population growth rates or alterations in economic structures and institutional frameworks. This overarching concept underscores the intricate interplay of factors shaping economic development and transformation within a nation's socio-economic landscape (Arsyad, 2015).

According to Mankiw (2003), GDP serves as a crucial metric that aggregates economic activity into a single monetary unit over a specified period. It denotes the aggregate market value of all final goods and services produced within an economy, encompassing both consumption expenditure and total income generated from production activities. GDP thus provides a comprehensive snapshot of economic performance, capturing the intricate dynamics of production, consumption, and income generation within an economy.

GDP growth is the basic measurement of economic growth. This occurs because GDP measures the total quantity of goods and services produced within a given period, valuing them based on prices from a base year and deducting intermediate input costs, which are also adjusted for constant prices (World Bank, 2025). The formula for calculating a country's economic growth with GDP is as follows:

$$\text{GDP} = \frac{\text{GDPt} - \text{GDPt}-1}{\text{GDPt}-1} \text{ x } 100\% \quad (1)$$

Fajrin and Laily (2016) asserts that several aspects of financial performance in a company are intricately tied to the measurements specified in the income statement. Net income stands out as a pivotal metric for assessing overall performance or as a cornerstone for further evaluations. Evaluating a company's financial performance is fundamental to assessing its financial health, often achieved through analyzing various financial ratios.

In addition, Husnan and Pudjiastuti (2007) also state that Financial performance serves as a critical tool for evaluating a company's accomplishments and financial health. Financial analysts rely on specific measures, often ratios or indices, that illustrate relationships between different financial data points. Analyzing and interpreting these ratios offers a more comprehensive understanding of a company's financial performance and condition compared to merely examining standalone financial statement data.

On June 11, 2011, the Financial Services Authority introduced Regulation No. 8/POJK.03/2014, marking a pivotal shift in assessing the financial performance of Sharia Commercial Banks and Sharia Business Units through the RGEC (Risk Based Bank Rating) framework. This regulatory innovation supplanted the traditional CAMELS method, emphasizing Capital adequacy, Asset quality, Management capability, Earnings performance, Liquidity position, and Sensitivity to market risks. The RGEC framework, mandated by the regulation, focuses on four core measurement factors : (1) Risk profile assessment, (2) Evaluation of Good Corporate Governance practices, (3) Analysis of earnings metrics, and (4) Capital adequacy evaluation.

Risk Profile

As stipulated in Financial Services Authority Regulation No. 8/POJK.03/2014, the assessment of a bank's risk profile entails a comprehensive evaluation of inherent risks and the efficacy of risk management practices across diverse operational facets. This comprehensive assessment covers ten distinct categories of risk: market risk, credit risk, strategic risk, operational risk, reputational risk, liquidity risk, yield risk, investment risk, compliance risk, and legal risk. This study will specifically concentrate on credit or financing risk, which is typically quantified using the NPF ratio. The NPF ratio serves as a pivotal indicator of asset quality and the efficacy of credit risk management within Islamic banking institutions.

The NPF ratio serves as an indicator of financing risk, which emerges when customers or counterparties do not fulfill their obligations to financial institutions according to the agreed terms (Barkhowa and Utomo, 2019). According to Rivai (2013), NPF represents problematic financing that doesn't fulfil the bank's goals or targets, such as issues with the repayment of principal or profit-sharing, which may lead to future risks. A higher NPF ratio indicates a greater potential for loss and reduced profitability for the company. The formula to calculate this ratio, as stipulated by POJK Number 8/POJK.03/2014, is as follows :

$$\text{NPF} = \frac{\text{Financing problems} - \text{CKPN financing problems}}{\text{Total financing minus CKPN}} \text{ x } 100\% \qquad (2)$$

Good Corporate Governance (GCG)

GCG is determined through an analysis of the governance or management practices of Islamic banks, focusing on their adherence to GCG standards. Islamic banks are required to conduct a self-evaluation of their GCG implementation in accordance with Bank Indonesia Regulation No. 11/33/PBI/2009 on the Implementation of Good Corporate Governance for Sharia Commercial Banks and Sharia Business Units and Financial Services Authority Circular Letter No. 10/SEOJK.03/2014 on the Health Level Assessment of Sharia Commercial Banks and Sharia Business Units.

The evaluation of Islamic Commercial Banks' effective implementation of superior corporate governance involves assessing the following eleven criteria: (1) Completion and execution of the Committee's tasks; (2) Fulfillment of the Board of Directors' responsibilities; (3) Execution of the Board of Commissioners' duties; (4) Fulfillment of responsibilities by the Sharia Supervisory Board; (5) Adherence to Sharia principles in fundraising, service provision, and fund distribution; (6) Management of conflicts of interest; (7) Implementation of the compliance function; (8) Conducting internal audits; (9) Conducting external audits; (10) Adhering to the Maximum Fund Disbursement Limit; and (11) Transparency in both financial and non-financial reporting.

Earnings

The evaluation of the profitability factor (earnings) involves a comprehensive assessment of the performance, sources, and sustainability of profitability within Islamic banks. In this study, the indicators used to assess earnings performance encompass ROA, NOM, and BOPO. These metrics provide insights into how effectively Islamic banks utilize their assets and manage operational expenses to generate profits.

Return on Assets (ROA)

ROA is a fundamental financial metric used to evaluate a company's profitability relative to its total assets. It serves as a key indicator of management's efficiency in leveraging these assets to generate earnings, thereby providing valuable insights into the operational effectiveness and financial performance of the organization. A higher ROA signifies greater efficiency in asset utilization, leading to increased profitability (Daryanto, 2020). The formula for obtaining this ratio based on POJK Number 8/POJK.03/2014 is:

$$\text{ROA} = \frac{\text{Net profit before tax}}{\text{Total Assets}} \text{ x } 100\% \quad (3)$$

Net Operating Margin (NOM)

NOM is a profitability ratio that evaluates how effectively an Islamic bank generates profit from its assets. It quantifie the efficiency of the bank's productive assets by comparing its operating income to its operating expenses in relation to the average productive assets. This ratio provides insight into how well the bank manages its resources to produce profitable outcomes (Bank Indonesia, 2012). The formula for obtaining this ratio based on POJK Number 8/POJK.03/2014 is:

$$\text{NOM} = \frac{\text{Fund Disbursement Income After Profit Sharing} - \text{Operating Expenses}}{\text{Average Earning Assets}} \times 100 \quad (4)$$

Operating Expenses to Operating Income (BOPO)

The BOPO ratio serves as a crucial efficiency metric that assesses how well bank management controls operating costs in relation to operating income. A decreasing BOPO ratio indicates enhanced efficiency, suggesting that the bank has improved its ability to generate profits while effectively managing its operational expenses. This metric highlights the bank's operational effectiveness and its capacity to optimize financial performance by reducing cost burdens relative to income generation (Rivai, 2013). The formula for obtaining this ratio based on POJK Number 8/POJK.03/2014 is :

$$\text{BOPO} = \frac{\text{Operating costs}}{\text{Operating Income}} \text{ x } 100\% \quad (5)$$

Capital

Evaluating the management and sufficiency of capital in Islamic banks is part of the capital factor evaluation process. By comparing the bank's capital to its risk exposure, CAR is commonly used to assess capital adequacy. By adjusting for risk in its operations, CAR helps to mitigate the losses that the bank may experience. A higher CAR shows that the bank has strong risk management procedures and is better able to control and absorb possible losses (Daryanto, 2020). To calculate this ratio, the following formula is as follows:

$$\text{CAR} = \frac{\text{Bank Capital}}{\text{Risk Weighted Assets (RWA)}} \text{ x } 100\% \quad (6)$$

Hypotheses Development

Hypotheses are developed based on theory and prior research, serving as provisional propositions pending empirical validation through data collection and processing. The findings from hypothesis testing provide insights into whether observed data aligns with theoretical expectations or presents new perspectives. So, the hypotheses in this study are:

Non-Performing Financing (NPF) on economic growth

Several previous studies have documented a negative impact of NPF on economic growth, as evidenced in the literature (SenGupta, 2020; Morakinyo and Sibanda, 2016; Klein, 2013; Ahmad et al., 2016). The higher NPF ratio causes economic growth to worsen or decline. Then the first hypothesis in this study is:

H1 = NPF has a negative effect on Indonesia's economic growth

Good Corporate Governance (GCG) on economic growth

According to a notion put forward by earlier studies, the financial performance of banks is much improved when GCG is implemented. This hypothesis states that a bank's financial performance improves when its GCG composite value is lower, indicating greater quality GCG practice execution. Thus, the following is the study's second hypothesis:

H2 = GCG has a negative effect on Indonesia's economic growth

Return on Assets (ROA) on economic growth

Based on previous research cited in references (Alam et al., 2021; Topaloğlu and Ege, 2020; Zahro and Dewi, 2019; Rabaa and Younes, 2016), it is established that ROA has a positive impact on economic growth. So, the third hypothesis in this study is:

H3 = ROA has a positive effect on Indonesia's economic growth

Net Operating Margin (NOM) on economic growth

Based on research by Tabash (2019), he states that there is no significant effect of NOM on economic growth but still has a positive influence. Meanwhile, the study by Ledhem and Mekidiche (2020), indicates that Net Operating Margin (NOM) does not have a statistically significant impact on economic growth. The fourth hypothesis proposed in this study is:

H4 = NOM has a positive effect on Indonesia's economic growth

Operating Costs on Operating Income (BOPO) on economic growth

Previous research states that there is a positive effect of the BOPO ratio on economic growth as stated in Topaloğlu and Ege (2020), Astuti (2015), Azhari et al. (2020), Syamsudin et al. (2015). Therefore, the fifth hypothesis in this study is:

H5 = BOPO has a positive effect on Indonesia's economic growth

Capital Adequacy Ratio (CAR) on economic growth

Previous research conducted by Anita (2018) showed that CAR has a significant negative effect on economic growth. So, the sixth hypothesis in this study is:

H6 = CAR has a negative effect on Indonesia's economic growth

Financial Performance on economic growth

Based on Sholiha et al. (2020), Alam et al. (2021), Topaloğlu and Ege (2020), and Syamsudin et al. (2015), several previous studies across various countries have consistently concluded that the financial performance of banking institutions positively influences economic growth. Similarly, research specifically focused on Islamic banking has yielded comparable results, indicating that the financial success of Islamic banks also positively contributes to economic growth (SenGupta, 2020; Bank Indonesia, 2012; Klein, 2013). As a result, the study's seventh hypothesis is:

H7 = Financial performance of Islamic banking has a positive effect on Indonesia's economic growth

METHOD

This study employs a quantitative, descriptive research design focusing on Indonesian Islamic commercial banks. The population of interest includes Islamic banks in Indonesia. The sample selection criteria utilized purposive sampling to ensure banks meeting specific qualifications; (1) registered with the Financial

Services Authority (OJK) and; (2) those that have consistently published financial reports from Q1 2016 to Q4 2020.

By ensuring that the chosen banks adhere to particular regulatory and reporting standards, this method offers a targeted dataset for the analysis and findings of the study. Bank BCA Syariah, Bank BNI Syariah, Bank BRI Syariah, Bank Jabar Banten Syariah, Bank Mega Syariah, Bank Muamalat Indonesia, Bank Panin Dubai Syariah, Bank Syariah Mandiri, Bank Syariah Bukopin, Bank Tabungan Pensiunan Nasional Syariah, Bank Victoria Syariah, and Maybank Syariah Indonesia are the twelve Islamic Commercial Banks that are included as samples in the study based on the specified criteria.

Secondary data, mostly gathered through documentation studies, are used in this study. Data on financial ratios are extracted from Islamic banks' quarterly financial statements, which cover the period from Q1 2016 to Q4 2020. Furthermore, included are Good Corporate Governance (GCG) reports that were obtained from the Financial Services Authority (OJK) and the corresponding Islamic banks' official websites. The Central Statistics Agency's (BPS) official website is the source of statistics on economic growth. In addition, the study integrates information from literature reviews of books, academic journals, and prior studies that are pertinent to the topic. These many data sources together offer a thorough foundation for analysis and interpretation inside the study framework.

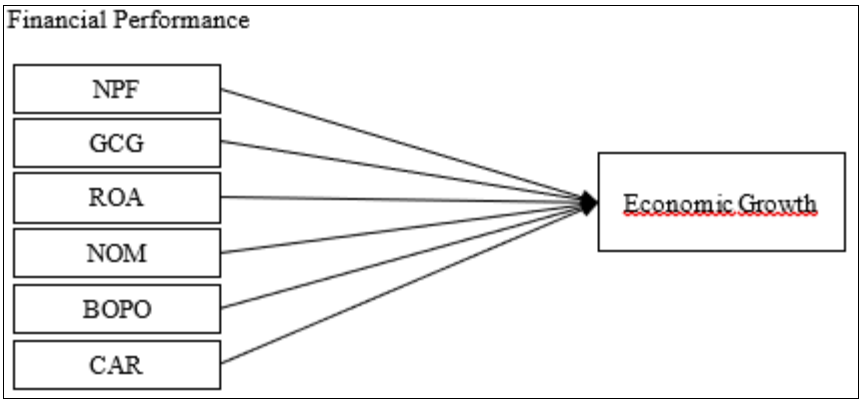
Panel data is chosen due to its ability to analyze both cross-sectional and time series data. This methodology facilitates the investigation of the temporal evolution of variables across diverse entities, including the Islamic Commercial Banks encompassed in the research. The Econometric Views program (Eviews 13) is used in this study's panel data regression analysis. Relevant variables from financial ratios, Good Corporate Governance (GCG) indicators, and perhaps statistics on economic growth are usually included in the analytical equation. Using the following analytic equation and this regression framework, the researcher may investigate the links and effects of these variables from Q1 2016 to Q4 2020:

$$Y = \alpha + \beta_1 X_{1it} + \beta_2 X_{2it} + \beta_3 X_{3it} + \beta_4 X_{4it} + \beta_5 X_{5it} + \beta_6 X_{6it} + et \quad (7)$$

Where,
Y: Dependent Variable
α: Constant
β: Regression Coefficient of Each Independent Variable
X: Independent Variable
i: Islamic Commercial Bank
t: Period
e: Error term (Residual)

In order to determine the most appropriate panel data regression model, this study employs a range of diagnostic tests, including the Chow and Lagrange multiplier tests, to ascertain the optimal model among the common effect, fixed effect, and random effect models. Subsequently, to assess both the individual and collective effects of factors on the dependent variables, T-statistical and F-statistical tests are conducted.

The model developed in this study includes six exogenous variables that affect the financial performances, which consist of NPF, GCG, ROA, NOM, BOPO, and CAR. The endogenous variable in this study is economic growth. Figure 3 below shows the study framework constructed for this study.



Source: Authors, 2024.

Figure 3 Model development in the research of Amidst Global Uncertainty: Does Islamic Banking Increase Indonesia's Economic Growth?

RESULTS AND DISCUSSION

Descriptive Analysis

The Table 1 outlines the structure and scope of the panel data study comprising Islamic commercial banks over a five-year research period, spanning from the first quarter of 2016 to the fourth quarter of 2020. The study includes data from 12 Islamic commercial banks samples: Bank BCA Syariah, Bank BNI Syariah, Bank BRI Syariah, Bank Jabar Banten Syariah, Bank Mega Syariah, Bank Muamalat Indonesia, Bank Panin Dubai Syariah, Bank Syariah Mandiri, Bank Syariah Bukopin, Bank Tabungan Pensiunan Nasional Syariah, Bank Victoria Syariah, and Maybank Syariah Indonesia. The total number of observations in the dataset utilized in this study is 240, reflecting the comprehensive nature of the empirical analysis conducted.

Table 1 Descriptive statistics in the research of Amidst Global Uncertainty: Does Islamic Banking Increase Indonesia's Economic Growth?

	NPF	GCG	ROA	NOM	BOPO	CAR	GDP
Mean	2.342042	0.480667	1.650250	-0.262542	94.48263	31.83504	3.940500
Median	2.390000	0.500000	0.780000	0.430000	93.80000	19.56000	5.035000
Maximum	13.54000	0.898438	17.23000	14.97000	217.4000	346.4300	5.170000
Minimum	0.000000	0.198047	-1.102.000	-5.306.000	40.36000	2.220000	-2.070.000
Std.Dev.	1.746036	0.150938	4.121917	7.697596	21.38298	46.61466	2.437003
Skewness	1.026830	0.409917	1.056920	-2.733.092	2.703147	4.615409	-1.872.518
Kurtosis	8.328010	2.528515	6.431002	16.21275	14.70078	25.35458	4.684677
Jarque-Bera	326.0521	8.944252	162.4009	2044.560	1661.361	5849.354	168.6344
Prob.	0.000000	0.013750	0.000000	0.000000	0.000000	0.000000	0.000000
Sum	562.0900	115.3600	396.0600	-6.301.000	22675.83	7640.410	945.7200
Obs.	240	240	240	240	240	240	240

Source: Research finding by authors, 2024 (processed data).

Regression Model Selection

At this stage of the study, a series of rigorous tests were conducted to identify the optimal model for analysis. These tests aimed to ascertain the most appropriate framework amidst various alternatives. The outcomes of these evaluations are detailed as follows:

Chow test

Table 2 Chow test results in the research of Amidst Global Uncertainty: Does Islamic Banking Increase Indonesia's Economic Growth?

Redundant Fixed Effect Tests			
Equation: FEM			
Test cross-section fixed effects			
Effects Test	Statistic	d.f.	Prob.
Cross-section F	1.266831	(11,222)	0.2450
Cross-section Chi-square	14.611090	11	0.2010

Source: Research finding by authors, 2024 (processed data).

The Chow test is a crucial statistical tool used in econometric analysis to ascertain the most suitable model, namely the common effect model or the fixed effect model. Based on the findings presented in Table 2, where the Chi-square probability value exceeds the critical significance level of 0.05, rejecting the null hypothesis (H_0) in favor of the alternative hypothesis (Ha). Consequently, the common effect model is deemed statistically more appropriate for this study compared to the fixed effect model. With the optimal model identified, the analysis progresses to conduct the Lagrange multiplier test.

Lagrange multiplier test

Table 3 Lagrange multiplier results in the research of Amidst Global Uncertainty: Does Islamic Banking Increase Indonesia's Economic Growth?

	Test Hypothesis		
	Cross-section	Time	Both
Breusch-Pagan	2.985882 (0.0840)	1155.276 (0.0000)	1158.262 (0.0000)

Source: Research finding by authors, 2024 (processed data).

The Lagrange multiplier (LM) test is a critical statistical tool used in panel data analysis to choose between the common effect model and the random effects model. The results from Table 3 show that the Lagrange multiplier test, with a Breusch-Pagan probability value of 0.0000, is significantly lower than the conventional significance level of 0.05. Consequently, the null hypothesis (H_0) is rejected and the alternative hypothesis (Ha) is accepted. Since the Lagrange multiplier test yielded a Breusch-Pagan probability value of 0.0000, which is lower than the conventional significance level of 0.05, and in conjunction with the findings from the Chow test, it can be deduced that the random effects model is the most suitable panel data regression model for this study. This decision ensures that the modelling approach is aligned with the characteristics of the data and adheres to the statistical assumptions necessary for robust inference and interpretation of results in panel data analysis.

Panel Data Regression

Table 4 Panel data regression results (random effect model) in the research of Amidst Global Uncertainty: Does Islamic Banking Increase Indonesia's Economic Growth?

Dependent Variable	: GDP			
Method	: Random Effect Model			
Total Panel Observations	: 240			
Variable	Coefficient	Std. Error	T-Statistic	Prob.
C	3.476704	1.224760	2.838681	0.0049
NPF	0.120409	0.108991	1.104761	0.2704
GCG	-2.861136	1.112639	-2.571485	0.0107
ROA	0.164476	0.075206	2.187004	0.0297

Table 4 Panel data regression results (random effect model) in the research of Amidst Global Uncertainty: Does Islamic Banking Increase Indonesia's Economic Growth? (continued)

Variable	Coefficient	Std. Error	T-Statistic	Prob.
NOM	-0.057530	0.027081	-2.124367	0.0347
BOPO	0.017698	0.012864	1.375769	0.1702
CAR	-0.012617	0.004895	-2.577673	0.0106
R-squared				0.062120
F-statistic				2.572110
Prob (F-statistic)				0.019717

Source: Research finding by authors, 2024 (processed data).

Following the testing of the selection of the optimal and appropriate model, the correct model result was identified as the random effect model. The estimation results obtained with the random effect model as presented in the above table, can be interpreted using the following equation.

$$GDP = \alpha + \beta_1 NPF_{it} + \beta_2 GCG_{it} + \beta_3 ROA_{it} + \beta_4 NOM_{it} + \beta_5 BOPO_{it} + \beta_6 CAR_{it} + et \quad (8)$$

$$GDP = 3.476704 + 0.120409\ (NPF)_{it} + -2.861136\ (GCG)_{it} + 0.164476\ (ROA)_{it} + -0.057530\ (NOM)_{it} + 0.017698\ (BOPO)_{it} + -0.012617\ (CAR)_{it} + et \quad (9)$$

Hypotheses Testing

T statistical test (T-test)

Using the assumption that all other variables stay constant, the t-test is used to evaluate the statistical significance of each independent variable's effect on each dependent variable. The following is how the t-statistical test results are displayed:

Table 5 T-test results in the research of Amidst Global Uncertainty: Does Islamic Banking Increase Indonesia's Economic Growth?

Variable	Coefficient	T-Statistic	Prob.	Results
NPF	0.120409	1.104761	0.2704	Ha_1: Rejected
GCG	-2.861136	-2.571485	0.0107	Ha_2: Accepted
ROA	0.164476	2.187004	0.0297	Ha_3: Accepted
NOM	-0.057530	-2.124367	0.0347	Ha_4: Rejected
BOPO	0.017698	1.375769	0.1702	Ha_5: Rejected
CAR	-0.012617	-2.577673	0.0106	Ha_6: Accepted

Source: Research finding by authors, 2024 (processed data).

As derived from the analysis, the results of hypothesis testing indicate the following insights: The coefficient associated with the NPF variable is estimated at 0.120409, accompanied by a probability of 0.2704. This indicates that the NPF variable does not demonstrate a statistically significant impact on Indonesia's economic growth, as its probability value exceeds the conventional significance level of 5%. Conversely, the GCG variable shows a negative coefficient of -2.861136 with a probability of 0.0107, indicating a significant adverse impact on Indonesia's economic growth. The probability value is below the 5% significance threshold, suggesting a robust statistical relationship.

On the other hand, the ROA variable exhibits a positive coefficient of 0.164476 with a probability of 0.0297, approaching the 5% significance level. This indicates a meaningful positive correlation with economic growth. Conversely, the NOM variable demonstrates a negative coefficient of -0.057530, accompanied by a probability of 0.0347, indicating an insignificant impact on Indonesia's economic growth, as its probability value exceeds the 5% significance level. Similarly, the BOPO variable demonstrates a positive coefficient of 0.017698, with a probability of 0.1702, indicating that there is no statistically significant effect on economic

growth. This is due to the probability value surpassing the 5% significance threshold. Finally, the variable exhibits a negative coefficient of -0.012617, with a probability of 0.0106, falling below the 5% significance level. This indicates a significant negative influence on Indonesia's economic growth.

F statistical test (F-test)

Table 6 F-test results in the research of Amidst Global Uncertainty: Does Islamic Banking Increase Indonesia's Economic Growth?

		Results
R-squared	0.062120	
F-statistic	2.572110	
Prob (F-statistic)	0.019717	Ha_7: Accepted

Source: Research finding by authors, 2024 (processed data).

The F-test was employed to ascertain the collective impact of all independent variables on the dependent variable. The regression analysis investigating the influence of Islamic banking performance utilizing the RGEC method on Indonesia's economic growth from 2016 to 2020, employing the random effect model, yielded a computed F statistic of 2.572110, with a p-value of 0.019717. It can therefore be concluded that the combined impact of Islamic banking performance using the RGEC method significantly affects Indonesia's economic growth during the specified period.

Coefficient of determination analysis

A statistical metric that quantifies the degree to which independent factors contribute to the variability observed in the dependent variable is the coefficient of determination or R^2. An R-squared value of 0.062120 was derived from the regression study that looked at how Islamic banking performance affected economic development. This suggests that, when utilizing the RGEC technique, the performance of Islamic banking may account for around 6.21% of the variation in Indonesia's economic development, the dependent variable under investigation. Other factors that were not taken into account in this specific investigation are responsible for the remaining variability.

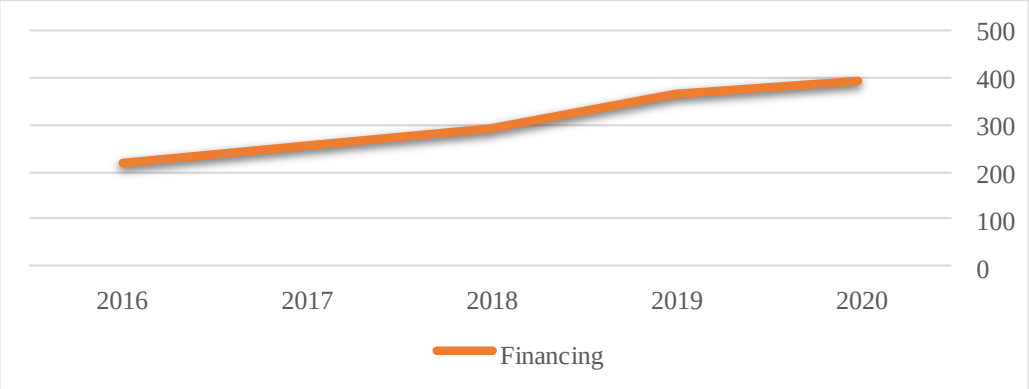
Non-Performing Financing (NPF) on Economic Growth

The findings reveal that the NPF variable has a probability value of 0.2704, which exceeds the standard 5% significance level. Therefore, H1 is rejected, indicating that the NPF variable does not have a statistically significant impact on Indonesia's economic growth.

According to Bank Indonesia's SE No. 9/24/DPbS, an NPF rate below 2% signifies a strong financial position. Furthermore, under SEOJK No. 10/SEOJK.03/2014, lower NPF values indicate effective risk management practices in banking, thereby reducing financing risks. Notwithstanding this, Islamic commercial banks have sustained an NPF ranking of 2 over the past five years, with an average NPF of 4.63%. This indicates that while the risk profile management assessment indicates adequacy and health, it has not significantly influenced economic growth. This observation is critical for policymakers and financial institutions as it highlights that simply maintaining low NPF levels is not a panacea for stimulating economic growth.

The data from the Financial Services Authority (OJK) indicates a consistent upward trend in Islamic banking financing over the past five years, with a total of 394.6 trillion rupiah in 2020. Nevertheless, despite the instrumental role of financing in boosting investment and production by directing funds to deficit units, the impact of this on economic growth remains inconclusive. Consequently, the non-performing financing (NPF) ratio exerts no significant influence on economic growth, regardless of whether the NPF ratio is deemed healthy or not. This is corroborated by previous research, including Zeqiraj et al. (2020) and Ledhem and Mekidiche (2020), which similarly found that Islamic banking financing does not significantly

affect economic growth. This consistency across found that the relationship between financial risk metrics and economic performance is complex and may be influenced by multiple intervening variables.



Source: Financial Services Authority, 2020.

Figure 4 Islamic banking financing in Indonesia (2016-2020)

Good Corporate Governance (GCG) on Economic Growth

Based on the study's findings, the Good Corporate Governance (GCG) variable shows a probability value of 0.0107, falling below the conventional 5% significance threshold. Coupled with a negative coefficient of -2.861136, this suggests that the second hypothesis is accepted, indicating a detrimental impact of the Good Corporate Governance (GCG) variable on Indonesia's economic growth.

Previous scholarly investigations have not explored the impact of GCG on national economic growth. This study demonstrates a significant negative relationship between GCG and economic growth in Indonesia. The mean GCG score for Islamic commercial banks in Indonesia is 0.48%, which places them in Rating 1 (GCG < 1.5%) according to Bank Indonesia SE No. 12/13/DPbS, indicating a high level of governance quality. A lower GCG composite score indicates a higher quality implementation of governance practices in banking. While this high ranking reflects strong governance, it is possible that these practices are more oriented toward compliance and less towards fostering innovation or risk-taking, which can be crucial for economic growth.

While GCG may not directly impact economic growth, its effective implementation within the banking sector can enhance financial performance. This aligns with the research findings of Pratiwi (2016), which illustrates that robust GCG practices, particularly in Islamic banking, significantly enhance financial performance. The improved financial performance of the banking sector, in turn, has the potential to positively contribute to overall economic growth.

Return on Asset (ROA) on Economic Growth

The findings indicated that the ROA variable exhibited a probability value of 0.0297, which is below the 5% significance level, and a positive coefficient of 0.164476. This suggests that H3 is accepted, thereby indicating that the variable ROA exerts a positive influence on Indonesia's economic growth.

Banks act as intermediaries that channel funds from savers to borrowers. A very healthy ROA, as defined by Bank Indonesia SE No. 9/24/DPbS, is above 1.5%. The average ROA of Indonesian Islamic Commercial Banks is 1.78%, indicating that Islamic Commercial Banks manage their assets efficiently and generate adequate income, thereby influencing economic growth in Indonesia. A higher ROA indicates better asset management and profitability, suggesting that Islamic Commercial Banks in Indonesia are effectively performing their intermediation role. Increased revenue enables Islamic banking to enhance its efficiency

in collecting funds from surplus parties, thereby stimulating economic growth through capital investment and portfolio investment. The findings of this study align with those of previous research conducted by various scholars, including Alam et al. (2021), Topaloğlu and Ege (2020), Zahro and Dewi (2019), Rabaa and Younes (2016) which demonstrated that ROA has a positive impact on economic growth. This consistency across studies underscores the robustness of the relationship and suggests that effective asset management in banks is a key driver of economic development.

Net Operating Margin (NOM) on Economic Growth

The findings of this study reveal a significant relationship between the NOM and Indonesia's economic growth. Specifically, the NOM variable exhibits a probability value of 0.0347, which is below the conventional 5% significance level, and a coefficient of -0.057530. This indicates a negative impact of NOM on economic growth, leading to the rejection of H4.

According to Bank Indonesia SE No. 9/24/DPbS, a very healthy NOM value is considered to be above 3%, with a tolerable range for reasonably healthy levels falling between 1.5% and 2%. However, the average net operating margin ratio for Islamic commercial banks in Indonesia is 0.27%, which places it in the fifth rank and indicates a very unhealthy status. The health of banks might not be directly aligned with broader economic indicators. The low NOM could be a sign of high operational costs or inefficiencies specific to the Islamic banking sector, which might necessitate targeted interventions rather than reflecting a general economic trend. This indicates that a low NOM is associated with increased economic growth. For instance, a decline in NOM could prompt government responses, leading to the implementation of broader economic policies that are supportive of economic growth. The findings of this study diverge from the conclusion of those prior studies conducted by Ledhem and Mekidiche (2020) and Tabash (2019), which concluded that the NOM variable does not significantly affect economic growth.

Operating Costs on Operating Income (BOPO) on Economic Growth

The analysis revealed that the probability value of the BOPO variable exceeded the 5% significance level, with a value of 0.1702. Consequently, H5 is rejected, indicating that the BOPO ratio does not impact Indonesia's economic growth. Contrary to the findings of previous research conducted by Astuti (2015), Azhari et al. (2020), Syamsudin et al. (2015), and Topaloğlu and Ege (2020), which concluded that the BOPO ratio has a positive effect on economic growth.

According to Bank Indonesia SE No. 9/24/DPbS, an optimal BOPO value is considered to be less than 83%. However, the average BOPO ratio for Islamic banking during the study period was notably higher, reaching 90%, which placed it in rank 5 with a very unfavorable status. A BOPO ratio of 90% indicates inefficiency in fund management due to high operational costs relative to operating income. This restricts the ability to allocate income effectively towards investment and productive activities, thereby limiting the potential of the banking sector to stimulate economic growth in Indonesia.

Capital Adequacy Ratio (CAR) on Economic Growth

The findings of the study indicate that the CAR variable exhibits a probability value of 0.0106, which is below the conventional 5% significance level, and a negative coefficient of -0.012617. This indicates that the null hypothesis (H6) is accepted, which suggests that the CAR has a negative impact on Indonesia's economic growth.

These findings are consistent with those of previous research conducted by Anita (2018), which similarly concluded that CAR has a significant adverse effect on economic growth. This is attributed to the selective nature of Islamic banking in extending financing to customers. Throughout the study period, the average CAR for Islamic commercial banks in Indonesia are notably high, exceeding 30%, indicating sufficient

capital resilience in meeting Bank Indonesia's mandated minimum ratio of 8%. However, as a financial intermediation, banks are expected to channel capital into productive investments that spur economic activity. Excessive high CAR values may imply the underutilization of capital in financing productive ventures, thereby potentially hindering Indonesia's economic growth. This underscored the need for a nuanced approach to capital management within Islamic banking.

Islamic Banking Financial Performance on Economic Growth

The results of the F statistical test reveal that the financial performance of Islamic banking, as assessed by the RGEC ratio, demonstrates a probability value of 0.019717, which is below the conventional 5% significance level. Moreover, the positive F statistic supports the acceptance of H7, indicating that Islamic banking's financial performance has a positive impact on Indonesia's economic growth.

These findings resonate with previous research by Ledhem and Mekidiche (2020), Rabaa and Younes (2016) and Tabash (2019), which also identified a beneficial relationship between Islamic banking's financial performance and economic growth. This consistency reinforces the idea that effective financial performance in Islamic banking can be a substantial driver of economic development. According to Zidan et al. (2020), the financial performance of the banking sector is crucial for economic growth as it facilitates the mobilization of savings from surplus units and allocates them as loans to deficit units. This process stimulates investment and production activities, which are essential drivers of economic growth. Additionally, it plays a crucial role in fostering economic expansion across various sectors such as agriculture, industry, and trade, while also contributing to the formation of initial capital for investment projects that stimulate overall economic growth in a country.

Although these results are in accordance with existing literature, it is imperative to consider several factors that may potentially influence the observed trends. The favorable impact of Islamic banking's financial performance on economic growth can be attributed to several underlying mechanisms. For example, Islamic banks may encourage more equitable financial practices and ethical investment, which could contribute to more sustainable economic development. Furthermore, the distinctive features of Islamic finance, such as profit-sharing and risk-sharing principles, could promote a more stable and resilient financial environment, thereby enhancing economic growth prospects.

CONCLUSION

This study eludicates the influence of the financial performance of Islamic banking institutions to Indonesia’s economic growth by employing the RGEC methodology, encompassing variables such as risk profile, Good Corporate Governance (GCG), earning ratios, and capital ratios. The key findings uncover that GCG, NOM, and CAR partially has a significant negative influence on economic growth based on the findings of panel data regression using a random effect model technique and the previously discussed. Notably, the study highlights that ROA has a positive effect on economic growth.

Consequently, the researchers recommend that Islamic banks develop a comprehensive strategy to enhance ROA. First, Islamic banking must improve operational efficiency through process digitization, and employee training to boost productivity is one suggested approach. Additionally, product and service diversification are crucial, involving the development of new sharia-compliant products and targeting a new market segment. Enhancing asset quality through effective risk management and stringent supervision of financing is also recommended. To increase revenue, Islamic banks should focus on optimizing financing in high-return sectors and augmenting fee-based income through additional services like fund transfers and agency services. Collaborations and partnerships with other financial institutions or fintech companies can further expand reach and efficiency. These integrated efforts will not only fortify the market

position of Islamic banking but also enhance its capacity to contribute positively to Indonesia's economic growth. More research on this topic is suggested, with the use of different financial performance indicators, longer research periods, and larger research samples. These changes should improve the accuracy of the results obtained in determining the impact of Islamic banking financial performance on Indonesia's economic growth.

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