The Causality of Islamic Money Market with Conventional Money Market

Submitted to Faculty of Economics and Social Science as partial requirement to Achieve a Degree of Economic (SE)

By

Kukuh Panji Yudhistira
Student ID: 604082000019

INTERNATIONAL PROGRAM
FACULTY OF ECONOMICS AND SOCIAL SCIENCE
SYARIF HIDAYATULLAH STATE ISLAMIC UNIVERSITY
JAKARTA
2010
DECLARATION SHEET

The undersigned here:

Name : Kukuh Panji Yudhistira
NIM : 604082000019
Faculty : Economic
Major : Management
Thesis Title : The Causality of Islamic Money Market with Conventional Money Market

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The Writer

Kukuh Panji Yudhistira
The Causality of Islamic Money Market with Conventional Money Market

Submitted to Faculty of Economics and Social Sciences as Partial Requirement for Acquiring the Bachelor degree of Economics

Submitted by:
Kukuh Panji Yudhistira
Student ID: 60408200019
Under Guidance of

Academic Advisor I
Prof. Dr. Ahmad Rodoni, MS

Academic Advisor II
Arief Mufraini.Lc., M.Si

INTERNATIONAL PROGRAM
FACULTY OF ECONOMICS AND SOCIAL SCIENCE
SYARIF HIDAYATULLAH STATE ISLAMIC UNIVERSITY
JAKARTA
2010
Curriculum Vitae

Personal details

- Name: Kukuh Panji Yudhistira
- Sex: Male
- Place, Date of Birth: Surabaya October 23, 1986
- Marital Status: Single
- Health: Perfect
- Religion: Moslem
- Address: Komp Cileduk Indah II blok C XI No. 17. Pedurenan, Kr.Tengah – Tangerang 15159
- Mobile: +62818 0744 3226
- Phone: +6221 730 9362
- Email: kupay23rxz@yahoo.com

Basic Education

- 2001 – 2004: SMAI AL-AZHAR 3 Kebayoran Baru, Jakarta, Indonesia
- 2007 – 2009: Exchange students in College of Business UUM, Malaysia

Working Experience

- October 2006 – 2007: 3D autobodyworks, Kr. Tengah - Tangerang, Indonesia
  - Worked as a manager at a car body repair
  - Managed simultaneously vehicle maintenance and repairmen within limited time and under pressure environment
  - Delivered satisfactory service both from clients and employees

Organizational experience

- 2001 – 2004: Member of OSIS in SMAI AL-AZHAR 3 jakarta
- 2007 – 2009: Member of Indonesian students in UUM - Malaysia (PPI-UUM), Member of International affair in UUM – Malaysia

Qualifications

- Computing & internet (Ms. Word, Ms. Excel, Ms. Power point, browsing jurnal & article, and etc)
- Language with Active fluent English skills
- Business & Management Skills (basic entrepreneurship, management control system, organizational behavior, measuring & control Asset, Human Resources Management, industry relations, International Business and etc)

Achievements

- Successfully held an art performance on FELICITY in SMAI AL-AZHAR 3
- Gain the TOEFL prediction test within overall score “653” in June 2007
ABSTRACT

This study aims to determine the reciprocal relationship (causal) between money market and capital market in Indonesia. In this study, which used as a research variable is the conventional interbank money market (PUAS), Islamic interbank money market (PUASSY), Bank Indonesia certificates (SBI) and Bank Indonesia Certificates (SWBIs). This study uses data from January 2008 until January 2010, so the amount available is 25. The research method used in this study is Granger Causality Test (which is reciprocal relationship). In this study, we use application of E-views version 4 and SPSS version 17.

The result showed that the significant value of 0.64983 > 0.05, so there is no significant relationship between market by 0.5255. Likewise there is no significant relationship between the Islamic interbank money market (PUASSY) with conventional interbank money market (PUAS) with significance value of 0.64983 > 0.05.

This research also shows that there is no significant relationship between Bank Indonesia Certificates (SBI) with Bank Indonesia Certificates (SWBI) due to the significant value of 0.59233 > 0.05. vice versa, the significance of 0.75559 > 0.05 indicates that there is no significant relationship between Bank Indonesia Certificates (SWBI) with Bank Indonesia Certificates (SBI).

Keywords: Capital Markets and Granger Causality Test.
Foreword

Praise is to Allah Almighty who has given us the opportunity to be able to present a thesis which will be a reference for the introduction of Islamic banking activities. And peace and hope is always devoted to supervising the Prophet Muhammad's faithful to his relatives, his friends, and his people until the end of time. An appreciation for me to publish this thesis as the embodiment of contributing and enriching the treasury for the development of sharia banks in the country in particular and the Islamic world in general.

The writer realizes that this thesis is too far from the perfection, realizing that the limitation of the knowledge as well as experiences that the writer has, but because many parties support, finally the writer could finish this thesis by hoping that it could be worthwhile for every reader. The writer also expects for any suggestion to improve the content of this thesis.

Jakarta, Oktober 2010

Kukuh Panji Yudhistira
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A. Background

In the financial system, financial markets (money market) and capital markets are part of the financial market. Money market is a market groups for short-term credit instruments, which are usually of high quality money market instruments for trading. The range time is usually due within one year or less. Money market is market who traded financial papers in a short time (Muhammad, Drs., M.Ag; 2002).

Every Monday at 1:30 P.M. EST a hand in the biggest and most lucrative (if you win) poker game in America is played. A typical hand may play for $200 billion, $300 billion, or more. The game is the Treasury Department’s weekly auction of Treasury securities to finance the federal government. (David S. Kidwell: 2005).

The existence of the money market is actually very closely related to liquidity problems. Financial markets in principle an alternative means especially for financial institutions, corporations non-financial and other participants in both the short-term funding needs and in order to fund the placement of excess likuiditasnya. Hence the presence in the money market economy system is absolutely necessary, due to the number of institutions or companies and individuals that have cash flows that do not fit between the inflows and outflows.

Thus, in order to increase efficiency in the management of bank funds if problems are associated with an Islamic banking liquidity conditions, then of course it takes an interbank
money market is based on the principles of Islamic teachings that exist. Therefore PUAS tool in the arena of Islamic banking in Indonesia is to meet the need of the money market.

The money market is a component of the financial markets for assets involved in short-term borrowing and lending with original maturities of one year or shorter time frames. Trading in the money markets involves Treasury bills, commercial paper, bankers' acceptances, certificates of deposit, federal funds, and short-lived mortgage- and asset-backed securities. It provides liquidity funding for the global financial system.

The money market consists of financial institutions and dealers in money or credit who wish to either borrow or lend. Participants borrow and lend for short periods of time, typically up to thirteen months. Money market trades in short-term financial instruments commonly called "paper." This contrasts with the capital market for longer-term funding, which is supplied by bonds and equity.

The core of the money market consists of banks borrowing and lending to each other, using commercial paper, repurchase agreements and similar instruments. These instruments are often benchmarked to (i.e. priced by reference to) the London Interbank Offered Rate (LIBOR) for the appropriate term and currency.

Finance companies, such as GMAC, typically fund themselves by issuing large amounts of asset-backed commercial paper (ABCP) which is secured by the pledge of eligible assets into an ABCP conduit. Examples of eligible assets include auto loans, credit card receivables, residential/commercial mortgage loans, mortgage-backed securities and similar financial assets. Certain large corporations with strong credit ratings, such as General Electric, issue commercial paper on their own credit. Other large corporations arrange for banks to issue commercial paper on their behalf via commercial paper lines.
In other meaning money market is the market that provides a means of allocating and short-term loans, because that money market liquidity is the primary market. While the capital markets associated with securities are long terms. The funds are traded in capital markets in the form of permanent or semi-permanent fund. Besides differences in capital market with the money market is in place the implementation of the transaction.

Capital markets own a certain place called the stock exchange transactions in financial markets effect. Transacts done through means of telecommunication, so the market is sometimes referred to as the abstract market transaction because the execution was not carried out in certain places such as on capital markets through the stock exchange. Financial markets are also a market that did not form an organized (unorganized market).

The development of SBI can be seen in the chart below:

Picture 1.1

SBI developments during 2008
Source: Data reporting BI (Processed Data)

Graph 4.1 inform the development of Bank Indonesia certificate data in 2008 than in January (1) until December (12). From the graph 4.1 above, we see that happened volatile than bank certificates of Indonesia. The average of the certificate data is 101.414. The highest value of bank certificates of Indonesia occurred in January while the month of December to the lowest point of the value of certificates of Bank Indonesia.
Can be seen in the table above that the development of certificates of Bank Indonesia has fluctuated from one month to another month.

Money market and capital market is a means of investment and the mobilization of funds for investors. Financial markets are currently looking for investments that offer the highest return expected to specific risk levels in line with the growth of world trade.

Financial markets are intended as a means of monetary control in conducting open market operations. Implementation of open market operations by the Bank Indonesia conducted using SBI (Bank Indonesia Certificates) and money market securities. SBI as an instrument in conducting open market operations are used for purposes of monetary contraction, while money market securities as instruments of monetary expansion. The parties involved in the money market transactions:

1. Financial institutions
2. Large companies
3. Government Institutions
4. Individuals
The development of SBSI can be seen in the chart below:

Picture 1.2

SBSI developments during 2008

Similarly, SBI, SBSIs also experienced fluctuating in progress during 2008. Table 1.2 shows that the highest value in the period of 2008 is happening on the 8th month.

Financial markets are mechanisms that bring together those who have surplus funds with those experiencing a deficit. Transactions in financial markets are largely short term. A financial market on the one hand serves as to meet the needs of the firm's short-term funds, financial institutions, and government, ranging from overnight to maturities of one year. At the same time financial markets also provide an investment outlet for the surplus in the short-term funds who want to earn revenue on unused funds. Therefore the existence of financial markets allow for borrowing and lending transactions.

In other side, Islamic Banking concept is relatively new for the Indonesian people, including for the Muslim community itself. Although the basic concepts of thought banking
sharia are already running long, in fact it was the practice of sharia banks new start in 1992. Based on the fact that the banking practices Sharia new in the early stages (an infant stage), it is reasonable when the system Islamic banking is still poorly understood by society, so most from their view, even some of them had participated in using bank services Sharia, with anticipation and doubt as well. Therefore before we get to the core subjects, first needs outlined briefly some aspects concerning the principles of the sharia related to banking.

Based on the above, it is important to know whether there is a reciprocal relationship (causality) between the conventional money market products with Islamic money market product. Therefore, the authors take the title of The Causality of Islamic Money Market with Market Conventional Market.
B. Problems

Based on background research, the formulation of the problem is as follows:

1. How the causality between PUAS with PUASSY?
2. How the causality between SBI with SBSI?

C. Objectives and Benefits

1. Research objectives

   In accordance with the formulation of the problem, objectives to be achieved in this study are:

   a. To analyze the pattern of causality between PUAS with PUASSY
   b. To analyze the pattern of causality SBI with SBSI

2. Research benefits

   The benefits to be gained from writing this essay are:

   a. For the money market sector (both conventional and Islamic, can serve as a note / correction to continue improving the existing weaknesses and shortcomings.

   b. For the development of Economics, especially issues of money market, this case study is expected to provide a useful contribution.

   c. For the academics / researchers, can be used as reference to make further research.
CHAPTER II
THE THEORETICAL BASIS

A. Money Market Definition

In the financial system, financial markets are part of the financial market (financial market) in addition to the capital market. Some recent literature also includes commodity markets and foreign exchange market as part of the financial markets. (Rodoni, 148).

Financial markets are markets where the group of short-term credit instruments (a meeting place between supply and demand will be short-term funds), which is generally of high quality to be traded and low risk. The term money market instruments usually maturing within one year or less.

B. The Function of Financial Market

Financial markets are essentially alternative means for agencies, non-financial companies and other participants in both the short-term funding needs and in order to make an investment of excess liquidity.

C. Money market participants

The main perpetrators of financial markets both as investors and as publisher of the instrument in order to mobilize funds include:

1. Financial institutions
2. Large companies
3. Government agencies

4. Individuals

D. The types of investment risks

1. Market Risk
2. Reinvestment risk
3. The risk of default
4. Inflation Risk
5. Currency Risk
6. Political Risk
7. Liquidity Risk

E. Money Market Instruments

Money market instruments that exist in Indonesia today are:

1. Bank Indonesia Certificates
2. Money Market Securities
3. Certificates of Deposit
4. Commercial Paper
5. Call Money
6. Repurchase Agreement
7. Banker's Acceptance
8. Promise Notes
F. Money in the view of Islam

Money is the way an economy's lubricant has always been a hot topic to discuss. Like an engine without oil, the economy also will not work without the money. However, many of us who only understand the meaning of money in the context of its form as bank notes and coins. In fact, the definition of money is anything that can be accepted as a means of payment for goods and services within a particular economic system. In fact, in ancient times people use stone, animal skins, salt, and shells as money. At the time of the Prophet (SAW), a gold coin (dinar) derived from the Roman and a silver coin (dirhams), which comes from the Persian are the two precious metals are regarded as currency. Today, paper money (fiat money) has become a commonly used means of payment in all countries in the world.

At the origin of money has three important functions, namely as a medium of exchange, store of value, and measuring the value of a commodity. However, the wide system of interest in the current financial transaction, the function of money has increased to a commodity. The function of money as a commodity is supported by several contemporary financial theory as in the Loan able Funds Theory. In this theory of interest is considered as the price of the funds available for lending (loan able funds), which became one of the variables that affect the rate of supply and demand of the loan able funds.

Based on the above theory, we can conclude that the supply loan able funds would be willing to lend money to the borrower if the borrower is only willing to return the borrowed money in amounts greater than the principal. The difference between the amount to be paid by the borrower and that the principal is called interest. By contract, the price (interest) the borrower must pay under any circumstances (the borrower's business profits or
losses) to the lender, because the lender is considered already sells a commodity called money.

Here is very clearly seen that in the current financial system, money is regarded as a tradable commodity. This is in contrast with the view that Islam does not accept the functions of money as a commodity. That’s because the money does not qualify as a commodity. According to Sheikh Muhammad Taqi Usmani, Shariah scholars of Islamic finance, there are at least three factors that differentiate the commodity currencies. First, money has no utility intrinsic. In contrast to commodities, money cannot be eaten, worn, or used directly. Money can only be exchanged for commodities, then commodities are going in to eat, wear or use. In economic terms, money only has value in exchange as commodities have value in exchange and value in use at once.

Second, money does not need the quality to determine the value, in terms of paper currency IDR 100.000 worn published in 2007 with paper money of Rp 100 000 new publications in 2009 has the same purchasing power. As with commodities, for example, the output of the Honda Jazz 2007 with output in January 2009 has a different price. This shows the difference in quality between the two cars on top of which reflected the differences between value and price.

Third, the money does not require specification of when the validity of transactions, while commodities have specific properties when the validity of the transaction. For example, if we want to buy the goods we will choose the things we want according to our tastes, like color, other complementary accessories. That is, if the seller offers the same goods but they were not in accordance with our tastes may be we will refuse. However, another case with the money that is not specific. For example, for the payment of
monthly electricity bills amounted to USD 300,000. We can pay these bills by using three pieces of money USD $ 100,000 or four sheets of currency USD 50,000 plus one sheet of USD 100,000 and even we can pay these bills with three hundred pieces of USD 1,000. For the recipient there will be no difference in the value of the three methods of payment above.

There is one additional difference between the money commodities, especially with fiat money we use today. Paper money (fiat money) to current has no intrinsic value. Banknotes became legal tender by law, issued a state that claimed legitimacy of the money. This shows that the acceptance of paper money as a means of payment only to the government because the trust factor that ensures the validity of these banknotes. That is, if the trust was lost or diminished the value of these currencies will weaken (depreciated) due to more people off, by selling money, than to have them. Because obviously, have no intrinsic value.

However, it should also be stressed here that fiat money is legitimate money on the side of the sharia. The author does not agree with the view that gold is only valid on the sharia. Indeed, the true gold is the money the best and most stable in value, and if we can re-use gold as a standard of value for money, is certainly the world's financial system would be much better. However, claims that only gold or silver are recognized Islam as the money and besides gold and silver will be invalid, this claim is excessive. The proof of the Caliph Omar never intended to make the camel as a currency, but then was advised not to do it, because eventually the camel will disappear from life.

Similarly Imam Malik once said that if people make the animal skin as a currency, he undoubtedly would ban the buying and selling animal skins but with cash and may not be delayed. Although today we are excited to return to gold as a standard currency
value, we should not be excessive and extreme by saying that fiat money is haram. Proscribe the same kosher is just bad on the side of Islam with that which is unlawful. If fiat money is haram, then surely we dowry becomes invalid, and our marriage was not valid, then our children are also to be illegitimate. Is not that logical consequence of the said fiat money is haram? And Allah knows best.

G. Theory of money demand in Islam

At the beginning of human self-sufficiency known as prabarter period. But with increasing demand and the number of humans, the exchange occurs of goods called barter. Along with the progress of the age, is something that is not practical if one has to find people who needed goods and at the same time require goods and services that are owned (or double coincidence of wants). And this will complicate muamalah among humans. Therefore we need a medium of exchange that can be accepted by all parties. Thus a medium of exchange called money. The first time, the money is known in Sumerian and Babylonian civilizations.

In the use of money, the Arabs had known solidus, gold coins in use since Roman times, and used silver dirhams Persia, before Islam came. After Islam came, and during the life of Prophet Muhammad, the use of solidus and the dirhams to be continued.

In the Qur'an explicitly mentioned gold (dinar) and silver (dirham) as a currency, as property or as a symbol of wealth owned. Besides mentioned in the verses of the Qur'an, Islamic Dinar and Dirham mentioned a lot in the Hadith of Prophet Muhammad.
1. Dinar to the Dirham, no excess in between the two (if exchanged) and Dinar and Dirham with no excess in between if exchanged.

2. In another Hadith the Prophet Muhammad used the term wariq; "silver coins whose numbers below five auqiyah no zakat on his obligations." (Narrated by Bukhari and Muslim)

In Islam anything which serves as money, it functions only as a medium of exchange. One of the most important characteristic is the money not needed for consumption, but is required to purchase other items that can fulfill human needs.

According to Imam al-Ghazali in Ihya Ulumaddin His book, money serves as a medium of exchange but money is not needed for the money itself. Money was created to facilitate the exchange and creation of a fair value of these exchanges, and money is not a commodity. Money likened to a mirror that has no color, but can reflect all the colors. Meanings of money does not have price. But it can reflect all of the price of goods. This is contrary to the principles of Classical Economics, known as direct-utility function. In an Islamic economy, if the money used to buy goods, the goods that provide uses.

There are two reasons for holding money in Islamic economics;
1. Transaction Motivation

Speculation in the meaning of Keynes's economics did not exist in Islam, so that the function of money demands for speculative purposes (as a function of the interest rate) to zero.

Demand for money in Islamic economics associated with the level of income. The amount of cash held inventories are influenced by income level and frequency of spending.
The same analysis can be used for companies that need the cash for the purchases of raw
materials and receipts from sales of products in the form of cash. Cash needs will change in
the interval timing and level of business activity.

Precaution motivation arises because individuals and companies need to consider
cash beyond what is used for transaction, in order to fulfill its obligations and the various
opportunities that are not supposed to purchase in advance, with very limited amounts.

Amount of money demanded in Islamic economics consist of only two
motivations that have been mentioned above, which is a function of income level, at a
certain level has been determined Zakat on less productive asset. Rising incomes will
increase demand for money by the community, to a certain income level affected zakat
formulated as follows;

\[ MD = f\left(\frac{Y}{\mu}\right) \]

\[ (\Delta MD/\Delta Y) \ d\mu = 0 \ > 0 \]

- \( MD = \) Money Demand in Islamic societies
- \( Y = \) Income
- \( \mu = \) Level of cost due to saving money in the form of cash

An increase in the cost of idle money which, at certain income levels will tend to
reduce the amount of the demand for money. In the following picture, if the income is \( Y_1 \)
and the level of costs is \( \mu_1 \) then the total demand for money is \( M1D \). Increase the level of
costs to \( \mu_2 \) will decrease the number of requests to \( M2D \), and so on.

Graph 2.1

Islamic Money Market
Associated with the function described the Liquidity Preference Keyness, from the results of statistical analysis, to all the Islamic countries (which the people of Islam more than 50%), it can be concluded:

1. Demand for money in an Islamic state is determined by income, in this case the motive of the transaction and on guard to dominate the Muslim population reasons.
2. Wealth is an important determinant in the demand for money in some countries
3. Money demand in the narrow sense and broad is not influenced by the level of interest so that its implications are:
   a. Preferences vary with the model of the Islamic ummah Keyness, so speculation is not a motive found in Islamic countries
   b. Elimination of the overall rate in the countries of Islam will not pose a serious problem in relation to the effectiveness of monetary policy in these countries.

H. Islamic money market demand
In view of sharia, the money is not a commodity but merely as a tool for achieving economic value added. Without the economic value added, the money cannot create prosperity. This is contrary to where the money interest-based banking develops breeding of money, no matter if used in productive activities or not. Time is the main factor. Meanwhile, in the view of sharia, the money will only grow when implanted into real economic activity (tangible economic activities). Thus the relationship between the Islamic bank and its customers is more a partner than as a lender or borrower. Islamic bank may act as buyers, sellers, or lessors (lessors). This can be done directly, which the bank has expertise to act as a trading company (trading house), or Indirect not by acting as an agent for its customers.

To generate the profit, money must be closely related to basic economic activities (Primary economic activity), either directly acting as a trading house engaged in transactions such as trade, industrial activity or lease etc., or indirectly acting as an investment company doing capital investment in order to do one or all of these business activities.

Based on the principles of Sharia Bank may withdraw funds in the form:
1. Deposits (deposits), namely the security guarantees on deposits and repayment (guaranteed deposits), but without obtaining benefits or profit;
2. Capital participation and sharing of risk sharing (non-guaranteed deposits) for general investment (general investment account / mudharabah mutlaqah) where the bank will pay a share of the profits in proportion of the portfolio is financed by such capital;
3. Special Investments (Special investment / mudharabah muqayyadah) where the bank acts as investment manager for get fee. So the banks do not participate fully invested, while investors take a risk on these investments.
Thus, the sources of Sharia Bank funds consist of:

a) capital (core capital),

b) Quasi Equity (mudaraba accounts), and

c) Advances (Wadiah / non-remunerated deposits).

From the brief description is clear that the scope of Islamic banking business is a universal banking. It covers the commercial banking and investment banking. Nevertheless, Islamic banking system is in principle very different from the conventional banking system.

These differences have consequences the need for different settings with conventional banking arrangements, among others, such as regulations on the control pattern of liquidity, capital adequacy calculation and so forth.

Bank managers are always trying to maximize their profitability (Return on Total Assets) and how to invest as much as possible of available funds. However, management has also been urged by the need to have enough liquidity to solve every problem that occurs mismatch between assets and liabilities. One of the operational difficulties faced by Islamic banks is their difficulty controlling their liquidity efficiently. It looks at some of the symptoms include:

1. Unavailability of immediate investment opportunities for savings funds it receives. These funds accumulate and are unemployed for a few days hence reducing their income on average;

2. Difficulty withdraws funds ongoing investments, withdrawal of funds at the time there in critical situations. As a result, Islamic banks hold illiquid his equipment in larger quantities than the average conventional banking. Again, this condition also causes an average reduction in revenue.
With the average performance like that, then depositors who only seek profit, more likely to transfer funds to other banks, while our loyal customers impressed that follow Islamic principles mean more expense.

In general, two kinds of Islamic Banking experience problems when compared with conventional banks, namely:

1. Lack of access to obtain liquidity from the Central Bank funds (except only in some Islamic states only); and

2. Lack of access to the Money Market (Money Market) so that Islamic banks can only maintain liquidity in the form of cash.

As mentioned above, the main task of bank management, including the Islamic Bank is to maximize the welfare of the stakeholders by increasing the value of shareholders’ investment, minimize risk and ensure the availability of adequate liquidity. Management cannot arbitrarily draw customers to save their money in the bank, without any assurance that the funds can be invested profitably and may be returned when the fund at any time is withdrawn by the customer or the fund has matured. Besides, management must also simultaneously consider the various risks that will influence the changes in the level of profits.

To ensure that the assets of Islamic Banking in addition has provided funds over time, the Bank should maintain a high level of liquidity in anticipation of a withdrawal, the withdrawal of funds, because Sharia Banks should not draw funds from the sources of interest-based funds.

Obviously, that lack of access to the Bank to borrow funds in the money market to fund their assets is a fundamental problem that they face. If there is a withdrawal of large
amounts, for whatever reason, whether the funds from wadia or mudaraba, it will happen when:

1. No Inter-Bank Money Market Sharia
2. No sharia-based facilities from the Central Bank as lender of last resort
3. Sharia banks are prohibited from borrowing funds in interest, to replace funds withdrawn by customers.

Any banker would be able to imagine how the liquidity problems faced by Islamic banks. Then, what solution is best for them?

Without the money market facilities, as well as Conventional Banks, Islamic Banks will also face the same problem, considering that the banking sector in general difficult to avoid the financial position of the mismatched. To take advantage of temporarily idle funds, banks should be able to conduct short-term investments in money market, and vice versa to meet the funding requirements for short-term liquidity, due to mismatch, the bank must also be able to get the Money Market.

Because the securities that exist in conventional financial markets, except share, based on the system of interest, Islamic banks face constraints because they are not allowed to be part of the assets and liabilities that interest-based. This problem negatively affects the liquidity management and management of long-term investment. As a result of Islamic banking had to just concentrate their portfolios in the short-term asset, related to trade, and contrary to the purposes of investment and economic development.

Although management has succeeded in creating a market for Islamic banking, but they have not reached the depth of the market that guarantee profits (profit ABILITY) and business continuity (viability) the long term. Sooner or later than they get out of this mess,
will depend on speed, aggressiveness and effectiveness they build instruments and techniques that enable the achievement of intermediary functions in both directions for Islamic Banking. They find ways and means of rendering the development of Islamic financial instruments are marketable, in which the portfolio generated by the Islamic Banking can be marketed in the broader financial markets.

I. Islamic money market product

As mentioned above, the securities outstanding in the conventional financial markets are the securities-based rates, so that Islamic banking cannot take advantage of existing money market. Even if there is also a sign of its shares as a capital investment letter-based profit-sharing, but still require investments in research, whether the object is free of activity that is not approved by Islam. In other words there must be assurance that the issuers do not hold commercial goods that are prohibited by the sharia, or contain elements of usury, and gharar maisir. Therefore, to create a Money Market for the benefit of Islamic Banking Money Market instruments must be created based on sharia. With its active money market instruments on sharia Islamic Banking can perform its function fully, not only in facilitating trade in the short term but also serves to support the long-term investment. The financial structure of development projects that will enrich the sharia-based Islamic financial tool and opened a larger participation from all market participants, including non-Muslims, because those markets are open.

The main difference between Islamic financial institutions with conventional financial institutions are prohibiting riba (interest) in Islamic financial institutions, both usury nasiah, namely usury in lending and borrowing money (qard) and riba fadl, namely riba in
trade. Revenues or profits may only be obtained by working or conducting commerce that is not prohibited by Islam. To avoid violation of the limits set by the shariah is the financial tool that is created must be backed by assets, the project assets or transactions that lie behind them (underlying transaction).

Some sharia guidelines that must be considered in the creation of instruments financial markets, among others:

✓ Money cannot generate anything. Money will only grow if invested in real economic activity (tangible economic activity);

✓ The success of economic activity measured by return on investment (ROI). Return may only be estimated but should not be determined beforehand in front;

✓ Part of shares in the company, or partnership activity musharaka mudaraba can traded investment activities and not for speculative purposes or for purposes of trade paper;

✓ Islamic financial tools, such as the stake in a partnership or company can be negotiated (bought or sold) because he represents the share in total assets, from real business.

Some Restrictions relating to the sale and purchase of such share is:

✓ Money should not be sold to obtain money

✓ Value per share in the business must be based on assessment of the business itself (fundamental analysis)

✓ Cash transactions must be completed promptly in accordance with the contract

✓ Are allowed to buy shares in companies that have debt on corporate balance sheets, but the debt must not dominant

✓ Capital owners have the right to terminate its ownership if he wants, unless agreed otherwise.
Assets can be financed from equity or loan. Karana loans cannot be traded, while equities can be traded, then why do we not build a system where the financing is done by using the equity asset?

Financial tool that can be formed through the securitization of assets / projects assets (asset securitization), which is proof of ownership, either in the form of loss sharing (shared management), which include fixed capital (fixed capital) with the right to manage, supervise and voting rights in decision making (voting, light), or in the form of investment mudaraba (Participation share), representing the capital crimes (variable capital), with the rights of capital and profits from the capital, but without voting rights.

In order to provide the means for investment funds or fund management based on the principles of sharia in Indonesia, the first strategy has been implemented by Bank Indonesia, Bank Indonesia Regulation 2/8/PBI/2000 number dated February 23, 2000 on the Interbank Money Market Sharia (PUAS). Participants consisted of PUAS Bank and Bank Conventional. Sharia banks can conduct or management of funds and investment funds, while the Conventional Banks can only do investment funds. Instrument was used in the form of PUAS Mudharabah Interbank Investment Certificate (Certificate IMA). The amount of compensation for IMA Certificate refers to the rate of investment return for issuing banks mudaraba accordance with the planting period and an agreed profit sharing ratio.

Mechanism of trading in securities based on sharia-related and must remain within tolerance limits and provisions outlined by the sharia, such as among others:

✓ Fatwa Ulama at the symposium sponsored by the Dallah al Baraka Group in November 1984 in Tunisia, stated: “It is permissible to sell the capital share of each company where the management company remained in the hands of the owner of a trade name (owner of
trade name) that has been registered legally. Buyer only has rights over the capital and on capital gains in cash without the right supervision over the management or distribution of assets except to sell the shares that represent their interests “

✓ Scholars Workshop on Syariah Fund, Opportunities and Challenges in Indonesia, which was held in Jakarta on July 30 to 31, 1997, has enabled to trade in mutual funds that contain securities of companies whose products or operations are not contrary to Islamic sharia.

Funds that have been collected by the Islamic Bank in the form of deposit investment mudarababa largely invested in murabahah, bai al salam, istisnaâ, ijara, Ijarah Muntahia bi tamlik etc. those assets are then protect by Special Purpose Companies (SPC) which is managed by the Bank as the securitization vehicles. If the bank then the bank has mismatch

Allowances to withdraw the funds through the sale of investment units issued by such SPC. Other banks including the Central Bank can also purchase these units include the placement of funds. SPC is able to announce the price of investment units each month, every week or every day

Based on the calculation of net asset value is doing, so that investments in these units have a high level of liquidity. To provide flexibility for the Bank Syariah, SPCs Tiers will have two investment units, namely:

✓ Management Shares (the smallest part) and

✓ Variable Participation Shares (the largest number of units of)

A fund will be attracted to invest in financial instruments where it is believed that the instrument can be withdrawn at any time without reducing the effective income from
investments. Therefore any financial instrument must meet several requirements, among others:

- Income from good;
- Low risk;
- Easy disbursed (redeemable);
- Simple; and
- Flexibility.

In order to meet these conditions, without ignoring the limits allowed by the sharia, it is necessary to the existence of a special purpose company (hereinafter called ‘the company) the other as an investment vehicle, with the function as follows:

- Ensuring links between securitization with productive activities or development projects of new assets, in the framework of the primary market through the creation of new investment opportunities and to test the feasibility (feasibility) of his. This phase is called the ‘transaction making’ which is supported by the Initial Investors.

- Creating a secondary market that was built through a variety of approaches that can organize and promote consensus among the dealers trade, including a repurchase (redemption).

- Provide service to customers by establishing institutions payer (paying agent). This concept can be applied more broadly with the utilization of the resources of other agencies and the customers of Islamic Banking so allow for:
  - Creation of major projects and important;
  - Small savers and investors with low income may benefit from the projects feasible (feasible) and successful where they can easily melt back with a good income;
• Expanding the base for the primary market; and

• Bridging trouble finding companies willing to participate in the capital (joint stock companies) and quote them in the market.

Meeting in the Capital Markets Conference held in Beirut, Lebanon, reaffirming the necessity to develop the following concepts further guidance. The developers and makers of policy and procedure initiatives require money market, especially in the case of buy back guarantee for investors. Therefore, a quality marketing agencies are also required. If all of these needs can be met it will be many exciting new financial instrument, associated with productive projects, which can be developed in secondary market.

1. Indonesian bank certificates of Islamic deposits / sertifikat wadia bank Indonesia

Wadiah can be interpreted as a pure deposit of one party to another party, whether individuals or legal entities, which must be preserved and restored whenever the Care willed. Can also term wadiah yad al mandate. For this type of deposit or wadiah, the depositor may not use or take advantage of deposit.

If linked to Islamic banks, for this wadiah there such a thing al-yad wadiah dhamanah ADH. That means people who commend or storage (mustawda ‘, in this case the banks) were allowed to use the assets entrusted to be used or exploited. But there are a prerequisite, namely the mustawda ‘it must get permission from the Care (muwaddi’, in this case is the bank customer).

Concrete example is in applications in banking accounts (current accounts) and time deposits (saving accounts). As a consequence of ADH yadh dhamanah, all profits
generated from the deposits of the bank belongs, and also the bank as a guarantor all possible losses.

In return, the treasure Care gets security guarantees. However, as the recipient bank deposits, as well as parties who have made use of these funds, are not forbidden to provide such incentives in the form of bonuses on deposits, with terms not previously required, and the amount is not specified in nominal or percentage in advance, but it really is a policy management bank.

Sources of Law

a. The concept of wadiah is not specifically mentioned in the Quran. However, as far as safekeeping which is closely related to trust is concerned, there are some indications on this concept, which can be observed in the following verses:

   - “Those who are faithfully true to their trusts (amanah) and to their covenants”
     23:8
   - “Verily, Allah commands that you should render back the trusts to those, to whom they are due” 4:58

b. In the Sunnah, Al-Bayhaqi narrated that ‘A’ishah said on the occasion of the Prophet’s (pbuh) migration to Medina (Hijrah), “The Messenger of Allah asked ‘Ali to take his place in Makkah in order to deliver the deposited things to their owners.”

c. Moreover, the prophet (pbuh) is reported to have said: “Return the trust to those who entrusted you, and do not betray those who betrayed you.” (Abu Dawood and Tirmizi)

d. All Muslim jurists unanimously agree on the permissibility of Wadiah
In order to improve the provisions on procedures for the implementation of the national Islamic council fatwa NO: 36 / DSN-MUI/X/2002 on Indonesian bank deposits certificate stating the following points

a. Bank Indonesia as the central bank should publish monetary instruments based on Islamic principles, called Wadiah Bank Indonesia Certificates (SBSI), which can exploit by Islamic banks to cope with the excess liquidity.

b. Akad used for the instrument is an agreement SBSI wadiah as stipulated in the Fatwa DSN No. 01/DSNMUI / IV/2000 about the current accounts and the Fatwa DSN No. 02/DSNMUI / IV/2000 about Savings.

c. In SBSI there should be no compensation required, except in the form of ‘Athaya) from a voluntary the Bank Indonesia.

d. SBSI not be resold.

2. Certificate mudaraba interbank investments

Money market (money market) is a market within which the securities are traded short term. The articles that are traded in the money market are the money (money) and quasi money (near money). Money and quasi money, which is none other than the securities (financial paper), which represent money which the person (or company) has an obligation to the person (or company) other.

Securities that are traded in financial markets can vary, can be securities deposits of less than one year to securities with a maturity of five years, but in fact a large portion of financial assets traded in the money market securities futures is less than one
year. This is because the securities longer-term more than usually owned by investors in capital markets.

As mentioned above, that the main task of bank management, is to maximize profits, minimize risks and ensure adequate liquidity is always available, no less and no more. With the existence of the interbank money market facilities, the Shariah banks will have easy-ease, to utilize the funds that are temporarily idle, the bank can conduct short-term investments in money market, and vice versa, to meet liquidity needs short term; banks can also obtain it from the Money Market.

However, because of securities outstanding in the money market is a letter conventional interest-based securities, then banks cannot take advantage Shariah existing markets, because Shariah banking is not allowed to become part of the asset and liability interest-based, and this is a constraint on Shariah banking circles in managing liquidity. Therefore, to support Shariah banking in managing its liquidity, it needs money market instruments based on Shariah, that sharia banking can perform its function fully, not only in facilitating short-term trading activity but also play a role in support the long-term investment.

The device used in the transaction Sharia Interbank Money Market (PUAS) is Mudharabah Interbank Investment Certificate Shariah (IMA). This certificate is a certificate that is used as a means of investment for the Bank of the excess funds to make profit, and on the other hand Mudharabah Interbank Investment Certificate Shariah (IMA) as well as the means for the Bank Syariah experiences a lack of funds for short-term funds mudharabah principle. In Indonesia, this issue has been regulated by Bank Indonesia with PBI No.2/8/PBI/2000. And Fatwa DSN Number: 38/DSNMUI/X.2002.
For the issuance of Certificates of Investment Mudharabah Sharia Interbank (IMA) must meet four (4) the following requirements:

a. These rights include the following:
   1) The words “Mudharabah Interbank Investment Certificate”.
   2) Place and date of issuance of Investment Certificates Sharia Interbank Mudharabah (IMA).
   3) Certificate Serial Number Sharia Interbank Investment Mudharabah (IMA).
   4) Nominal Value of Investment.
   5) The profit sharing ratio.
   6) Investment Duration.
   7) Level Indication Rewards.
   8) Nominal Payment Date and Rewards.
   9) Place of Payment.
   10) Name of Bank Investors Fund.
   11) Bank Issuer Name and signature of authorized officials.

b. Longest term of 90 days (ninety) days.

c. Published by the bank headquarters Shariah or Syariah Business Unit.

d. Format Mudharabah Interbank Investment Certificate Shariah (IMA) should follow the regulations stipulated by Bank Indonesia.

For Islamic banks that have been issued a Certificate of Sharia Interbank Investment Mudharabah (IMA) are required to report to Bank Indonesia on the day of issuance of Investment Certificates Sharia Interbank Mudharabah (IMA) is about things:

Investment Certificates Sharia Interbank Mudharabah (IMA) is about things:
a. Nominal Value of Investment.

b. Profit sharing ratio.

c. Investment Duration and

d. IMA certificate indication level benefits.

The mechanism and settlement of investment transactions Mudharabah Inter-Bank Shariah (IMA) in the money market are as follows:

a. Interbank Investment Certificate Mudharabah Shariah (IMA) which issued by Bank Managers of funds in triplicate, sheet The first and the second shall be submitted to the bank as proof of investor funds for investment, while the third sheet is used as an archive like the bank issuing the funds.

b. Bank investor funds in the Certificate of Sharia Interbank Investment Mudharabah (IMA) make payment to the bank issuing the certificate of IMA using credit notes through clearing, or Giro Bank Indonesia by attaching a second sheet Mudharabah Interbank Investment Certificate Shariah (IMA) or by electronic funds transfer that is accompanied by delivery of the second sheet Mudharabah Interbank Investment Certificate Shariah (IMA) to Bank Indonesia.

c. Alienation Mudharabah Interbank Investment Certificate Shariah (IMA) can only be done by the bank’s first venture fund, while the second fund investor banks are not allowed to transfer the other bank until the end of term time, means a certificate of Sharia Interbank Investment Mudharabah (IMA) may be transferred only once. It is intended that the certificate issuer Bank IMA can make a payment to the bank which is entitled, therefore, the bank shall notify the holder of the last certificate of ownership certificate to the bank issuing Sharia Interbank Investment Mudharabah (IMA).
d. Then at the Mudharabah Interbank Investment Certificate Shariah (IMA), maturity, settlement of transactions conducted by Publisher banks Mudharabah Interbank Investment Certificate Shariah (IMA) to make payments to the holders of certificates Investments last at nominal value (face value) with using credit notes through the clearing, using BI current accounts or using electronic funds transfer. While the benefits Mudharabah Interbank Investment Certificate Shariah (IMA) will be paid at the first business day following month.

Furthermore, the calculation of benefits Mudharabah Interbank Investment Certificate Shariah (IMA) was calculated based on the level of benefits realization Mudharabah Interbank Investment Certificate Shariah (IMA), based at the level of benefits Mudharabah Investment Deposits at the bank issuing the term of the investment.

SHARIAH FATWA NATIONAL BOARD NO: 38/DSN-MUI/X/2002 About Mudharabah Interbank Investment Certificate (IMA) establishes a fatwa about Mudharabah Interbank Investment Certificate (IMA)

a. Investment certificates based on interbank rates are not justified according to sharia.

b. Investment certificates based on Mudaraba contract, which called Mudharabah Interbank Investment Certificate (IMA), justified by Sharia.

c. IMA certificates transferable only once after the first purchased.

d. Certificate IMA participants are:

e. Islamic bank as an owner or recipient of funds.

f. Conventional banks only as the owner of the funds.
3. **Bank Indonesia Certificates sharia (SBIS)**

An Indonesian bank regulation on bank certificates of Islamic Indonesia has established the general provisions in these regulations definitions shall apply:

1) **Sharia Banks**, hereinafter called the BUS is a Commercial Bank as referred to in Act Number 7 Year 1992 on Banking as amended by Act No. 10 Year 1998, which is conducting business based on sharia principles.

2) **Syariah Unit**, hereinafter referred to UUS is:
   
   a) Work unit in a conventional bank’s headquarters that serves as office parent of a branch office or unit of sharia and sharia, or
   
   b) Work units in the branches of a conventional bank domiciled abroad who serves as principal office of syariah branch offices and / or sharia units.

3) **Sharia** is the principle of sharia principles as referred to in Article 1 number 13 of Law Number 7 Year 1992 on Banking as amended by Act No. 10 of 1998.

4) **Certificate of Bank Indonesia Sharia** hereinafter called SBIS is a letter securities based on Sharia Principles denominated short term amount of money issued by the Bank Indonesia.

5) **Bank Indonesia Script less Securities Settlement System**, hereinafter called the BISSS is a means of transactions with Bank Indonesia, including its administration and administration of securities electronically and connected directly between participants, organizers and the Indonesian Bank System –Real Time Gross Settlement.
6) Repurchase Agreement Transactions SBIS hereinafter called Repo SBIS is a lending transaction by Bank Indonesia to the BUS or UUS with collateral SBIS (collateralized borrowing).

7) Current Account is an account owned by BUS or UUS funds in currencies Bank Indonesia rupiah.

8) Securities Account is an account owned by BUS or UUS in the BI-SSSS used to record the ownership of SBIS.

9) Transactions SBIS is purchasing transaction SBIS and/or Repo SBIS.

   As for the contract and the characteristics used in the Indonesian bank certificates of sharia which also stipulated in article 3 and article 4 in the regulation of Indonesian banks SBIS issued by Bank Indonesia to use Ju’alah and SBIS contract has the following characteristics:

   1) Unit of Rp.1,000,000, 00 (one million rupiahs);
   2) A term of at least 1 (one) month and not exceeding 12 (twelve) months;
   3) Published without the paper (scrip less);
   4) Can be pledged to Bank Indonesia; and
   5) Cannot be traded in the secondary market.

Bank Indonesia issued SBIS through an auction mechanism. SBIS Issuance referred in paragraph (1) using BISSSS.

1) Parties can have a BUS or UUS SBIS.

2) BUS or UUS shall meet the requirements of Financing to Deposit Ratio (FDR) set by Bank Indonesia.
3) BUS or UUS can have SBIS through direct purchases and / or through money market brokers rupiah and foreign currencies.
   a) BUS or UUS Repo SBIS can be submitted to Bank Indonesia. Repo SBIS as intended based on the principle followed by Rahn and qard. BUS or UUS who filed Repo SBIS must be entered in the Framework Agreement SBIS Delays Repo SBIS and submitted the required supporting documents to Bank Indonesia.
   b) Bank Indonesia eventually establishes and charge for Repo SBIS. With the issuance of these instruments, the SBIS:
   c) Bank Indonesia Certificates have been issued before the Bank Regulation Indonesia is imposed, shall remain valid and subject to the provisions of Bank Indonesia Regulation Number 6/7/PBI/2004 dated February 16, 2004 regarding Certificates of Bank Indonesia to Bank Indonesia Certificates The fall time.
   d) With the issuance of this Bank Indonesia Regulation, Bank Indonesia Regulation Number: 6/7/PBI/2004 dated February 16, 2004 regarding Bank Certificates Indonesia revoked and declared invalid.

4. Al-sharf

Foreign exchange in terms of English known as money changer or foreign exchange, while the Arabic term al-called sharf. In the dictionary of al-Munjid fi al-Lughah mentioned that al-sharf means selling currency with other currencies. Al-Sharf harfiyah which means the addition, exchange, avoidance, or sale and purchase transactions. Thus al-Sharf is an exchange sale and purchase agreement with any other
currency. Forex or al-sharf freely interpreted as currency issued and used as legal tender in other countries.

Muhammad al-Adnani defines al-sharf with money exchange. An-Nabhani Taqiyuddin defines al-sharf with obtaining property by other property, in the form of gold and silver, which is similar to one another between the gold, which equates with a gold one another, or between the silver one with the other silver or gold with different types such as silver, with matching or overestimate the kind that one with another type.

He also stated that currency trading is buying and selling transactions in financial form which he said included some of the following:

1) Purchase of currency with the same currency as exchange of the new Iraqi dinar banknotes with old dinars.
2) The exchange of currency with foreign currencies like the pound-dollar exchange Egypt
3) Purchases of certain goods with money and the purchase of such currency with foreign currencies such as buying a plane with the dollar, and exchange of dollars to Iraqi dinars in a deal.
4) Sales of goods in the currency, e.g. U.S. dollars with Australian dollars.
5) Sales PROMIS (letter of agreement to pay money) with a particular currency.
6) Sales of shares in certain companies with a particular currency.

J. Previous Research

Nurul Huda in 2009 studied the causal relationship of Islamic and conventional financial markets. Variables used in the interbank money market, Islamic interbank money
market, certificates of Indonesian banks, and certificates wadiah Indonesian bank. Research results show that there is no significant reciprocal relationship between PUAS with PUASSY. Likewise there is no significant reciprocal relationship between the SBI with SBSIs.

Moreover, with Obiyathulla Ismath Bacha in 2009 Islamic money market yields that move in sync with conventional rates simply means that, users of a central bank would face the same extent of interest rate risk that conventional players do. It is indeed ironical that despite creating new markets and institutions that are supposed to enable interest free operations, players end up with as much interest rate exposure if not more. This, unfortunately is the reality of central bank operating within a dual banking system. Just as water cannot be at two levels within the same container, an Islamic financial system operating within a larger conventional macro environment cannot completely sterilize itself from interest rate risks.

If a common customer pool that can freely move funds between banking systems is the explanation for interest rate risk transmission to Islamic banks. The results of this study imply that the existence of a central bank may actually enhance this transmission. There are at least 3 additional channels of transmission with an IIMM. These are; (i) through the pricing in interbank rates, (ii) through the pricing of Islamic money market instruments and (iii) through the central bank’s money market operations.

Picture 2.1

Theoretical Framework
As Figure 2.1 shows, as a result of Malaysia’s dual banking system there is an interesting dimension to the IIMM. Not only do Islamic banks and other Islamic financial institutions have access, conventional banks, insurance companies and other conventional NBFI’s (non-bank financial institutions) have access to the IIMM. This is particularly so, for the second component of IIMM, which is Islamic money market instruments. While Islamic financial institutions have no access to the conventional money market, the opposite is not the case.

Conventional financial institutions have access to the IIMM. There are no limits on the participation of conventional financial institutions in buying Islamic money market instruments or selling the ones they own. They cannot issue their own Islamic papers into IIMM, nor bid for them in the primary market. In the secondary market, however, there is no differentiation. In fact, until end-2003, conventional banks were allowed to issue Green BAs which were essentially Islamic banker’s acceptances. This effectively meant that conventional banks could raise funds in the IIMM. The Shari’ah compatibility of the Green BAs came from the fact that
their underlying asset was halal. Since January 2004, the practice has been disallowed and Green BAs have ceased to exist.

K. Consideration Framework

In this study, to calculate all the variables that have obtained the data will be processed using the software Microsoft Excel 2007, after which the Excel-formatted data is converted to E-views version 4 for further testing requirements stationery analysis of test data. Then to see the interrelationships among variables in this study will use analytical methods granger causality test. Framework of thought can be seen in the following table:

Picture 2.2
Consideration Framework
L. Hypothesis

1. PUAS and PUASSY
   \[ H_0 : b_1 = 0, \quad \text{there is no significant causality between PUAS and PUASSY.} \]
   \[ H_1 : b_1 \neq 0, \quad \text{there is a significant causal relationship between PUAS and PUASSY.} \]

2. PUASSY and PUAS
   \[ H_0 : b_1 = 0, \quad \text{there is no significant causality between PUASSY and PUAS.} \]
   \[ H_1 : b_1 \neq 0, \quad \text{there is a significant causal relationship between PUASSY and PUAS.} \]

3. SBI and SBSI
   \[ H_0 : b_1 = 0, \quad \text{there is no significant causal relationship between SBI and SBSI.} \]
   \[ H_1 : b_1 \neq 0, \quad \text{there is a significant causal relationship between SBI and SBSI.} \]

4. SBSI and SBI
   \[ H_0 : b_1 = 0, \quad \text{there is no significant causality between SBSI and SBI.} \]
   \[ H_1 : b_1 \neq 0, \quad \text{there is a significant causal relationship between SBSI and SBI.} \]
CHAPTER III
RESEARCH METHODOLOGY

A. Research Scope

Descriptive research design was causal. Descriptive research related to the exposure of data relating to research, while the causal research to see the relationship that exists between independent variables and the dependent variable, whether a two-way relationship, a relationship in one direction or independently. The following briefly described in an econometric data analysis techniques. Data used in this research that in 2008 up to 2010 January.

B. The Method To Determine Sample

This thesis is prepared by conducting the election using non-probability sample (a non-random). The method is the selection of samples taken under consideration (judgment sampling) that is the type of sample selection is not random that the information obtained with the use of certain considerations (which is adapted to the purpose or research problem).

C. Data Collection Methods

Data used in this study are secondary data. Secondary data used in this study are:
1. Research Library

Data obtained from various literatures such as books, magazines, journals, newspapers, internet and other related aspects of research.

2. Field Research

Data obtained through direct observation in the field especially related to the research object.

D. Data Analysis Method

An analytical technique used in analyzing data of this study is a quantitative analysis. Where quantitative analysis is a study that aims to find the description thoroughly, accurately, and comprehensively based on empirical data.

A problem solved with quantitative approach, an analyst will concentrate on quantitative facts or data related to the problem and then create a mathematical model that describes the objectives, constraints and others associated with the problem, then with one or several other methods, the analyst will provide recommendations based on quantitative data (Anderson, 1994).

The next step is to enter the values of these variables into the software Microsoft Excel 2007 and then converted into Software Eviews4, then analyzed using statistical tests. The detailed steps in the test statistic are:

1. Stationary Test

This test is performed to detect whether the data really are stationary, because the data does not mean there is instability of stationary time series models that allow for
autocorrelation can cause interference on econometric models. To see this phenomenon, this is using the unit root test.

Stationary testing whether the data to be analyzed, carried out by using the unit root test. Testing procedures performed were as follows:

For example, time series model has the form like:

\[ Y_t = b_1 Y_{t-1} + e_{1t} \] (without intercept)

\[ Y_t = a_2 + b_1 Y_{t-1} + e_{1t} \] (with intercept)

\[ Y_t = a_3 + b_1 Y_{t-1} + c_3 + e_{1t} \] (with intercept and trend time)

Ho: \( b_1 = 0 \) (with unit root, Variable Y unstationer)

H1: \( b_1 \neq 0 \) (without unit root, Variable Y stationer)

By using the Dickey Fuller table corresponding to model time series (2), the null hypothesis which states the nature of the stationary in the model (2) will be rejected if the value of t-statistics obtained by the regression coefficient associated with this model is smaller than the Dickey-Fuller tables on certain significance level.

Stationary test is needed before making a granger causality test. Stationary test goal is to make the mean stable and its random error = 0, so that they obtained regression model has the ability to predict more reliable and there is no spurious regression. If the two variables tested did not stationary, it can generate fake regression. By granger and newold, if \( R^2 > D \)urbin-Watson statistics, we should suspect that the result is a regression palsy. This research will be conducted on a stationary test method Augmented Dickey Fuller (ADF).

2. Granger Causality Test
Once they are satisfied that the data used has been stationary, it can be done granger causality test. Granger causality test using the writer to know whether there is causality between the dependent variable. In essence, the test can indicate whether a variable has a two-way relationship, one-way, or no relationship at all (independent)

Why Granger Causality Test?

The basic "Granger Causality" definition is quite simple. Suppose that we have three terms, \( X_t \), \( Y_t \), and \( W_t \), and that we first attempt to forecast \( X_{t+1} \) using past terms of \( X_t \) and \( W_t \). We then try to forecast \( X_{t+1} \) using past terms of \( X_t \), \( Y_t \), and \( W_t \). If the second forecast is found to be more successful, according to standard cost functions, then the past of \( Y \) appears to contain information helping in forecasting \( X_{t+1} \) that is not in past \( X_t \) or \( W_t \). In particular, \( W_t \) could be a vector of possible explanatory variables. Thus, \( Y_t \) would "Granger cause" \( X_{t+1} \) if (a) \( Y_t \) occurs before \( X_{t+1} \); and (b) it contains information useful in forecasting \( X_{t+1} \) that is not found in a group of other appropriate variables.

Naturally, the larger \( W_t \) is, and the more carefully its contents are selected, the more stringent a criterion \( Y_t \) is passing. Eventually, \( Y_t \) might seem to contain unique information about \( X_{t+1} \) that is not found in other variables which is why the "causality" label is perhaps appropriate.

The definition leans heavily on the idea that the cause occurs before the effect, which is the basis of most, but not all, causality definitions. Some implications are that it is possible for \( Y_t \) to cause \( X_{t+1} \) and for \( X_t \) to cause \( Y_{t+1} \), a feedback stochastic system. However, it is not possible for a determinate process, such as an exponential trend, to be a cause or to be caused by another variable.

E. Operational Definition of Variables
Operational research variable is the specifications of researchers in measuring a variable. The specification shows the dimensions and indicators of variables obtained through observation and previous research.

1. PUAS

    Financial markets are markets where the group of short-term credit instruments (a meeting place between supply and demand will be short-term funds), which is generally of high quality to be traded and low risk. The term money market instruments usually maturing within one year or less.

2. PUASSY

    Islamic money market is the market where short-term credit instruments (a meeting place between supply and demand will be short-term funds), which is generally of high quality to be traded and low risk. The term money market instruments usually maturing in one year or less by using the principles of sharia.

3. SBI

    (SBI) are securities issued by Bank Indonesia in recognition of short term debt (1-3 months) with a system of discount / interest. SBI is one of the mechanisms used by Bank Indonesia to control the stability of the rupiah. By selling SBI, Bank Indonesia can absorb excess money supply in circulation.
4. SBSI

SBSI is an instrument of Bank Indonesia as the short-term care facilities fund for conventional banks that run on conventional principles.
CHAPTER IV

FINDING and RESULTS

A. Objects Overview Research

Since the economic crisis that hit Indonesia since mid 1997 has resulted in a sharp decline in economic activity and weakening consumer purchasing power. Most banks in Indonesia have experienced negative spread and cover bad loans in large numbers.

Due to withdrawal of funds in large numbers, to avoid a worsening liquidity, not a few conventional banks that have no other choice but to offer high deposit interest rates at 50 percent to 70 percent. As a result, dozens of banks to be dying and many businesses closed down for failing to pay their duty. This condition is not the case with Islamic banks is implementing revenue-sharing system and be free from the influence of interest rate fluctuations that occur. Since then, the numbers of Islamic banks thrive because profit-sharing system has to offer and in fact is not less profitable than conventional banks are applying the system of interest. So it is not surprising that until now many of the conventional banks also opened units or sharia his window to see a promising prospect of this alternative banking system.

In the context of the development of this Islamic banking sector is only fitting to walk side by side with the real sector and financial sector as an area of Islamic investment. Hence the establishment of appropriate infrastructure ranging from legal instruments that govern it, the completeness of monetary instruments and financial markets until the formation of other provisions associated with it is absolutely necessary. The components of the system and the existing financial instruments cannot provide assurance most satisfaction
with the community in its operational mechanism, so the expectations that arise related to
the financial system in accordance with Islamic values can be realized and this may be an
alternative option for Muslim investors to promote their funds in an investment. Data used in
this study were data from 2008 until January 2010.

B. The Findings And Discussion

To better understand the data, it will be presented in advance the characteristics of
the data, namely:
1. **Descriptive Analysis**

   a. **SBI Data in 2008**

   ![Graph 4.1](image)

   **Source: BI Report Data (Data processing)**

   Graph 4.1 informs the development of Bank Indonesia certificate data in 2008 from January (1) until December (12). From the graph 4.1 above, we see that happened volatile than bank certificates of Indonesia. The average of the certificate data is 101.414. The highest value of bank certificates of Indonesia occurred in January while the month of December to the lowest point of the value of certificates of Bank Indonesia.
b. SBI Data for 2009 and 2010 in January

Graph 4.2
Certificates of Bank Indonesia in 2009 and 2010 months January

Graph 4.2 inform the development of Bank Indonesia certificate data for 2009 from January (1) until December (12) and 2010 January (13). From the graph 4.2 above, we see that happened volatile than bank certificates of Indonesia. The average of the certificate data is 106.171.

The highest value of bank certificates of Indonesia occurred in January while the month of December to the lowest point of the value of certificates of Bank Indonesia.
c. SBI Data in 2008 until January 2010

Graph 4.3
SBI Data in 2008 until January 2010

Report Data (Data processing)

Graphs 4.3 inform the development of Bank Indonesia certificate data from 2008 until January 2010. From the graph 4.3 above, we see that happened volatile than bank certificates of Indonesia. The average of the certificate data is 103.888.

The highest value of bank certificates of Indonesia occurred in August 2009 while the month of December in 2009 to the lowest point of the value of certificates of Bank Indonesia.
d. SBSI data 2008

Graph 4.4
Data SBSI 2008

Source: BI Report Data (Data processing)

Graph 4.4 of data to inform the development of Certificates of Bank Indonesia in 2008. From the graph 4.4 above, we see that happen to fluctuate from Indonesian banks wadiah certificate. The average of the certificate data is 2.103

The highest value of bank certificates of Indonesia occurred in August while April to the lowest point of the value of wadiah Bank Indonesia certificates.
SBSI data from 2009 to January 2010

Graph 4.5
SBSI data from 2009 to January 2010

Source: BI Report Data (Data processing)

Graph 4.5 informs the development of Bank Indonesia Wadiah certificate data from 2009 to January 2010. From the graph 4.5 above, we see that happen to fluctuate from Indonesian banks wadiah certificate. The average of the certificate data is 2.864.

The highest value of bank certificates of Indonesia occurred in July while January of 2010 to the lowest point of the value of wadiah Bank Indonesia certificates.
f. SBSI data 2008 to January 2010

Graph 4.6
Data SBSI 2008 to January 2010

Source: BI Report Data (Data processing)

Graph 4.6 informs the development of Bank Indonesia Wadiah certificate data from 2009 to January 2010. From the graph 4.6 above, we see that happen to fluctuate from Indonesian banks wadiah certificate. The average of the Indonesian bank wadiah certificate data is 2.499.
Graph 4.7
PUAS data in 2008

Source: BI Report Data (Data processing)

4.7 Graph of data to inform the development of conventional interbank money market in 2008. From the graph 4.7 above, we see that happen to fluctuate from the interbank money market certificate conventional. The average of the certificate data is 292.499

The highest value from the conventional interbank money market occurred in March while June to the lowest point of the conventional interbank money market.
h. PUAS data from 2009 to January 2010

Graph 4.8
PUAS data from 2009 to January 2010

Source: BI Report Data (Data processing)

8.4 Graph of data to inform the development of conventional interbank money market in 2009 until January 2010. From the graph 4.8 above, we see that happen to fluctuate from the conventional interbank money market. Average data from the conventional interbank money market is 130.197.
i. PUAS data in 2008 until January 2010

Graph 4.9
Data PUAS 2008 until January 2010

Source: BI Report Data (Data processing)

4.9 Graph of data to inform the development of conventional interbank money market in 2008 until January 2010. From the graph 4.9 above, we see that happen to fluctuate from the conventional interbank money market. Average data from the conventional interbank money market is 208.102.
j. PUASSY Data in 2008

Graphics 4.10
PUASSY Data in 2008

4.10 graph data to inform the development of Islamic interbank money market in 2008. From 4.10 graphs above, we see that happen to fluctuate from Islamic interbank money market. The average of the interbank money market data for the shariah is 155.
k. PUASSY data from 2009 to January 2010

Graphics 4.11
PUASSY data from 2009 to January 2010

Source: BI Report Data (Data processing)

4.11 graph data to inform the development of Islamic interbank money market in 2009 until January 2010. From 4.11 graphs above, we see that happen to fluctuate from Islamic interbank money market. The average of the interbank money market data sharia is 193.
1. PUASSY data 2008 until January 2010

Graphics 4.12
Data PUASSY 2008 until January 2010

![Graph showing PUASSY data from 2008 to January 2010](image)

*Source: BI Report Data (Data processing)*

4.12 graph data to inform the development of Islamic interbank money market in 2008 until January 2010. From 4.12 graph above, we see that happen to fluctuate from Islamic interbank money market. The average of the interbank money market data sharia is 174.
2. Data Analysis

   a. Stationary test

   Stationary test is needed before making a granger causality test. Stationary test goal is to make the mean graphic and its random error = 0, so that they obtained regression model has the ability to predict more reliable and there is no spurious regression. If the two variables tested did not stationary, it can generate fake regression. By granger and newold, if $R^2 > $ Durbin-Watson statistics, we should suspect that the result is a regression palsy.

   Before doing Granger causality test we must perform the stationary test data firstly, while the method used is the ADF test statistic where this test will compare the value of the critical value and test value of ADF test. Critical value taken in 5% or 95% confidence level. If the test results of ADF test value < CV then the data is stationer, so reject Ho, otherwise if PP tests > CV then the data are not stationary. Test results with the help of the program Eviews 4.1 shows all the variables are stationary at different levels.
1) Stationery Variable SBI

Table 4.1
Stationary test with Augmented Dickey Fuller (ADF)

<table>
<thead>
<tr>
<th>Variabel</th>
<th>Level</th>
<th>Test Results</th>
<th>Result</th>
</tr>
</thead>
<tbody>
<tr>
<td>SBI</td>
<td>1st difference</td>
<td>ADF test : -3.33936</td>
<td>Data was Stationer</td>
</tr>
<tr>
<td></td>
<td></td>
<td>CV 5% : -1.956406</td>
<td></td>
</tr>
</tbody>
</table>

Source: BI Report Data (Data processed by E-views 4)

Value ADF (Augmented Dickey Fuller) test of -3.33936 with a critical value (CV), which has an alpha of 5% in Table 4.1 indicating that the variable Bank Indonesia certificates after testing the stationary using E-Views 4, it turns out certificates of Bank Indonesia has been variable Stationary at 1st level difference. That is, do not do anymore testing stationary on 2nd level difference.

2) Stationary Variable SBSI

Table 4.2
Stationary test with Augmented Dickey Fuller (ADF)

<table>
<thead>
<tr>
<th>Variabel</th>
<th>Level</th>
<th>Test Results</th>
<th>Result</th>
</tr>
</thead>
<tbody>
<tr>
<td>SBSI</td>
<td>1st difference</td>
<td>ADF test : -4.375366</td>
<td>Data was Stationer</td>
</tr>
<tr>
<td></td>
<td></td>
<td>CV 5% : -1.9564062</td>
<td></td>
</tr>
</tbody>
</table>

Source: BI Report Data (Data processed by E-views 4)

Similarly, the variable Bank Indonesia certificates, certificates of variables wadihah Bank Indonesia (SBSI) even after the stationary tests using
the unit root test (augmented Dickey Fuller) is stationary in 1st difference. this is shown by the ADF test after test conducted using the test the unit root test that is equal to -4.375366 by CV values of -1.9564062 (alpha 5%).

3) Stationary Variable PUAS

<table>
<thead>
<tr>
<th>Variabel</th>
<th>Level</th>
<th>Test Results</th>
<th>Result</th>
</tr>
</thead>
<tbody>
<tr>
<td>PUAS</td>
<td>2nd difference</td>
<td>ADF test : -2.040625 CV 5% : -1.96843</td>
<td>Data was Stationer</td>
</tr>
</tbody>
</table>

Source: BI Report Data (Data processed by E-views 4)

In table 4.3 above, after testing using the unit root test with the results of the ADF and the CV-value of -2.040625 -1.96843 (alpha 5%). This data shows PUAS been stationary at the 2nd level difference.
4) Stationary Variable PUASSY

<table>
<thead>
<tr>
<th>Variabel</th>
<th>Level</th>
<th>Test Results</th>
<th>Result</th>
</tr>
</thead>
<tbody>
<tr>
<td>PUASSY</td>
<td>1st difference</td>
<td>ADF test: -9.448894</td>
<td>Data was</td>
</tr>
<tr>
<td></td>
<td></td>
<td>CV 5%: -1.956406</td>
<td>Stationary</td>
</tr>
</tbody>
</table>

Source: BI Report Data (Data processed by E-views 4)

Variable PUASSY already stationary in 1st difference. Test results using the unit root test ADF value of -9.448894 with CV value of -1.956406 (alpha 5%).

Based on Graph 2 above it shown that SBI stationary in 1st difference WHERE the result ADF (-3.33936) > CV 5% (-1.956406) that means Ho is Rejected when the data was stationary. SBSI s stationary in 1st difference WHERE the result ADF (-4.375366) > CV 5% (-1.956406) that means Ho is Rejected when the data was stationary.

PUAS stationary in 2nd difference WHERE the result ADF (-2.040625) > CV 5% (-1.96843) That means Ho is Rejected when the data was stationary. PUASSY stationary in 1st difference WHERE the result ADF (-9.448894) > CV 5% (-1.956406) that means Ho is Rejected when the data was stationary.
b. Granger Causality Test

To answer the research hypotheses and research questions, then carried the granger causality test. After which there is certainly all the variables have been stationary, the granger causality test can be performed, this test essentially indicates that a variable can have two-way relationship, or only in one direction or independently. On a test that can be seen granger causality is the influence of the past to the present.

1) Granger Causality between PUASSY and PUAS

Table 4.5
Granger Causality between PUASSY and PUAS

<table>
<thead>
<tr>
<th>Variabel</th>
<th>Obs</th>
<th>F-Stat</th>
<th>Prob</th>
<th>Result</th>
</tr>
</thead>
<tbody>
<tr>
<td>PUASSY and PUAS</td>
<td>25</td>
<td>0.44153</td>
<td>0.64983</td>
<td>PUASSY does not Granger Cause PUAS</td>
</tr>
</tbody>
</table>

Source: BI Report Data (Data processed by E-views 4)

Table 4.5 informs that there is no causality between the Islamic money market with the conventional money market. based on test results using granger causality test, the probability value of 0.64983 > 0.05 (alpha).

If the probability value is greater than the alpha value, then as they arrive and Ho is accepted Ha rejected. In this case, the probability value, amounting to 0.64983 > 0.05 (alpha). That is, Ho is accepted and Ha is rejected. In other words, there is no causal relationship between PUASSY with PUAS.
This study together with previous research conducted by Nurul Huda in 2009. Where there is no significant causality between PUASSY and PUAS.

PUASSY as we know it is the Islamic interbank money market where a market is the meeting place of market interactions that occur in sharia. Prohibition of usury as a guideline in the Islamic money market. In interactions, many instruments are bought and sold in this market, while not deviating from Islamic practices.

The result showed that the absence of a significant relationship kusalitas between Islamic interbank money market with the conventional money market money between the two markets shows that the practice is independent. The absence of significant intervention of what happened in the Islamic interbank money market with the conventional interbank money market. all forms of transactions that occurred in the Islamic interbank money market with all its derivatives will not affect the conventional interbank money market.
Further results of this study showed that the positive rate of growth of money market based on sharia Principle. Because it has nothing to do with conventional bank money market.

2) Granger Causality between PUAS and PUASSY

Table 4.6
Granger Causality between PUAS and PUASSY

<table>
<thead>
<tr>
<th>Variabel</th>
<th>Obs</th>
<th>F-Stat</th>
<th>Prob</th>
<th>Result</th>
</tr>
</thead>
<tbody>
<tr>
<td>PUAS and PUASSY</td>
<td>25</td>
<td>0.66696</td>
<td>0.5255</td>
<td>PUAS does not Granger Cause PUASSY</td>
</tr>
</tbody>
</table>

*Source: BI Report Data (Data processed by E-views 4)*

The data in table 4.6 above shows that after a thorough examination using granger causality test (granger causality test), yielding the probability value of 0.5255 with an F-Statistic of 0.66696.

Statistical testing to see whether the presence or absence of a reciprocal relationship between the variables of conventional inter-bank money market with Islamic interbank money market can be explained simply that if the probability value is greater than the alpha value, then Ho is accepted and Ha is rejected. Vice versa, if the probability value smaller than the alpha value, then Ho is rejected and Ha accepted.
In this study, the probability value is 0.5255. If we compare with the value of alpha, then \(0.5255 > 0.05\). That is, accept \(H_0\) and reject \(H_a\). So in this study there is no significant causality between the conventional interbank money market with Islamic interbank money market.

Previous research as done by Nurul Huda in 2009, showed the same thing. Where there is no significant causality between the conventional interbank money market with Islamic money market in Indonesia.

The results of this study show the same thing with what was done in previous studies. Because this study wanted to see the relationship is reciprocal, it is carried out using granger causality.

Absence of a significant relationship between the timbale behind the interbank money market with the conventional Islamic interbank money market shows that whatever happens in the conventional interbank money market will not affect the Islamic interbank money market in Indonesia.

In table 4.5 shows that there is no significant relationship between the timbale behind money market between Islamic banks with a conventional bank money market; show the same thing where there is no causal relationship between the conventional interbank money market to the Islamic interbank money market in Indonesia.
The results of this study further reinforce that existing money market presence in Indonesia (both conventional and Islamic), the absence of direct relationship that is mutual. Means that whatever happens in the Islamic money market will not significantly affect the conventional interbank money market, as well as with the opposite.

3) Granger Causality between SBSI and SBI

Table 4.7
Granger Causality between SBSI and SBI

<table>
<thead>
<tr>
<th>Variabel</th>
<th>Obs</th>
<th>F-Stat</th>
<th>Prob</th>
<th>Result</th>
</tr>
</thead>
<tbody>
<tr>
<td>SBSI and SBI</td>
<td>25</td>
<td>0.53922</td>
<td>0.59233</td>
<td>SBSI does not Granger Cause SBI</td>
</tr>
</tbody>
</table>

*Source: BI Report Data (Data processed by E-views 4)*

Previous research as done by Nurul Huda in 2009, showed the same thing. Where there is no significant causality between the conventional interbank money market with Islamic money market in Indonesia.

The results of this study show the same thing with what was done in previous studies. Because this study wanted to see the relationship is reciprocal, it is carried out using granger causality.
Absence of a significant relationship between the timbale behind the interbank money market with the conventional Islamic interbank money market shows that whatever happens in the conventional interbank money market will not affect the Islamic interbank money market in Indonesia.

In table 4.7 shows that there is no significant relationship between the timbale behind money market between Islamic banks with a conventional bank money market; show the same thing where there is no causal relationship between the conventional interbank money market to the Islamic interbank money market in Indonesia.

The results of this study further reinforce that existing money market presence in Indonesia (both conventional and Islamic), the absence of direct relationship that is mutual. Means that whatever happens in the Islamic money market will not significantly affect the conventional interbank money market, as well as with the opposite.
4) Granger Causality between SBI and SBSI

Table 4.8
Granger Causality between SBI and SBSI

<table>
<thead>
<tr>
<th>Variabel</th>
<th>Obs</th>
<th>F-Stat</th>
<th>Prob</th>
<th>Ket</th>
</tr>
</thead>
<tbody>
<tr>
<td>SBI and SBSI</td>
<td>25</td>
<td>0.28466</td>
<td>0.7559</td>
<td>SBI does not Granger Cause SBSI</td>
</tr>
</tbody>
</table>

Source: BI Report Data (Data processed by E-views 4)

This study shows that the probability value of 0.75559 and the F-statistics are at 0.28466. Statistical testing to see if there is any relationship between variables timbale behind wadiah Bank Indonesia certificates with certificates of Bank Indonesia can be explained simply that if the probability value is greater than the alpha value, then Ho is accepted and Ha is rejected. Vice versa, if the probability value smaller than the alpha value, then Ho is rejected and Ha accepted. In this study, namely 0.75559 probabiliyanya value> 0.05 (alpha). Means Ho Ha received and rejected. Then it is, then it could be concluded no significant relationship between the timbale behind Bank Indonesia certificates with certificates of Bank Indonesia.

A previous study by Nurul Huda in 2009 showed the same thing. Where there is no significant relationship between the timbale behind a bank certificate of Indonesia with Bank Indonesia certificates.

This study informs that even if the value of bank certificates of Indonesia - as the basis for determining the rate of conventional bank bung - up or down, will not
affect the value of wadiah certificates of Bank Indonesia (the Shariah compliant). The results of this study inform interested to be studied further, because the Bank Indonesia, which confirmed that in Indonesia enacted a dual banking system have started to be corroborated by the results of this research. Because it is not a significant relationship between a bank certificate of Indonesia with Bank Indonesia certificates wadiah.

Despite its name, Granger causality is not sufficient to imply true causality. If both X and Y is driven by a common third process with different lags, one might still accept the alternative hypothesis of Granger causality. Yet, manipulation of one of the variables would not change the other. Indeed, the Granger test is designed to handle pairs of variables, and may produce misleading results when the true relationship involves three or more variables. A similar test involving more variables can be applied with vector auto regression.

Another interpretation is when the test for Granger causality works by first doing a regression of ΔY on lagged values of ΔY. (Here ΔY is the first difference of the variable Y — that is, Y minus its one-period-prior value. The regressions are performed in terms of ΔY rather than Y if Y is not stationary but ΔY is.) Once the set of significant lagged values for ΔY is found (via t-statistics or p-values), the regression is augmented with lagged levels of ΔX. Any particular lagged value of ΔX is retained in the regression if (1) it is significant according to a t-test, and (2) it and the other lagged values of ΔX jointly add explanatory power to the model according
to an F-test. Then the null hypothesis of no Granger causality is accepted if and only if no lagged values of ΔX have been retained in the regression.

The researcher is often looking for a clear story, such as X Granger-causes Y but not the other way around. In practice, however, it may be found that neither variable Granger-causes the other, or that each of the two variables Granger-causes the other.
CHAPTER V
CONCLUSION and IMPLICATION

According to the research question of this research then there are some conclusions as follows:

1. Islamic money market product include product certificate wadiah Indonesian bank (SBSI) whose existence from 31 March 2008 was replaced with a bank certificate of Islamic Indonesia (SBIS) that uses a sell contract. In addition, there are products of Islamic investment certificates interbank mudaraba (IMA) and the product AL-Sharf (buying and selling foreign currencies).

2. This study shows that the probability value of 0.75559 and the F-statistics are at 0.28466. In this study, namely 0.75559 the probability value > 0.05 (alpha). Means Ho and Ha accepted and rejected respectively. Then it is, then it could be concluded no significant reciprocal relationship between certificates of Bank Indonesia with Bank Indonesia certificates. This study informs that even if the value of bank certificates of Indonesia - as the basis for determining the rate of conventional bank - up or down, will not affect the value of wadiah certificates of Bank Indonesia (the Shariah compliant). The results of this study inform interested to be studied further, because the Bank Indonesia, which confirmed that in Indonesia enacted a dual banking system have started to be corroborated by the results of this research. Because it is not a significant relationship between a bank certificate of Indonesia with Bank Indonesia certificates wadiah. In this study, namely 0.59233 the probability value > 0.05 (alpha). Means Ho Ha received and rejected. Then it is, then it could be
concluded no significant reciprocal relationship between Bank Indonesia certificates wadiah with a Certificate of Bank Indonesia.

3. In this study, the probability value is 0.5255. If we compare with the value of alpha, then 0.5255 > 0.05. That is, accept Ho and reject Ha. So in this study there is no significant causality between the conventional interbank money market with Islamic interbank money market. The result showed that the absence of a significant relationship causality between Islamic interbank money market with the conventional money market money between the two markets shows that the practice is independent. The absence of significant intervention of what happened in the Islamic interbank money market with the conventional interbank money market. All forms of transactions that occurred in the Islamic interbank money market with all its derivatives will not affect the conventional interbank money market.

4. Given the very strong correlation we have seen between the inter-bank rates, changes in interest rates in the conventional money market would simply be transmitted to Islamic banks when they use the PUASSY for their liquidity management. Similarly, since PUASSY instruments are priced using discounting, interest rate changes cause re-pricing risk because discount rates change. Prices and yields of PUAS instruments will invariably converge with those of conventional money markets because of the possibility for pure arbitrage. As such, Islamic institutions issuing PUASSY instruments will face higher cost if conventional interest rates rise, while investors of PUASSY instruments would get lower returns if the opposite happens. The third transmission channel arises from central bank intervention. Regardless of whether the intervention is a routine open market operation to influence liquidity or execution of new monetary policy, the central bank’s actions in the PUAS must reflect its actions in the conventional money market. Failing which, profitable arbitrage
against the central bank or a carry trade between the markets would both be feasible. Given
this, no matter how supportive a central bank is of the Islamic financial sector, it cannot
possibly maintain dual rates nor cause changes in one market and not in the other.

5. Paradoxical as it may seem, the implication is that a PUASSY could bring the Islamic
banking sector into closer orbit with the conventional sector. Does this mean that not having
a PUASSY is better in a dual banking system? Obviously not. While an IIMM may provide
additional channels for rate risk transmission, as we saw in the first section, it nevertheless
plays several pivotal roles, liquidity management being the most important. The challenge
then is to have well functioning PUASSY that do not pass on rate risks. One tempting
solution is to detach the Islamic financial system form the conventional one and keep it truly
separate by not allowing transactions across markets. Not only would this not be feasible, it
would also be hugely distortionary and very costly to maintain. Unless the Islamic financial
sector is to be kept as a small niche, it would simply not be possible to keep it totally
detached.
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