Does Inter-Bank Investments Restraints Financing Performance of Islamic Banks?

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INTRODUCTION

Interbank markets proved to play a crucial role in propagating the distress during the recent financial crisis. Unsecured financing determines clear links between creditors and debtors, stating explicitly the risk relation (Leur, 2016). If a debtor defaults, the lender's risk materializes and she has to bear the losses. Since the beginning of the financial crisis, the interbank market has been carefully scrutinized by commentators and policy-makers. It is also considered as crucial stress indicators during financial crises: they reveal not only banks' concerns regarding to the risk of financing of their counterparts, but also regarding their own liquidity needs. Accordingly, the impact of the monetary-policy measures followed by Malaysia Islamic banks, the need to look long term effect involving financing capability. Disentangling financing and liquidity effects has essential policy implications. On the one hand, if a rise in spreads reflects poor liquidity, policy measures should aim at improving funding facilities. On the other hand financing concerns should be addressed by enhancing debtors' solvency (Buigut, 2010). This question has been of utmost importance in this industry over the last few years, where most of the interbank operations conducted by Central Bank of Malaysia were designed to reduce interbank market stress. This article seeks to examine the involvement of Malaysia Islamic banks in Islamic inter-bank money market (IIMM) investment within a financing framework in dual banking system in Malaysia. This paper also focuses on effects bank specifications, changes in monetary policy and economic environment on financing behaviour of Malaysia Islamic banks.

The article is divided into five parts. The second section describes background and performance of financing activities in Islamic banks in Malaysia. The third section, examines some previous researches and articles related with this topic. In fourth section, model and data specification adopted used in this article. The fifth section is the finding of the research. Section five and six look at the future research direction and conclusion.

BACKGROUND

Since Islamic banking was established in Malaysia in 1983, financing growth rate showed an encouraging performance. However, that performance was not consistent over the operation period of 27 years. Since there are circumstances where it is affected in economy situation. The evidence is in 1987 and 1998 when the global economy was suffering from the recession. At that time Islamic banking financing decreased from 18.36 percent to 2.68 percent. However, this situation improved and the amount of Islamic financing continued to rise for the next year since the world economy got in good condition and stable.

Table 1 shows the use of the Malaysia Islamic banking funds in aggregate in the form of several types of financing. In reference to the table, the

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Table 1. Financing by type/sector

Type of Financing			2006	2007	2008	2009	2010
			RM Million				
Overdraft			2731.0	3,278.0	3,740.1	4,203.5	4,446.7
Term financing	Hire purchase	Total	26567.7	29,208.8	33,570.7	39,164.1	44,959.0
		where: Passenger car	23127.2	25,422.9	29,154.8	36,498.9	41,569.3
	Leasing		376.5	505.2	331.1	760.4	875.4
	Financing based on block		0.0	0.0	0.0	0.0	0.0
	Connector financing		369.2	465.9	384.4	413.5	397.6
	Syndicate financing		1199.1	772.2	521.8	2,504.4	2,061.1
	Factoring		0.0	0.0	0.0	0.0	0.0
	Personal financing		4526.4	6,001.0	8,484.0	11,727.3	15,540.2
	Home financing		16403.0	17,036.6	18,940.8	22,728.3	29,792.6
	Others		14027.9	17,764.8	23,882.5	34,453.2	43,181.6
	Due time which:	Until 1 year	1255.6	2,096.6	4,289.4	4,183.1	3,878.4
		Exceeding 1 year	53460.3	60,720.5	75,642.8	104,596.9	127,185.1
Financing Bill			9164.2	10,291.8	10,070.0	8,056.9	7,881.8
Trustworthy receipt			512.4	571.3	728.2	652.8	664.3
Revolve credit			2117.3	2,079.6	3,058.5	5,268.8	6,230.4
Financing in foreign currencies			327.4	841.6	2,628.2	3,132.9	3,956.9
Others			1004.6	1,050.8	1,381.6	1,907.6	2,425.0
Total			80460.5	89,867.6	107,721.8	134,973.5	162,412.6

Source: National Bank of Malaysia (2006-2010)

Islamic banking financing flows are broken down into some type of overdraft financing: term financing, bill financing, trust receipts, revolving credit in foreign currencies, and the rest is represented by other available financing. During the five years of 2006 to 2010, the direction of financing flow of Malaysia Islamic banking increased around 11 to 25 percent each year with the latest financing in December 2010 making RM162,412.6 million. The majority of the total financing is contributed by the term financing type that covered financing such as leasing, financing by block, syndicate, factoring, private financing, home financing and others. Meanwhile the least type of financing demand by the client is the trustworthy receipt[1] which only represents around 0.4 per cent from the total financing every year (Mahmood, 1997).

It should be noted, though Islamic banking offers the client interest-free financing, but the reality is the Islamic banking is still facing various form of risk s especially credit risk which involves the capability of the bank to offer more financing. When this situation occurs, the bank will strive to reduce the financing volume in the future where