**Factors affecting the price of corporate Islamic bonds in Indonesia, January 2010 - July 2015**

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***Abstract***

*This study aims to determine partial and simultaneous influence of interest rates on deposits, deposits of mudaraba, the price of state shari'a securities (SBSN), Rupiah exchange rate against US Dollar, and the Index of Industrial Production on the price of corporate Islamic bonds in Indonesia, for short-term or long-term period. Data are obtained from published reports of Bank Indonesia, Central Bureau of Statistics (BPS), ICAMEL library, Indonesian Capital Market Electronic Library during January 2010 to July 2015, and web support providing the price of Islamic bonds data. Corporations that become the objects of this research are PT. Listrik Negara (PLN), PT. Indosat, Tbk, and PT. Bank Muamalat Indonesia. The results using Error Correction Model (ECM) at PT. Perusahaan Listrik Negara show that variables affecting the price of Islamic bonds in short-term period are Shari’a Securities (SBSN), Index of Industrial Production, shari’a securities (SBSN) and bond prices in the previous month, while in long-term period, variables that affect the price of Islamic bonds are shari’a securities (SBSN) and Index of Industrial Production. As for PT. Indosat, variables that affect price of Islamic bonds in short-term period is the profit share of deposits, while in long-term period, they are the interest rate of deposits and the Index of Industrial Production. As for PT. Bank Muamalat Indonesia, variables that affect the price of Islamic bonds in short-term period is the deposits, the State Shari’a Securities, the previous price, and the previous deposit rates, while in the long-term period, they include the outcome of deposits, and state shari’a securities.*

***Keyword: Islamic corporate bond, macroeconomic, Islamic investment theory market equilibrium.***

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# Introduction

Islamic Financial management is a finance system based on Islamic laws where *riba*, *gharar*, *maysir* are forbidden. The development of Islamic finance begins with the establishment of Myt Ghamr Bank in 1963 in Egypt. The development in several Muslim countries rapidly increases and has encouraged some parties in Indonesia to establish shari’a banks. In Indonesia, the development of shari’a banking begins with the establishment of Bank Muamalat Indonesia in 1992.

Fachrudin (2206) in Rosida (2014) states that shari'a-based concept is considered capable of providing fairness better than the interest system applied to the conventional ones. *Khaleej Times* has published a study on shari'a banking, conducted by Morgan McKinley. The result of the research shows that global asset value of shari'a banks is estimated reaching the amount of 6.5 trillion USD in 2020.

According to the study conducted by Karim Consulting (2015), the global asset of shari'a finance has been recorded reaching the amount of 1.658 trillion USD, with the total institution of 993 units in 2013. The biggest shari'a asset is owned by Malaysia, with the total asset of 423 billion USD, followed by Iran with the total asset of 232 billion USD. The rest is held by Muslim countries and Muslim-majored countries with total asset less than 150 billion USD.

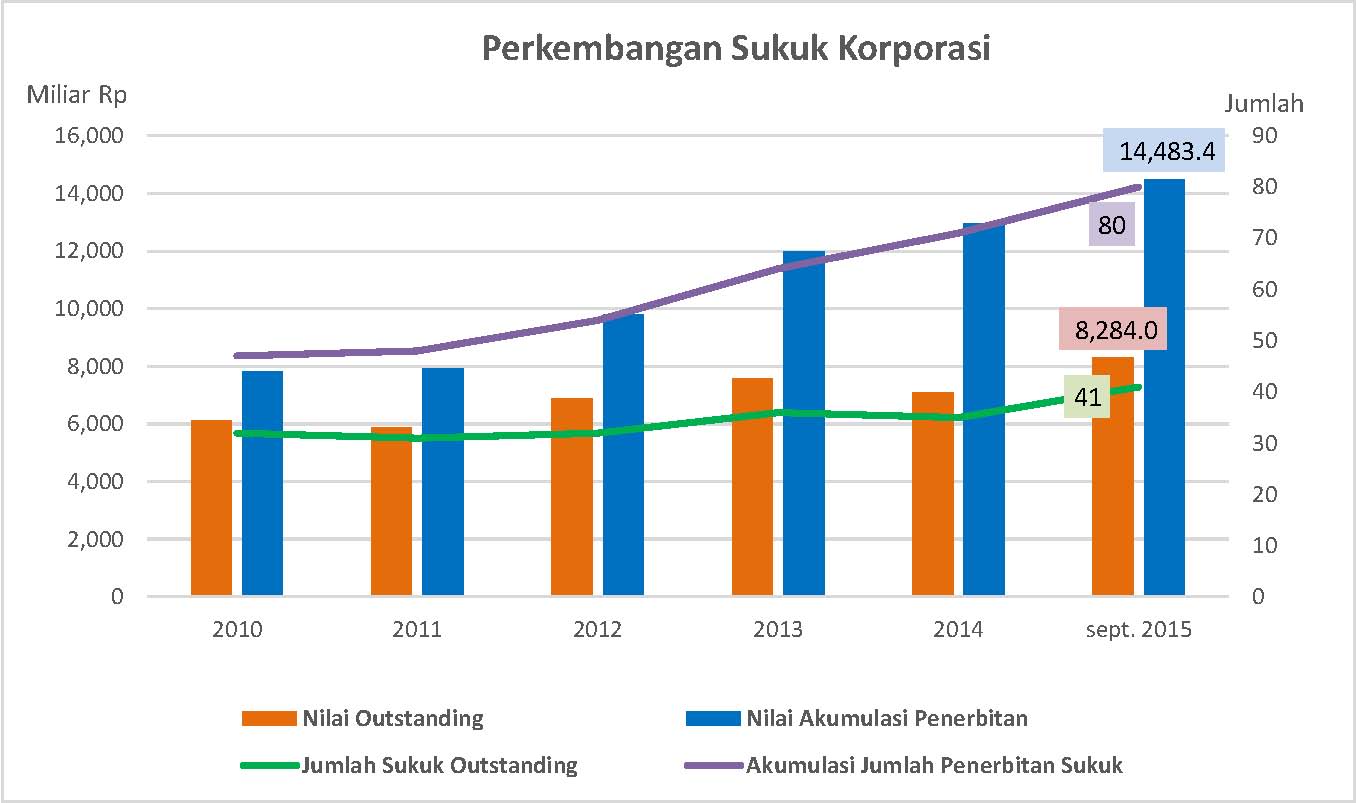
**Graphic 1.1.: Market Share of Global Islamic Bonds in 2014 and 2015 (in percentage)**

**Source: Bloomberg, (analyzed in 2015)**

As drawn in the graphic above, Malaysia still becomes the highest market of Islamic bonds issuance, with the total percentage of 42.3% approximately in 2015, even though it declined around 31.7% from the previous year which reached 74% approximately. In the second place, there is the United Arab Emirates with the total percentage around 18.2% in 2015, rising about 13.5% from the previous year. The third area is held by Bahrain, with the total percentage of 14.2% in 2015 and followed by Indonesia in the fourth place with total percentage about 14.1%, rising about 9.5% compared to that in 2014 which was only 4.6%.

According to data of Indonesia Stock Exchange (2015), the outstanding share of Islamic bonds in Indonesia is held by PT. Bank Mualamat Tbk. which is 17.76%. In the second place, PT. Perusahaan Listrik Negara (PLN) follows with the percentage of 13.80% and followed by PT. Indosat Tbk in the third place which is 12.76%. Total issuers of outstanding share value until September 2015 reached 8.440,40.

**Graphic 1.2.: Development of corporate Islamic bonds in Indonesia in 2015**



**Source: Statistics issued by Financial Services Authority (OJK) (2015)**

As drawn in the graphic above, the development of corporate Islamic bonds during 2010-2015 increases even though not significantly. In 2010, the outstanding value reached 6.2121,00 which declined about 5.88% in 2011.

Kartikasari, Director of Shari'a Capital Market of FSA (OJK), stated that, according to the data released by FSA, there is still no significant improvement in corporate Islamic bonds since last year. Since 2014 until now, the outstanding value of corporate Islamic bonds is only 7.1 billion rupiahs, with total issued bonds of 35. Nonetheless, during last year, there was seven bonds were issued, worth about 923 billion rupiahs. It was lesser than that in 2013 which issued ten bonds, worth about 2.2 trillion rupiahs. From this case, the development of Islamic bonds market is considered slow. Since 2013, the development of emission value of Islamic bonds is only 8% which is from 11.99 trillion rupiahs to 12.95 trillion rupiahs (Bisnis.com, 2015).

Capital Market & Financial Institution Supervisory Agency (Bapepam-LK) (2012), in Rosida (2014), stated that the obstacle factor affecting the slow development of Islamic bonds is the economic condition in the country itself. The economic situation in a country has changed the ups-and-downs of Islamic bonds demand. However, according to the study conducted by Amir (2007), the external factors affecting the price of Islamic bonds can be caused by the price of other bonds in the bond market and macro condition, indicated by interest rate of deposits, exchange rate of rupiahs against USD, and others (a case study conducted by PT. Bank Bukopin Tbk in 2003). Hence, in this study, the researcher analyzes several macro-economic factors that may affect the price of Islamic bonds within particular corporations during 2010 until 2015, both in the short-term and long-term period. If investigated further, the development of macroeconomics in Indonesia during 2010-2015 experienced a significant fluctuation, as has been shown by the data below:

**Table 1.2.: Growth of Macroeconomics in Indonesia during 2010 until August 2015**

|  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- |
| **Year** | **2010** | **2011** | **2012** | **2013** | **2014** | **2015** |
| Interest Rate on Deposit | 6.23 | 6.70 | 5.61 | 5.63 | 8.21 | 8 |
| Deposit of *Mudharabah* | 7,03 | 7,46 | 6,33 | 5,10 | 6.89 | 7.87 |
| Exchange Rate | 9078.25 | 8769.5 | 9418.58 | 10089.52 | 10571.14 | 10113.52 |
| SBSN / State Shari’a Securities | 106.847 | 107.048 | 104.458 | 109.67 | 101.36 | 100.97 |
| IPI / Index of Industrial Production | 100 | 104.12 | 108.38 | 114.88 | 120.35 | 124.59 |

**Source: Bank Indonesia, FSA (OJK), and CBS (BPS), 2015**

In 2010, the interest rate of deposit was 6.23% and rose about 0.47% in 2011. During 2012-2013, it declined significantly, approximately 1.07%. Meanwhile, in 2014, it rose approximately 2.58% and was about 8% in 2015.

Since 2010 until August 2015, the deposit of *mudharabah* did not experience significant fluctuations, which was 7.03% in 2010 and rose about 0.43% in 2011. During 2012-2013, the deposit of *mudharabah* also significantly declined, about 2.36%. Meanwhile, since 2014 until August 2015, it rose about 0.98%.

During 2010-2015, the exchange rate of Rupiahs against USD experienced depreciation amounted to Rp 9078.25 and depreciated by 89.76%. On the contrary, the Index of Industrial Production has shown continuous appreciation from 100 to 124.59 in 2015.

# Review of Literature

Studying the relation of other investment instruments in the market can be used to analyze the macro-variables that affect the price of Islamic bonds. Several previous studies are focusing on Islamic bonds. Among others are conducted by Amir (2007), Wafa (2010), and Hastin, Idris & Aimon (2013).

In 2002, a case study on Islamic bond of PT. Indosat Tbk, with several subjects of study, had been conducted. This study analyzes impact of independent variables e.g. (1) interest rate of SBI, (2) exchange rate of Rupiahs against USD, (3) Composite Stock Price Index (IHSG), (4) Inflation, (5) corporate performance (Profits), (6) corporate liquidity, (7) Leg 1 of Islamic bonds towards Islamic bond. The study had shown that the factors affecting the price of Islamic bonds of PT. Indosat Tbk was the exchange rate (Rupiahs against USD) and Leg 1 (Syafirdi, 2006).

In 2013, a comparative study of conventional and Islamic bonds at PT. Bank Bukopin Tbk, with subjects of study including (1) interest rate of SBI, (2) Composite Stock Price Index (IHSG), (3) exchange rate, (4) Return on Assets (ROA), (5) and Leg 1 of bond price against conventional and Islamic bonds, had been conducted. The study had shown that the exchange rate of Rupiahs against USD became the most affecting factor, whether in the conventional or Islamic institution (Amir, 2007).

In a further study using VAR Regression method, with subjects of study including (1) retail state shari'a bonds, (2) price of ORI003 retail bond, (3) percentage rate of profit sharing deposit, and (5) interest rate against retail bonds -1 request, had concluded that, partially, all of the subjects analyzed in the study had significantly affected the demand for retail state shari'a securities (SBSN) during March 2009-June 2010 (Wafa, 2010). There was also a similar study which shared two similarities. First, some variables including the interest rate of SBI, budget deficit, government foreign loan, and bond demand had affected state securities. Second, some variables including interest rate of SBI, composite stock price index (IHSG), and state securities offer had transformed the state securities, using the quarter data since 2004 until 2011 (Hastin et al., 2013).

Some international studies also denote several financing factors which may affect the use of Islamic bonds in the corporation. Credit rate and maturity are two of several factors that determine the use of Islamic bonds in the global enterprise (Ayturk, Asutay & Aksak, 2017). Adequate market access also becomes one of the reasons why companies issue Islamic bonds (Nagano, 2016). Malaysia, UAE, and Saudi Arabia are the first three markets for Islamic bonds (Naifar, Hammoudeh, & Al-dohaiman, 2016). One of the reasons why Islamic bonds are issued is to fix the debt ratio (Mohamed, Masih, & Bacha, 2015).

In line with the review of literature above, this study proposes several hypotheses, in which:

1. It is presumed that interest rate of deposits is positively affected the price of corporate Islamic bonds in Indonesia.
2. It is presumed that deposit of *mudharabah* is negatively affected the price of corporate Islamic bonds in Indonesia.
3. It is presumed that State Shari’a Securities (SBSN) is negatively affected the price of corporate Islamic bond in Indonesia.
4. It is presumed that the exchange rate of Rupiah against USD is negatively affected the price of corporate Islamic bond in Indonesia.
5. It is presumed that Index of Industrial Production is positively affected the price of corporate Islamic bond in Indonesia.
6. It is presumed that interest rate of deposit, the deposit of *mudharabah*, State Shari’a Securities, exchange rate (Rupiah against USD), and Index of Industrial Production have together affected the price of corporate Islamic bond in Indonesia.

# Methods of Study

Method applied in this study is the quantitative method. In analyzing the factors affecting the price of corporate Islamic bond in Indonesia during January 2010 until July 2015, *Error Correction Model* (ECM) approach is applied (Koop, 2013).

Samples of study are three outstanding corporations in January 2010 until July 2015. The corporations taken as the sample are those which have the biggest outstanding share, in which PT. Perusahaan Listrik Negara (Persero) with the Islamic bond series No. SIKPPLN01, PT. Indosat Tbk with the *ijarah* bond series No. SIKISAT04B, and PT. Bank Syariah Muamalat Indonesia with the *mudharabah* bond series No. SMKBBMI01.

Data is gathered from secondary data, in which monthly report published by Indonesia Stock Exchange (BEI), Bank Indonesia (BI), Central Bureau of Statistics (BPS), and Indonesian Capital Market electronic-Library during the mentioned period.

Based on the ECM analysis method, the variables in this study are called as endogenous variables, operationally defined as:

1. Price of Islamic Bond

It is an elaboration of the transaction in real sectors. The rise-and-decline of price is a clear picture of corporate performance and activity.

1. Interest Rate on Deposit

In this study, the interest rate of deposit used is the average interest rate in general bank within one month, taken from Bank Indonesia.

1. Deposit of *Mudharabah*

The deposit used in this study is the percentage of profit sharing of *mudharabah* in shari'a commercial bank within one month, taken from Bank Indonesia.

1. Price of State Shari’a Securities (SBSN)

Price of State Shari’a Securities used in this study is the closing price of State Shari’a Securities with the series No. IFR0003.

1. Exchange Rate of Rupiah against USD

The data used in this study is the mean rate which is resulted from selling and buying rates issued by Bank Indonesia.

1. Index of Industrial Production (IPI)

The data of IPI used in the study is gathered from large and medium industries in Indonesia.

The ECM analysis method applied in this study (Koop, 2006) has several procedures, in which:

1. Data Normality Test
2. Unit Root Test
3. Co-integration Test
4. *Error Correction Model*

The equation of ECM is as seen below:

DPt = β0 + β1DIRt + β2DBGt + β3DSBSNt +β4DKURSt *+* β5DIPIt+β6DPt-1 + β7DIRt-1 + β8DBGt-1 + β9DSBISt-1 + β10DSBSNt-1 +β11DKURSt-1 *+* β12DIPIt-1 + Yµt-1 + et

-1 < γ < 0 (3.1)

***Detail:***

D = First Difference

P = Price of Islamic Bond year-t

IR = Interest Rate of Deposit year-t

BG = Deposit of *Mudharabah* profit sharing year-t

SBSN = Price of State Shari’a Securities (SBSN) IFR003 year-t

KURS = Rupiah Exchange Rate against USD year-t

IPI = Index of Industrial Production year-t

Y = *Error Correction Term*

µt = Pt - β0 - β1 IRt - β2BGt – β3SBSNt –β4KURSt *–* β5IPIt (3.2)

et = *error-disturbance* year-t

By substituting the equation (3.3), resulting in coefficient **u**, the equation (3.3) can be changed into:

DPt = β0‘+β1DIRt + β2DBGt + *β*3DSBSNt +β4DKURSt *+* β5DIPIt *–*β6Pt-1- β7IRt-1 – β8BGt-1 – β9SBISt-1 - β10SBSNt-1 –β11KURSt-1 *–* β12IPIt-1 +et (3.3)

To find out a valid model, *Error Correction Term* (ECT) coefficient is tested. If the test result is significant, the ECM is considered valid.

# Result of Study

The corporations taken as the sample are those which hold the biggest Islamic bond outstanding share in Indonesia from 2010 until 2015. The series chosen for the study are those which are issued from January 2010 until July 2015.

The normality test using JB statistic test applied to PT. PLN, PT. Indosat Tbk, and PT. Bank Muamalat shows that the statistic value is as much as 3.7, 5.20, and 0.17, with probability value as much as 0.15, 0.07, and 0.91. This result shows that JB statistic value and probability value are quite high. Therefore, it is concluded that the residue distributed by each variable is considered normal.

Stationary test in this study, using *unit root*, shows that all variables studied, including price of Islamic bond within each corporation, interest rate, profit sharing, price of Shari’a State Securities (SBSN), exchange rate, and Index of Industrial Production are stationary in the real level of 5%, where the probability value of integration 1 is less than the real level, and ADF difference value of all variable is higher than 5% of McKinnon critical value.

From the data analysis, the residue is obtained and later used in the co-integration test by doing the stationary test. The co-integration test on the residue (ECT) will apply Augmented Dickey-Fuller (ADF) model. It compares ADF statistics with its critical value with its significant 1 level of 1%. If the ADF statistic value is higher than the critical value, it indicates the existence of co-integration between variables.

The ECT stationary test on the three corporations which issue Islamic bond shows that residue's stationary value in zero order is obtained from the ADF absolute count value that is higher than the critical value of α=1%. When the primary purpose of the co-integration test is obtained, the next step is to do ECM regression analysis.

If co-integration exists, ECM estimation is then followed. The ECT model is a method to find the continuous model whether in the short-term or long-term period. Here is the ECM estimation result of PT. PLN (Persero), PT. Indosat Tbk, and PT. Bank Muamalat Indonesia:

1. As for PT. PLN (Persero), the ECT results in an equation model which is used to meet the validity of dynamic ECM. It can be applied to estimate the influence of independent variables on the dependent variables, whether in the short-term or long-term period, valued as much as -0.779552.

Based on the ECM result, it is concluded that, by analyzing the probability value, price of State Shari’a Securities (SBSN), Index of Industrial Production, price of Islamic bond No. SIKPPLN01 in the previous month, and price of SBSN in the previous month have affected the price of Islamic bonds No. SIKPPLN01 with real value of 5% and probability value of 0.0105, 0.0457, 0.0136, and 0.0306.

Meanwhile, the probability value of f-statistic of PT. PLN (Persero) is as much as 0.000105 showing that, simultaneously, the independent variables significantly affect the price of Islamic bond of PT. PLN (Persero), with signification level of 5%. The value of R2 reaches 56.74%, meaning that 56.74% of the price can be explained by its variables (interest rate, the deposit of *mudharabah*, the price of SBSN, exchange rate, and Index of Industrial Production) used in the model. Whereas the rest is explained by other variables that are not analyzed in the ECM.

1. As for PT. Indosat Tbk, the ECT results in an equation used to meet the validity of dynamic ECM, so it can be applied to estimate the influence of independent variables on the dependent variables, whether in the short-term or long-term period, valued as much as -0.779552.

From the result of ECM, it is concluded that, by analyzing the probability value of PT. Indosat Tbk, the profit sharing deposit affects the price of Islamic bond, with the real value of 5% and the probability value of 0.0303. The probability value of f-statistic is as much as 0.043963, showing that, simultaneously, the independent variables significantly affect the price of Islamic bond of PT. Indosat Tbk, with signification value of 5%. The value of R2 reaches 35.07%, meaning that 35.07% of the price can be explained by its variables (interest rate, the deposit of *mudharabah*, the price of SBSN, exchange rate, and Index of Industrial Production), whereas the rest is explained by other variables that are not used in the ECM.

1. As for PT. Bank Mualamat, the ECT results in an equation that is used to meet the validity of dynamic ECM. Thus it can be used to estimate the influence of independent variables on the dependent variables, both in the short-term and long-term period, with the value of -0.728352. Meanwhile, its independent variables (profit sharing deposit, the price of SBSN, the price of previous Islamic bond, and interest rate of prior deposit) affect the price of Islamic bond of PT. Bank Muamalat, with the real value of 5% and 10%.

From the result of ECM, it is concluded that, by analyzing the probability value of PT. Bank Muamalat Indonesia, the profit sharing deposit and price of previous Islamic bond of PT. Bank Muamalat affect the price of Islamic bond, with the alpha value of 0.05 or 5% and the probability value of 0.0494 and 0.0251. On the other hand, the price of SBSN and interest rate of deposit affect the price of Islamic bond with the alpha value of 0.10 or 10% and the probability value of 0.07 and 0.08.

The probability value of f-statistic of the price is as much as 0.000000, showing that, simultaneously, the independent variables significantly affect the price of Islamic bond, with signification value of 5%. The value of R2 reaches 61.8%, meaning that 61.8% of the price can be explained by its variables (interest rate, deposit of *mudharabah*, price of SBSN, exchange rate, and Index of Industrial Production) used in this model. While the rest is explained by other variables that are not used in the ECM.

# Discussion

From the result of ECM, the influence of each independent variable on the dependent variables by analyzing the value of t-coefficient can be figured out. The interpretation is as seen below:

## PT. Perusahaan Listrik Negara (Persero)

1. If a one-percent change in the index of SBSN does occur, then it will affect the demand for the Islamic bond as much as 530.128 sheets.
2. If a one-percent change in the Index of Industrial Production does occur, then it will affect the offer of Islamic bond as much as 165.110 sheets.
3. If a one-percent change in the price of previous Islamic bond does occur, then it will affect the demand for Islamic bond as much as 292.532 sheets.
4. If a one-percent change in the index of previous SBSN does occur, then it will affect the demand for Islamic bond as much as 450.727 sheets.
5. In the long-term period, if SBSN depreciated to Rp/USD 1, the price of Islamic bond will experience appreciation as much as 559.999 billion (*ceteris paribus*). The rise itself means that, in the Islamic bond market, there is a long-term balance, in which excess demand. To rebalance, the price of Islamic bond should be declined to 559.999 billion (*ceteris paribus*).
6. In the long-term period, if Index of Industrial Production is declined as much as one percent, the price of Islamic bond will also decline, as much as 228.277 billion. This means that, in the Islamic bond market, there is a long-term balance which excess offer. To rebalance the offer, the price of Islamic bond should be raised as much as 228.277 billion (*ceteris paribus*).

## PT. Indosat, Tbk.

1. If a one-percent change in profit sharing deposit does occur, then it will affect the demand for Islamic bond as much as 530.128 sheets.
2. In the long-term period, if interest rate depreciated as much as Rp/USD 1, the price of Islamic bond will experience appreciation as much as 214.977 billion (*ceteris paribus*). This rise means that, in the Islamic bond market, there is a long-term balance in which excess demand. To rebalance demand, the price of Islamic bond should be declined as much as 214.977 billion (*ceteris paribus*).
3. In the long-term period, if profit was sharing deposit depreciated as much as Rp/USD 1, the price of Islamic bond will experience appreciation as much as 236.425 billion (*ceteris paribus*). The rise shows a long-term balance in which excess demand. To rebalance, the price should be declined as much as 236.425 billion (*ceteris paribus*).
4. In the long-term period, if Rupiah exchange rate against USD depreciated as much as Rp/USD 1, the price of Islamic bond experience appreciation as much as 3.337 billion (*ceteris paribus*). The rise means that, in the Islamic bond market, a long-term balance does occur, in which excess demand. To rebalance, the price should be declined as much as 3.337 billion (*ceteris paribus*).
5. In the long-term period, if the Index of Industrial Production depreciated Rp/USD 1, the price of Islamic bond will experience appreciation as much as 211.922 billion. This means that, in the Islamic bond market, a long-term balance does exist, in which excess offer. To rebalance, the price should be raised as much as 211.922 billion (*ceteris paribus*).

## PT. Bank Muamalat Indonesia, Tbk.

1. If a one-percent change in profit sharing deposit does occur, it will affect the demand for Islamic bond, as much as 707.085 sheets.
2. If a one-percent change in the price of SBSN does occur, it will affect the demand for Islamic bond as much as 1.039 sheets.
3. If a one-percent change in the price of previous Islamic bond does occur, it will affect the demand for Islamic bond as much as 282.111 sheets.
4. If a one-percent change in the interest rate of previous deposit does occur, then it will affect the demand for Islamic bond as much as 284.388 sheets.
5. In the long-term period, if profit was sharing deposit depreciated as much as Rp/USD 1, the price of Islamic bond will experience appreciation as much as 555.640 billion (*ceteris paribus*). The rise means that, in the Islamic bond market, a long-term balance, in which excess demand, does happen. To rebalance, the price of Islamic bond should be declined as much as 555.640 billion (*ceteris paribus*).
6. In the long-term period, if the price of SBSN depreciated as much as Rp/USD 1, the price of Islamic bond will experience appreciation as much as 1.075 billion (*ceteris paribus*). The rise means that, in the Islamic bond market, a long-term balance, in which excess demand, does happen. So, to rebalance, the price of Islamic bond should be declined as much as 1.075 billion (*ceteris paribus*).

# Conclusion

This study applies *the Error Correction Model* method and analyzes five independent variables, in which: 1) interest rate of deposit, 2) deposit of *mudharabah*, 3) state shari’a securities (SBSN), 4) Rupiah exchange rate against USD, and 5) Index of Industrial Production. The corporations taken as the sample in this study are those which have the highest outstanding share, in which PT. PLN (Persero), PT. Indosat, Tbk, and PT. Bank Muamalat Indonesia, Tbk.

According to the data analysis, the researcher formulates several conclusions. For PT. PLN (Persero), the variables that affect the short-term price of Islamic bond are (1) state shari’a securities (SBSN), (2) Index of Industrial Production, (3) previous state shari’a securities (SBSN), and (4) the price of Islamic bond in the previous month. Meanwhile, in long-term price, the variables that affect the price of Islamic bond are (1) state shari’a securities (SBSN) and (2) Index of Industrial Production.

For PT. Indosat, Tbk, variable that affects the short-term price of Islamic bond is the profit sharing deposit, whereas, in long-term period, variables that affect the price are: (1) interest rate of deposit, (2) profit sharing deposit, and (3) Index of Industrial Production. For PT. Bank Muamalat Indonesia, Tbk, variables that affect the short-term price of Islamic bond are: (1) profit sharing deposit, (2) shari’a state securities (SBSN), (3) price of previous Islamic bond, and (4) interest rate of previous deposit, whereas in long-term period, variables that affect the price of Islamic bond are: (1) profit sharing deposit and (2) shari’a state securities (SBSN).

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