TRANSMISSION MECHANISM OF SHARIA FINANCING IN MALAYSIA

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ABSTRACT

A country that adopts dual banking system provides options to their customers to choose their modes of financing. When interest rate increases, sharia financing instrument might become an option to the conventional method. Sharia financing to the real sector could create equilibrium condition between monetary and real sector. This study aims to show the transmission sharia channel (sharia financing) with vector error correction model (VECM) approach. The result of impulse response function shows that sharia financing reduces negative effect of interest rate to inflation after sixth months. However sharia financing is unable to substitute conventional credit, when interest rate increases.

Keywords: Transmission Mechanism, Sharia Financing, VECM