

# **Are Deposit and Investment Accounts in Islamic Banks in Malaysia Interest-Free?**

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**Abstract.** Islamic banking and Finance (IBF) provides products and services guided by the Shari'ah. Therefore, they are supposed to be different from their conventional counterparts. Islamic deposit rates should be different from conventional deposit rates. Islamic banking profit rates are supposedly less risky due to risk-sharing attribute embedded in their structure as compared to the Conventional banking interest rates on similar-risk investment products. This paper addresses this concern by examining the differences in the monthly fixed deposit rates of conventional and investment deposit rates of Islamic banks and finance companies in Malaysia for the period from January 1994 to December 2012 and determines the causality relationship between profit rates and interest rates on these investments. The findings suggest that profit rates of Islamic banks are significantly linked with interest rates of conventional banks. The findings also indicate that profit rates of Islamic banks and finance companies are affected by the movements of interest rates of conventional banks and finance companies respectively and not vice versa. The findings imply that there is a gap between Islamic banking theory and practice. Lack of infrastructure for full compliance and lack of stringent enforcement of regulatory requirements are possible reasons for such behavior of Islamic financial institutions in Malaysia.

**Key Words:** Islamic finance, Conventional rates of return compared to Islamic profit rates, Islamic finance companies, Shari'ah-compliance of Islamic banks and finance companies.

**KAUJIE Classification:** L0, L25

## **1. Introduction**

The perception that there is no real difference between Islamic Banking (IB) and Conventional Banking (CB) in terms of their intermediation functions remains an intriguing empirical issue<sup>(1)</sup>. The advocates of

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(1) Islamic Banking and Finance (IBF), established for more than four decades, provides products and services guided by the Shari'ah, and is, therefore different from its conventional counterparts. IBF has recorded double digit growth almost every year and is catching-up fast with the conventional banking sector. Ernst & Young World Islamic Banking Competitiveness Report 2013, notes that global Islamic banking assets held by commercial banks stand at US\$1.8 trillion, up from the US\$1.55 trillion in 2012.

Islamic banking are convinced on its advantages and contributions to the welfare gains to the whole society compared to conventional banking (Ahmed, 1993; Zaman and Zaman, 2002; Ayub, 2007; Sugema, Bakhtiar and Effendi, 2010). They claim that Islamic banking is better in terms of efficiency and stability and can better serve justice to all its stakeholders. This is based on the premise that unlike conventional banking, Islamic banking operates based on principles of justice and fairness and not just on maximizing profits. However, the skeptics claim that in reality, Islamic banks are no different from conventional banks as most of the products are very similar to conventional banking products and they operate with interest in a disguised form (Rosly, 1999; Zaman and Movassaghi, 2002; Kuran, 2005; Khan, 2010; Ariff and Rosly, 2011). Moreover, Bacha (2008) explains that the replication of conventional banking products and services strategy used by Islamic banks when they were first introduced in Malaysia in the early 1980s is still prevalent. This is a critical and important issue as Islamic banks are supposed to perform their intermediation function based on Shari'ah-based principles<sup>(2)</sup>. In practice, if the skeptics are right and IBs are operating as conventional banks, this divergence from theory will adversely affect the reputation of IBs and could negatively impact Islamic banking sector in the long run.

Following Chong and Liu's (2009) evidence on the lack of significant difference in the profit and interest rates of deposit and investment accounts in IBs and CBs, this paper revisits the issue using larger sample and more advanced analysis techniques to validate the documented evidence and in addition determines the causality

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(2) Profit-and-loss sharing (PLS) is the central tenet in Islamic banking system. Dar and Presley (2000) explains that PLS is broadly defined as a contractual agreement between two or more transacting parties, which allows them to pool their resources to invest in project to share in profit and loss. Based on PLS concept, the assets and liabilities of an Islamic bank should be integrated in a way, which ensures that depositors and borrowers share profits and losses with the bank (Cevik and Charap, 2011). Although PLS contracts are the desired alternative for Islamic banking system, other non-PLS contracts are also allowed. These contracts are sometimes referred as "trade-based financing modes" (Khan, 2010). Such financing contracts, for example, may be based on *murābahah* ('mark-up' or cost-plus sale), *ijārah* (lease), *bay' salam* (forward sale), *istiṣnā'* (manufacturing contract), *bay' mu'ajjal* (deferred payment sale), *ju'alah* (service fee) and *qard ḥasan* (benevolent loan).

relationship between profit rates and interest rates<sup>(3)</sup>. The profits and interest earned by IBs and CBs respectively on deposit and investment accounts in both IBs and CBs in Malaysia were collected for analysis<sup>(4)</sup>. This was facilitated by the fact that Malaysia operates a dual banking system, where Islamic banks run parallel with their conventional counterparts.

The monthly fixed deposit rates of conventional and investment deposit rates of Islamic banks were sourced from Bank Negara's monthly statistical bulletin for the period from January 1994 to December 2012. However, data for finance companies were only available till December 2005<sup>(5)</sup>. The Vector Autoregressive method is used to identify the casual relations and dynamic interactions between variables. Our findings confirm that profit rates of Islamic banks are significantly linked with interest rates of conventional banks in the short and long-run. The results were also fairly consistent with finance companies, as profit rate of Islamic finance companies is pegged with interest rate of conventional finance companies. However, the impact of interest rate is less severe for Islamic finance companies.

The findings also indicated that profit rates of Islamic banks are affected by the movements of interest rates of conventional banks and not vice versa. Similar findings were observed for Islamic finance companies,

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(3) Theoretically, Islamic deposit rates should be different from conventional deposit rates as both are based on different principles; that is the IB products are supposedly be less risky due to risk sharing attribute embedded in their structure (and therefore, more stable in uncertain times) compared to the CB products.

(4) Deposits are divided into two types: investment deposit and savings deposit. Savings deposit for the Islamic banks and finance companies is based on *al-wadī'ah* contract which is solely for savings purpose and is not allowed for investment purpose. Returns are only offered on the investment deposit, whereas IBs may offer discretionary gifts (*hibah*) on their savings deposit. On the other hand, *muḍārabah* contract which is equity-like and profit sharing contract divides profit among contracting parties according to a pre-agreed ratio. In the event of loss, the capital provider (*rabb-al māl*) bears all financial losses, while the entrepreneur losses only his effort unless it is obvious that the entrepreneur's loss was due to negligence, in which case he/she has to share the financial loss.

(5) Between 2006-2007, as part of the initiatives to strengthen the financial sector in Malaysia as aspired in the First Financial Sector Master plan, there were the merging of merchant banks, stockbroking companies, and discount houses into a single entity called investment banks. The whole exercise was completed by early 2007.

but the impact was less severe. These findings raise doubts on the Profit and Loss Sharing (PLS) paradigm of Islamic banks. The need to be competitive in performance as expected by shareholders and the lack of genuine 'Islamic' products and services could be the possible explanation for the findings, consistent with the documented evidence in Malaysia (Chong and Liu, 2009; Zainol and Kassim, 2010) and for the participation banks in Turkey Cevik and Charap (2011) and Ergec and Arslan (2013). This paper is organized as follows. Section 2 reviews the literature and motivation of the study. Section 3 explains the empirical framework and Section 4 discusses the findings. Section 5 concludes the paper.

## **2. Literature and Motivation**

### *2.1 Literature Review*

Islamic banking system based on the risk-sharing paradigm is a viable alternative to conventional banking especially in times of severe financial stress like the recent global crisis. However, much skepticism remains about the practicality of the Islamic banking model in real markets where the infrastructure is predominantly set-up for conventional banking system. The business model of Islamic banks apparently is a direct replication of conventional banks with Shari'ah-compliant contracts. In fact, Zaman and Movassaghi (2002) argues that the use of 'Islamic' financial instruments that resemble interest-based instruments is a deception and there is a need for some form of gate-keeping to validate the authenticity of the products, services and processes of Islamic banks operations in practice.

Kuran (2005) claims that almost all banking services in most heavily Muslim contemporary communities are interest-based. He argues that even though interest is prohibited there is no real mechanism to punish offenders, and the ban on interest has raised the cost of credit and blocked financial modernization. He concludes that no Muslim polity has had a genuinely interest-free economy. El-Gamal (2006) claims that Islamic financial institutions disguise interest bearing loans by substituting them with a mark-up sale or lease financing on the asset side and using Islamic securitization on the liability side. Khan (2010) corroborates that there remain substantial divergences between IBF's ideals and its practices, and Islamic banks functions are indistinguishable from conventional banking. The advocates of Islamic banking however

suggest that the similarity of some Islamic banking products with conventional products is just a transition phase that IB products and services will gradually achieve full compliance in the near future. Ahmed (1993) suggests that Islamic banks are offering ‘conventional like products’ like *murābahah* (or cost-plus financing) due to the familiarity of Islamic banks with these products since most of the management of Islamic banks currently are sourced from the conventional banking sector. Muhammad Ayub (2007) explains that the claim ‘Islamic finance should operate on return-free basis and conduct business only with *mushārahah/muḍārahah* contracts is a misconception. All contracts, whether debt or equity based are permissible provided the required Sharī‘ah requirements are met.

Sugema, Bakhtiar and Effendi (2010) explain that only Profit and Loss Sharing system (PLS) framework of production technology can provide a buffer against uncertainty due to adverse economic impact. This is because PLS system distributes evenly the risk at individual level amongst lenders and borrowers. While under the production certainty and competitive market both PLS and interest-based systems are efficient and just. They also have proposed a theoretical model that will improve the performance of a PLS system from capital owners’ perspective by introducing a so-called risk pooling bank, where a bank absorbs all the risk encountered by the capital owners. This maintains their income distribution and reduces the risk for borrowers.

To ascertain the independency of Islamic banking in a dual-banking system, the common evidence is on the effect of interest rate movement on Islamic banks’ rate of return, its total deposit level and financing rate (Kassim, Majid and Yussof, 2009; Kader and Leong, 2009; Chong and Liu, 2009; Zainol and Kassim, 2010) for Malaysia and Cevik and Charap (2011) and Ergec and Arslan (2013) for Turkey. Overall findings provide consensus that Islamic banks are affected by interest rate risk due to the close correlation between Islamic return rates and conventional bank interest rates. Khan and Ahmed (2001) surveyed 17 Islamic financial institutions in 10 different countries and concluded that rate of return risk is considered as the most critical risk facing IFIs because bankers feel that returns on investment deposit should be similar to the returns offered by conventional banks on their investment deposits. These bankers argue that the customers will blame them for the lower

returns, thus invoking withdrawal risk. Their survey also indicated that Islamic banks and their customers perceived profit-sharing financing modes and deferred-sale products (*salam* and *istiṣnāʿ*) to be riskier.

Metwally (1997) observed the structural differences between Islamic banks and conventional banks using logit, probit and discriminant analysis with data covering 15 Islamic bank and 15 conventional banks from various parts of the world. The findings showed that Islamic banks are over-dependence with *murābahah* financing (mark-up and fixed rate), which have similar attributes as conventional financing. This explains the similar returns, as conventional deposits, given to depositors of Islamic banks.

Solarin, Wan Sulaiman and Jauhari (2011) investigated the impact of conventional bank interest on the volume of financing of Islamic banks in Malaysia for the period 2006 to 2011. The findings suggest that it is a long-run relationship; validating the fact that interest rates significantly influence Islamic bank financing and there is a dire need for Islamic banks to initiate more profit and loss based activities as to eliminate or at least mitigate the influence of conventional banks' interest rates on their financing activities. Anouar Hassoune (2012) examines the profit smoothing activities of PLS-based Islamic banks. Since conventional banks rely on debt and deposits with fixed interest rates, Islamic banks rely on funding based on equity and therefore returns on equity, it is proposed that the return on equity is less volatile and more profitable than the interest rates of conventional banks in an interest rate cycle. The Islamic banks are able to smoothen their return on assets by absorbing shocks, which unlike conventional banks, is a kind of buffer to the banking industry's systemic risk.

## 2.2 Motivation

To further substantiate the literature on the relationship between profit rates offered by Islamic banks and the interest rates offered by conventional banks on similar investments, this paper documents the evidence on the correlation between profit rates and interest rates of similarly risky investments in all the 17 Islamic banks in Malaysia and their conventional counterparts respectively. In theory, these rates should not correlate as Islamic banks operate on the on profit-and-loss sharing paradigm. However, if Islamic banks operate their business in a similar

manner as the conventional banks except for disguised ‘Islamic’ procedures and labels to fit the Sharī‘ah-compliance requirement, then we can expect high correlation between profit rates and the interest rates on similar investments. Islamic banks that diverge from Islamic banking tenets will consequently be subject to reputational and withdrawal risk that will have negative implications on the Islamic banking sector in the long run. If the uniqueness is lost, the banking system will converge towards conventional or just another version of conventional banking industry.

The main issue of interest is whether the Islamic banks’ investment and deposit accounts in Malaysia are really interest-free in the sense that the money deposited is invested based on the Sharī‘ah precepts and the profits are shared according to an agreed ratio and/or the profit rates on the investment are not correlated with the interest rates of similar accounts in conventional banks. If the evidence suggests a close relationship between interest rates and profit rates, then we infer that profit rates on investment and saving rates in Islamic banks are not really interest-free. The second issue of concern is due to competitive pressure to perform by depositors, it is possible that Islamic banks benchmark their profit rates to the interest rates of similar accounts in the conventional banks.

### **3. Empirical Framework**

#### *3.1 Methodology*

The analysis is conducted using the vector auto regression (VAR) model to identify the causal relations and dynamic interactions between the profit rates and interest rates in conventional banks. VAR treats all variables in the system as potentially endogenous and allows for very general patterns of interactions among them. VAR also captures the regularity of data with limited theoretical restrictions. Moreover, the forecast obtained from VAR models are in most cases better than those obtained from more complex simultaneous equation models (Asteriou and Hall, 2007). We believe VAR is well suited to address the nature of our research question and to capture the relationship of profit rates and interest rates where both are potentially endogenous in short and long run. We also employ the DCC-MGARCH model to estimate unconditional correlation coefficient and conditional volatility to strengthen our findings further.

The tests were conducted using a bivariate model<sup>(6)</sup> for each maturity-matched pair (i.e., Islamic banks' investment deposit rate for 1 month with conventional banks' fixed deposit rate for 1 month; Islamic finance companies' investment deposit rate for 1 month with conventional fixed deposit rate for 1 month and so on). After examining the standard unit root tests and the order of the VAR, the Johansen cointegration tests were conducted to examine the long run theoretical or equilibrium relationship and to rule out spurious relationship among the variables<sup>(7)</sup>. The vector error-correction model (VECM) was applied to indicate the direction of Granger-causality both in the short and long run and the variance decomposition (VDC) technique or out-of-sample causality test was applied to indicate the relative exogeneity/endogeneity of a variable by decomposing (or partitioning) the variance of the forecast error of a variable into proportions attributable to shocks (or innovations) in each variable in the system including its own (Masih and Masih, 2001).

The impulse response function (IRF) was used to indicate the graphical exposure relative exogeneity or endogeneity of a variable. The persistence profiles (PP) are applied to estimate the speed with which the variables get back to equilibrium when there is a system-wide shock (unlike the IRF which traces out the effects of a variable-specific shock on the long run relationship). The Granger causality test on both Islamic and conventional banks and finance companies was used to ascertain whether Islamic deposit rates movement affect conventional deposit rate and vice versa.

### *3.2 Data*

Conventional banks fixed deposit rates are the average fixed deposit rates for each type of financial institution for maturities of 1-, 3-, 6-, 9- and 12-months<sup>(8)</sup>. Savings deposit rate are the average savings deposit rates for

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(6) Chong and Liu (2009) have used similar bivariate model in their paper. However, our study has taken the research farther by applying more advance econometric methods.

(7) We also conducted additional test by applying Clemente-Montanes-Reyes unit-root test with both single and double mean shift (structural break) but found similar results. We do not report results of these tests to conserve space. However, these are available upon request from the authors.

(8) Rate for maturities below 1-month is not available. Rates for fixed deposits with maturities exceeding 12-months are negotiable and therefore not included.



each type of financial institution weighted to account for the different rates that apply in the case of multi-tiered savings accounts in addition to the traditional single-rate savings accounts<sup>(9)</sup>. Two dummy variables were used in the VAR models; D1 and D2 to account for the Asian and subprime crisis during the analysis period<sup>(10)</sup>. All the variables are expressed and computed in real terms as they are originally in percentage form.

Descriptive statistics for deposit rates for both Islamic and conventional banks summarized in Table 1 indicate that on average, Islamic investment deposit rates and savings deposit rates are lower than the conventional deposit rates for both the banks and finance companies but Islamic finance companies' deposit rates are quite close to the rates of their conventional counterpart. Moreover, for both the banks and finance companies, the volatility and minimum-maximum range of Islamic investment deposit rates are significantly lower than those of conventional deposit rates. However, the Islamic banks' deposit rate is slightly lower than their conventional counterpart. These results are not consistent with expectations. In theory, Islamic investment deposit should be based on the PLS methods, where returns are obtained through *muḍārabah* or *mushārah* contracts. As these contracts are based on the investment performance, they should be more volatile than conventional banks' deposit rates that are fixed in nature. The correlation coefficient for the rates in both banks and finance companies are relatively high (0.90) and similarly the correlation coefficient for both banks' and finance companies' saving deposit rate is at 0.975 and 0.946 respectively. This close movement of interest and profit rates in both Islamic and conventional banks seems to infer that one rate is benchmarked with the other, and the profit rate is not based on the PLS paradigm<sup>(11)</sup>.

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(9) Referred from BNM website glossary.

(10) D1 represents the Asian financial crisis and D2 represents the subprime crisis.

(11) Our DCC M-GARCH analysis further strengthens our results. We find both rates are positively correlated and the interest rates have higher conditional volatility than profit rates. We also find that the higher volatility for interest rates is mainly due to Asian financial crisis from 1997-1999. We do not report the results of DCC MGARCH analysis to conserve space but they are available upon request.

**Table 1: Descriptive statistics on the average investment and saving deposit rates of Islamic and Conventional Banks and Finance companies for the period 2001 – 2012.**

Variable	Rate of Islamic Bank's Investment Deposits						Rate of Isl. Finance Companies' Investment Deposits					
	ICB_1	ICB_3	ICB_6	ICB_9	ICB_12	IBSD	IFC_1	IFC_3	IFC_6	IFC_9	IFC_12	IFSD
Min	1.6000	2.1600	0.4800	2.3800	2.3000	0.8800	2.6300	2.7300	2.9400	3.1100	3.3700	2.1900
Max	7.5500	7.7800	8.2400	8.4300	8.5900	5.1100	7.9400	8.1000	7.7700	8.2500	8.2800	5.8100
Median	2.9760	3.0878	3.2150	3.3700	3.6300	2.0200	3.6350	3.6950	3.9600	4.2450	4.4450	3.2650
Mean	3.5080	3.6548	3.8140	3.9994	4.2173	2.2210	4.3756	4.4978	4.6843	4.8867	5.0881	3.5432
S.D.	1.3010	1.3631	1.4033	1.4178	1.4223	1.2000	1.4889	1.5415	1.4694	1.4875	1.4461	1.0385
C.V.	0.3709	0.3750	0.3679	0.3545	0.3372	0.5403	0.3403	0.3427	0.3137	0.3044	0.2842	0.2931
Skewness	1.5315	1.5188	1.4625	1.5272	1.4505	0.8020	0.8129	0.8419	0.7968	0.9581	0.8212	0.7135
Kurtosis	4.3023	4.2167	4.3608	4.3007	4.0199	2.5331	2.3031	2.3047	2.1905	2.5775	2.2357	2.1193
Obs	228	228	228	228	228	228	144	144	144	144	144	144

Variable	Deposit Rates of Conventional Banks						Deposit Rates of Conventional Finance Companies					
	CCB_1	CCB_3	CCB_6	CCB_9	CCB_12	CBSD	CFC_1	CFC_3	CFC_6	CFC_9	CFC_12	CFSD
Min	2.0000	2.0300	2.0400	2.0500	2.5000	0.8000	3.0000	3.0000	3.0000	3.0200	3.6600	1.5200
Max	10.1400	10.2700	10.2800	10.2400	10.2800	4.5400	10.9300	10.9700	10.8800	10.8200	10.8800	5.9900
Median	3.1250	3.2000	3.2800	3.3700	3.7700	1.9200	3.4688	3.5250	3.6200	3.8500	4.2350	3.3200
Mean	4.0159	4.0657	4.1294	4.1918	4.5249	2.2462	4.5610	4.6388	4.7085	4.8177	5.1769	3.4748
S.D.	1.8795	1.9044	1.9106	1.9018	1.7674	1.1017	2.0353	2.0749	2.0770	2.0732	1.8561	1.1817
C.V.	0.4680	0.4684	0.4627	0.4537	0.3906	0.4905	0.4463	0.4473	0.4411	0.4303	0.3585	0.3401
Skewness	1.5335	1.5385	1.5097	1.4641	1.4734	0.5517	1.6738	1.5645	1.4736	1.4107	1.5791	0.1908
Kurtosis	4.3982	4.4516	4.3962	4.2912	4.5306	2.0377	5.3290	4.8835	4.5801	4.2580	4.9133	1.9718
Obs	228	228	228	228	228	228	144	144	144	144	144	144

Notes: \* - denotes the coefficient of correlation test for each pair-wise maturity matched deposit.  
 \*\* - denotes the number of observations used in each test. Refer to Table 6 for variable

### *3.3 Preliminary Analysis*

We establish the stochastic properties of the variables by carrying out the unit root tests on all the variables to test the stationarity (null hypothesis) or non-stationarity (alternative hypothesis), the Augmented Dickey Fuller (ADF) and Phillips-Peron (PP) procedures were applied and the findings indicate non-stationary in level form but stationary in first differences form. Therefore, it could be concluded that these variables are integrated of order 1, i.e.,  $I(1)$ .

The VAR order selection procedure was applied to select the optimal order or lag for the VAR on the basis of Akaike Information Criteria (AIC). Schwarz bayesian Criteria (SBC) shows that optimal order gave different results for both banks and finance companies and since we are analyzing a short time series and in the interest to mitigate the risk of over-parameterization, two was the order of choice for testing both the banks and finance companies.

The Johansen cointegration test applied to ascertain the long-run relationship between the rates and the findings (Table 2) show that all the Islamic investment deposit rates are cointegrated with their maturity-matched conventional fixed deposit rates at 5% significance level. These results are consistent with prior evidence (Chong and Liu, 2009; Haron and Azmi, 2005; Kader and Leong, 2009; Ergec and Arslan, 2013) that the relationship between Islamic investment deposit rates and conventional fixed rates is not spurious and have a long-run relationship. The evidence of cointegrated relationship implies that there are factors contributing towards this relationship such as competition, loss from arbitrage opportunities and influence of interest rates on similar investments. The cointegration implies the extent of competition in the long term and infer that the rates are interdependent and integrated as if they are from the same system of banking.

**Table 2: Correlation matrix on the average investment and saving deposit rates of Islamic and Conventional Banks and Finance companies for the period 2001 – 2012.**

Rate of Islamic Bank's Investment Deposits vs. Deposit Rates of Conventional Banks												
Variable	ICB_1	ICB_3	ICB_6	ICB_9	ICB_12	IBSD	CCB_1	CCB_3	CCB_6	CCB_9	CCB_12	CBSD
ICB_1	1	0.998	0.975	0.991	0.985	0.921	0.953	0.951	0.946	0.942	0.923	0.883
ICB_3	0.998	1	0.976	0.992	0.988	0.920	0.950	0.948	0.944	0.940	0.919	0.883
ICB_6	0.975	0.976	1	0.972	0.963	0.902	0.941	0.940	0.935	0.932	0.917	0.873
ICB_9	0.991	0.992	0.972	1	0.992	0.929	0.946	0.944	0.939	0.935	0.918	0.892
ICB_12	0.985	0.988	0.963	0.992	1	0.937	0.942	0.940	0.935	0.931	0.916	0.902
IBSD	0.921	0.920	0.902	0.929	0.937	1	0.904	0.899	0.893	0.894	0.902	0.975
CCB_1	0.953	0.950	0.941	0.946	0.942	0.904	1	1.000	0.998	0.995	0.990	0.895
CCB_3	0.951	0.948	0.940	0.944	0.940	0.899	1.000	1	0.999	0.997	0.991	0.892
CCB_6	0.946	0.944	0.935	0.939	0.935	0.893	0.998	0.999	1	0.999	0.992	0.889
CCB_9	0.942	0.940	0.932	0.935	0.931	0.894	0.995	0.997	0.999	1	0.993	0.894
CCB_12	0.923	0.919	0.917	0.918	0.916	0.902	0.990	0.991	0.992	0.993	1	0.903
CBSD	0.883	0.883	0.873	0.892	0.902	0.975	0.895	0.892	0.889	0.894	0.903	1

Rate of Isl. Finance Companies' Investment Deposits vs. Deposit Rates of Conventional Finance Companies												
Variable	IFC_1	IFC_3	IFC_6	IFC_9	IFC_12	IFCSD	CFC_1	CFC_3	CFC_6	CFC_9	CFC_12	CFCSD
IFC_1	1	0.985	0.983	0.974	0.972	0.933	0.923	0.930	0.935	0.937	0.927	0.910
IFC_3	0.985	1	0.996	0.985	0.984	0.951	0.923	0.933	0.937	0.941	0.928	0.924
IFC_6	0.983	0.996	1	0.986	0.984	0.947	0.912	0.922	0.928	0.931	0.916	0.921
IFC_9	0.974	0.985	0.986	1	0.975	0.934	0.900	0.911	0.914	0.930	0.907	0.907
IFC_12	0.972	0.984	0.984	0.975	1	0.928	0.897	0.906	0.909	0.913	0.903	0.900
IFCSD	0.933	0.951	0.947	0.934	0.928	1	0.894	0.903	0.908	0.911	0.895	0.938
CFC_1	0.923	0.923	0.912	0.900	0.897	0.894	1	0.998	0.997	0.990	0.994	0.864
CFC_3	0.930	0.933	0.922	0.911	0.906	0.903	0.998	1	0.999	0.994	0.996	0.876
CFC_6	0.935	0.937	0.928	0.914	0.909	0.908	0.997	0.999	1	0.995	0.996	0.885
CFC_9	0.937	0.941	0.931	0.930	0.913	0.911	0.990	0.994	0.995	1	0.992	0.894
CFC_12	0.927	0.928	0.916	0.907	0.903	0.895	0.994	0.996	0.996	0.992	1	0.870
CFCSD	0.910	0.924	0.921	0.907	0.900	0.938	0.864	0.876	0.885	0.894	0.870	1

#### **4. Findings**

The evidence of cointegration between the profit and interest rates of matching investments in both banking systems do not indicate the causality relationship, and the vector error-correction modeling technique was applied for this purpose. The information summarized in Table 3 infers that for each maturity-pair the conventional deposit rates are the exogenous variables. The coefficient error-correction term for the all the Islamic commercial banks (ICB) are negative and statistically significant at 5% including that of conventional commercial banks (CCB) for: 6-month, 9-month and 12-month maturity, inconsistent with expectations. While almost all the CCB variables are not statistically significant. The general implication is that conventional bank deposit rates are the exogenous and therefore does not depend on the changes in the profit rates of the Islamic banking system. This indicates that CCBs are the driver and the ICB profit rates respond to the changes in the interest rates on matching investments in the CCBs.

This also implies that the deviation of the rates (represented by the error-correction term) has a significant feedback effect on the ICB variables that bear the brunt of short-run adjustment to bring about the long-term equilibrium among the cointegrating rates. For example, the coefficient of the ICB\_1 ECT indicates that the speed of short-run adjustment would be occurring from the bottom up (-0.035). ICB\_3 exhibits slower adjustment speed as compared to ICB\_6 (fastest).

Similar to ICBs results, IFCs have a negative and significant coefficient of ECT at 5 % significant level. Contrary to our prediction, CFCs have only two exogenous variables (CFC\_9 and CFCSD), while the other variables are endogenous. It implies that competition for long-term deposits between Islamic and conventional finance companies is intense. For example, the IFC\_1 corrects itself from the bottom up with a coefficient for error-correction term of (-0.099). IFC\_6 exhibits the slowest adjustment speed as compared to the fastest that is IFCS. The findings also imply that the Islamic deposit rates of matching investments follow the changes in the conventional deposit rates for both banks and finance companies.

**Table 3: Vector error correction estimates (VECM).**

<b>Banks</b>						
Dependent Variable	ICB_1	ICB_3	ICB_6	ICB_9	ICB_12	IBSD
ECM(-1) Coef	-0.035	-0.030	-0.109	-0.041	-0.052	-0.064
ECM(-1) t-ratio p-value	0.021*	0.026*	0.002*	0.011*	0.01*	0.001*
Implication	ENDO	ENDO	ENDO	ENDO	ENDO	ENDO
Dependent Variable	CCB_1	CCB_3	CCB_6	CCB_9	CCB_12	CBSD
ECM(-1) Coef	-0.050	-0.048	-0.067	-0.066	-0.069	-0.023
ECM(-1) t-ratio p-value	0.071	0.067	0.009*	0.01*	0.006*	0.323
Implication	EXO	EXO	ENDO	ENDO	ENDO	EXO
<b>Finance Companies</b>						
Dependent Variable	IFC_1	IFC_3	IFC_6	IFC_9	IFC_12	IFCSD
ECM(-1) Coef	-0.099	-0.068	-0.061	-0.082	-0.090	-0.143
ECM(-1) t-ratio p-value	0.007*	0.005*	0.007*	0.006*	0.005*	0.001*
Implication	ENDO	ENDO	ENDO	ENDO	ENDO	ENDO
Dependent Variable	CFC_1	CFC_3	CFC_6	CFC_9	CFC_12	CFCSD
ECM(-1) Coef	-0.106	-0.101	-0.098	-0.092	-0.103	-0.044
ECM(-1) t-ratio p-value	0.026*	0.029*	0.035*	0.051	0.021*	0.082
Implication	ENDO	ENDO	ENDO	EXO	ENDO	EXO

Notes:

- The VECM tests are done according to pairwise maturity-matched deposit terms. For each period (i.e. 1-month), the test is conducted twice. First test is where the dependent variable is Islamic deposit, and the conventional deposit is the dependent variable for the latter test.
- ICB= Islamic bank investment deposit rate; IBSD = Islamic bank saving deposit rate; CCB = Conventional bank deposit fixed deposit rate; CBSD = Conventional bank saving deposit rate. The above within-sample results tend to indicate that in the long-term all, the conventional deposit rates are exogenous, and all the Islamic deposit rates are endogenous, except for 6-month, 9-month and 12-month.
- (\*) - indicates significance at 5% level. It implies that all of the Islamic deposit rates are weakly endogenous including conventional deposit rates for 6-month, 9-month and 12-month.

### Variance Decomposition (VDC)

The generalized variance decomposition (VDC) technique was applied to determine the relative exogeneity or endogeneity of the variable<sup>(12)</sup>. The

(12) The relative exogeneity or endogeneity of a variable can be decided by the proportion of the variance explained by its own past shock (Masih et al., 2010). The most exogenous variable is identified as the variable which is explained mostly by its own shock. In this study, we choose to apply generalized variance decomposition technique rather than orthogonalized VDC because of some factors. The orthogonalized VDC are sensitive to the order of the variables and also assumes that all other variables in the system are switched off when a particular variable is shocked. On the other hand, generalized VDC is insensitive and does not make such assumption.

results for over a 24-month horizon are summarized in Tables 4a and 4b. The 12-month forecast period indicates that almost all the conventional bank deposit rates are the exogenous. However, as the number of months (as seen in the forecast horizon number 18 and 24) is increased, Islamic deposit rates (ICB<sub>12</sub> and IBSD) were found to be the exogenous variable in their pairs implying intense competition for long-term deposits between Islamic and conventional banks. For example, at the forecast horizon number 24, we find that for 1-month maturity bank deposit rate, that 64.37 percent of the forecast error variance of ICB<sub>1</sub> is explained by its own shocks, and in the case of CCB<sub>1</sub> that proportion is 97.22 percent. Hence, CCB<sub>1</sub> appears to be stronger in explaining the change in ICB<sub>1</sub> and not vice versa.

**Table 4a: Generalized Variance Decompositions for banks**

Percentage of Forecast Variance Explained by Innovations in:

Months		ICB_1	CCB_1		ICB_3	CCB_3		ICB_6	CCB_6
12	ΔICB_1	0.6520	0.3480	ΔICB_3	0.7327	0.2673	ΔICB_6	0.7744	0.2256
	ΔCCB_1	0.0101	0.9899	ΔCCB_3	0.0091	0.9909	ΔCCB_6	0.0895	0.9105
18	ΔICB_1	0.6461	0.3539	ΔICB_3	0.7261	0.2739	ΔICB_6	0.7716	0.2284
	ΔCCB_1	0.0155	0.9845	ΔCCB_3	0.0255	0.9745	ΔCCB_6	0.1488	0.8512
24	ΔICB_1	0.6437	0.3563	ΔICB_3	0.7235	0.2765	ΔICB_6	0.7711	0.2289
	ΔCCB_1	0.0278	<b>0.9722</b>	ΔCCB_3	0.0473	<b>0.9527</b>	ΔCCB_6	0.1953	<b>0.8047</b>
Months		ICB_9	CCB_9		ICB_12	CCB_12		IBSD	CBSD
12	ΔICB_9	0.7641	0.2359	ΔICB_12	0.8723	0.1277	ΔIBSD	0.9817	0.0183
	ΔCCB_9	0.0263	0.9737	ΔCCB_12	0.0753	0.9247	ΔCBSD	0.0109	0.9891
18	ΔICB_9	0.7589	0.2411	ΔICB_12	0.8774	0.1226	ΔIBSD	0.9816	0.0184
	ΔCCB_9	0.0654	0.9346	ΔCCB_12	0.1335	0.8665	ΔCBSD	0.0081	0.9919
24	ΔICB_9	0.7570	0.2430	ΔICB_12	<b>0.8672</b>	0.1328	ΔIBSD	0.9816	0.0184
	ΔCCB_9	0.1098	<b>0.8902</b>	ΔCCB_12	0.1873	0.8127	ΔCBSD	0.0078	<b>0.9922</b>

Notes:

- Each deposit is matched with their maturity-matched opposites (i.e. ICB<sub>1</sub> with CCB<sub>1</sub>).
- Each variable is denoted in the xxx\_yyy format, where xxx is the deposit of different financial institutions; yyy is the maturity in months. For example ICB<sub>1</sub> = Islamic commercial bank investment deposit with 1-month maturity; CCB<sub>1</sub> = Conventional commercial bank fixed deposit with 1-month maturity. Another difference is IBSD and CBSD, where IBSD = Islamic commercial bank saving deposit with no fixed maturity; CBSD = Conventional commercial bank saving deposit with no fixed maturity.

The results for finance companies in Table 4b are not similar to the results of banks, where all Islamic finance deposit rates are the exogenous variable in their maturity-matched pairs. These results are consistent with the results from the VECM test that only two variables were exogenous (CFC\_9 and CFCSD), while all the variables were endogenous. These findings also imply a close competition for deposits between by Islamic and conventional finance companies.

Several factors could explain the findings for finance companies. In general, finance companies are more dependent on deposits as their source of funding and are also less regulated, hence able to provide loans for those who are unable to get loans from banks. Therefore, many customers (especially Muslims) with low credit-worthiness will obtain funds from Islamic finance companies. The ability of conventional deposit rates to explain the changes in the Islamic deposit rates varies at different maturity period and different types of deposit. However, in general, the Islamic deposit rates are influenced by the conventional deposit rates.

#### *Impulse Response Function (IRF)*

The information in VDC test can be represented by IRF graphics. Figures 1 to 12 show generalized impulse response functions (IRF) in respect of investment and saving deposit rates of Islamic and conventional bank deposit rates. In all cases, the results are reported over a 24-month horizon to observe the persistence of the shocks. The Islamic banks deposit rate variables are sensitive to a one standard deviation shock in themselves and to conventional banks deposit rates, which is consistent with the earlier VDC results. Overall results show that when ICB is shocked, CCB responds positively and immediately, but this response changes negatively very quickly after some lags. However, when CCB is shocked, ICB responds positively and immediately but turns negative progressively. For example, when ICB\_3 is shocked (Figure 3), CCB\_3 gives a positive response to the shock in the beginning and progressively turns into negative only after five months. When CCB\_3 is shocked (Figure 4), ICB\_3 responses positively and gradually decreases but lasts over the 24-month horizon. Therefore, we conclude that CCB\_3 is the least sensitive to a standard deviation shock to both deposit rates.



**Table 4b:** *Generalized Variance Decompositions for Finance companies Percentage of Forecast Variance Explained by Innovations in:*

Months		IFC 1	CFC 1		IFC 3	CFC 3		IFC 6	CFC 6
12	$\Delta$ IFC 1	0.7538	0.2462	$\Delta$ IFC 3	0.7046	0.2954	$\Delta$ IFC 6	0.7226	0.2774
	$\Delta$ CFC 1	0.0443	0.9557	$\Delta$ CFC 3	0.0963	0.9037	$\Delta$ CFC 6	0.1092	0.8908
18	$\Delta$ IFC 1	0.7521	0.2479	$\Delta$ IFC 3	0.7031	0.2969	$\Delta$ IFC 6	0.7213	0.2787
	$\Delta$ CFC 1	0.0520	0.9480	$\Delta$ CFC 3	0.0769	0.9231	$\Delta$ CFC 6	0.0870	0.9130
24	$\Delta$ IFC 1	0.7516	0.2484	$\Delta$ IFC 3	0.7027	0.2973	$\Delta$ IFC 6	0.7209	0.2791
	$\Delta$ CFC 1	0.0714	<b>0.9286</b>	$\Delta$ CFC 3	0.0702	<b>0.9298</b>	$\Delta$ CFC 6	0.0781	<b>0.9219</b>
Months		IFC 9	CFC 9		IFC 12	CFC 12		IFCSD	CFCSD
12	$\Delta$ IFC 9	0.7546	0.2454	$\Delta$ IFC 12	0.7720	0.2280	$\Delta$ IFCSD	0.7823	0.2177
	$\Delta$ CFC 9	0.1042	0.8958	$\Delta$ CFC 12	0.0296	0.9704	$\Delta$ CFCSD	0.0380	0.9620
18	$\Delta$ IFC 9	0.7539	0.2461	$\Delta$ IFC 12	0.7697	0.2303	$\Delta$ IFCSD	0.7811	0.2189
	$\Delta$ CFC 9	0.0814	0.9186	$\Delta$ CFC 12	0.0423	0.9577	$\Delta$ CFCSD	0.0304	0.9696
24	$\Delta$ IFC 9	0.7536	0.2464	$\Delta$ IFC 12	0.7691	0.2309	$\Delta$ IFCSD	0.7809	0.2191
	$\Delta$ CFC 9	0.0700	<b>0.9300</b>	$\Delta$ CFC 12	0.0647	<b>0.9353</b>	$\Delta$ CFCSD	0.0287	<b>0.9713</b>

- Notes:
- Each deposit are matched with their maturity-matched opposites (i.e. ICB\_1 with CCB\_1).
  - Each variable is denoted in the xxx\_yyy format, where xxx is the deposit of different financial institutions; yyy is the maturity in months. For example ICB\_1 = Islamic commercial bank investment deposit with 1-month maturity; CCB\_1 = Conventional commercial bank fixed deposit with 1-month maturity. Another difference is IBSD and CBSD, where IBSD = Islamic commercial bank saving deposit with no fixed maturity; CBSD = Conventional commercial bank saving deposit with no fixed maturity.

The results suggest a significant impact of conventional deposit rates on Islamic deposit rates. This conventional banks deposit rates drives the Islamic deposit rates (ICBs are affected by the movement of CCB). For finance companies, the profit rates of Islamic finance companies seem to be influenced by deposit rates of conventional finance companies. Overall, results suggest that when IFC is shocked, CFC responds positively and immediately but this response turns negative only progressively. When CFC is shocked, IFC responds positively but turns negative at a faster pace. These results do imply an element of intense competition for deposits by Islamic and conventional finance companies. For example, when IFC\_3 is shocked (Figure 3), CFC\_3 gives a positive response to the shock in the beginning and progressively turns into negative approximately after 13 months. When CFC\_3 is shocked (Figure 4), IFC\_3 responses positively and gradually decrease but lasts over the 24-month horizon. Therefore, we conclude that CFC\_3 is the least sensitive to a standard deviation shock to both deposit rates. The results are similar with results of banks, but profit rates of Islamic

finance are less affected by deposit rates of conventional finance companies as compared to Islamic banks.

### *Persistence Profile (PP)*

Finally, persistence profile (PP) analysis (Figures 25-36) show the effects or the time horizon required to return to equilibrium when there is a system-wide shock on the long-run relations. Both PP and IRF have the same function, which is to estimate the speed with which the variables return to equilibrium. However, they differ in the sense that IRF traces out the effects of a variable-specific shock. For example, in Figure 25 for ICB\_1 and CCB\_1, when there is a system-wide shock to cointegrating vector, the persistence gradually comes back to equilibrium after 42 months. Other persistence profile analysis of banks deposit rates shows familiar speed, where most of them return to equilibrium after passing 30 months mark except ICB\_6 (comes back to equilibrium after 17 months).

For finance companies, the saving deposit rate (IFCSD and CFCSD) was the fastest to return to equilibrium, at only after 16 months. Other finance companies deposit rates approached equilibrium, on average, after 20 months. To summarize, finance companies have a faster recovery to equilibrium as compared to banks.

### *Robustness Test*

To ascertain the robustness of the earlier documented results on the positive relationship between the deposit rates of Islamic banks and finance companies and the rates on matching deposits for conventional banks and finance companies, and the former rates are driven by the rates of conventional banks and finance companies, pair-wise Granger causality tests (2 lags) to each maturity period (bivariate model as conducted in earlier tests) is applied. Information summarized in Table 5 confirms that the conventional bank deposit rates do Granger cause Islamic bank investment and saving deposit rates. The results show one-way causality and are consistent with the findings of previous studies (Bacha, 2004; Kaleem and Isa, 2005; Chong and Liu, 2009; Cevik and Charap, 2011). Similar results are observed for finance companies where changes in the deposit rates of conventional finance companies cause adjustment in the deposit rates of Islamic finance companies. In summary, the results from the Granger causality tests suggest that changes in conventional deposit

rates Granger cause changes in Islamic bank investment and saving deposit rates and not vice-versa.

**Table 5: Estimate Results of Granger Causality and Diagnostic Tests.**  
*Banks*

<b>Null hypothesis</b>	<b>No. Obs.</b>	<b>F-statistic</b>	<b>p-value</b>
<i>ICB_1 does not Granger Cause CCB_1</i>	226	0.188	0.829
<i>CCB_1 does not Granger Cause ICB_1</i>		68.29	8E-24*
<i>ICB_3 does not Granger Cause CCB_3</i>	226	0.256	0.774
<i>CCB_3 does not Granger Cause ICB_3</i>		64.77	7E-23*
<i>ICB_6 does not Granger Cause CCB_6</i>	226	0.866	0.422
<i>CCB_6 does not Granger Cause ICB_6</i>		51.25	5.00E-19*
<i>ICB_9 does not Granger Cause CCB_9</i>	226	0.604	0.547
<i>CCB_9 does not Granger Cause ICB_9</i>		57.59	7E-21*
<i>ICB_12 does not Granger Cause CCB_12</i>	226	0.410	0.664
<i>CCB_12 does not Granger Cause ICB_12</i>		55.83	2E-20*
<i>IBSD does not Granger Cause CBSD</i>	226	3.994	0.020
<i>CBSD does not Granger Cause IBSD</i>		15.02	8.00E-07*
<b>Finance companies</b>			
<b>Null hypothesis</b>	<b>No. Obs.</b>	<b>F-statistic</b>	<b>p-value</b>
<i>IFC_1 does not Granger Cause CFC_1</i>	142	1.374	0.257
<i>CFC_1 does not Granger Cause IFC_1</i>		6.689	0.0017*
<i>IFC_3 does not Granger Cause CFC_3</i>	142	1.302	0.275
<i>CFC_3 does not Granger Cause IFC_3</i>		3.930	0.022**
<i>IFC_6 does not Granger Cause CFC_6</i>	142	1.233	0.294
<i>CFC_6 does not Granger Cause IFC_6</i>		3.478	0.034**
<i>IFC_9 does not Granger Cause CFC_9</i>	142	0.738	0.480
<i>CFC_9 does not Granger Cause IFC_9</i>		3.182	0.045**
<i>IFC_12 does not Granger Cause CFC_12</i>	142	0.433	0.649
<i>CFC_12 does not Granger Cause IFC_12</i>		9.953	9.00E-05*
<i>IFCSD does not Granger Cause CFCSD</i>	138	2.111	0.125
<i>CFCSD does not Granger Cause IFCSD</i>		6.780	0.0016*

Notes: \* Significant at 1%; \*\* Significant at 5% level. The Granger causality tests are done according to pairwise maturity-matched deposit terms (i.e. ICB\_1 with CCB\_1). Each variable is denoted in the xxx\_yyy format, where xxx is the deposit of different financial institutions; yyy is the maturity in months. For example ICB\_1 = Islamic commercial bank investment deposit with 1-month maturity; CCB\_1 = Conventional commercial bank fixed deposit with 1-month maturity. Other difference is IBSD and CBSD, where IBSD = Islamic commercial bank saving deposit with no fixed maturity; CBSD = Conventional commercial bank saving deposit with no fixed maturity.

## **5. Conclusion**

The main issue addressed in this paper is whether the profit rates on investment and saving accounts in Islamic financial institutions (banks and finance companies) are interest-free. That is determined by examining any difference between interest rates of conventional banks and finance companies and the profit rates of Islamic banks and finance companies on similar investments with matching maturity. Secondly, if there is a difference; is there a causality relationship? Analyses of the relationship between deposit rates from Islamic and conventional banks and finance companies was done using monthly data for investment and saving deposit rates for the period between January 1994 and December 2012 using the VAR approach.

Overall, the findings are consistent with those of previous findings (Bacha, 2004; Kaleem and Isa, 2005; Bacha, 2008; Kassim, Majid and Yussof, 2009; Kader and Leong, 2009; Chong and Liu, 2009; Zainol and Kassim, 2010) Cevik and Charap, 2011 and Ergec and Arslan, 2013) that profit rates of Islamic banks are significantly influenced by the interest rates of conventional banks in the short and long run. The profit rates of Islamic banks and finance companies are driven by the movements of interest rates of conventional banks and finance companies respectively. These findings suggest the gap between Islamic banking in theory and practice. Though it is expected that Islamic banks operate based on Profit Loss Sharing principles (PLS); in reality this seems not to be the case probably due to competitive pressure on the part of Islamic banks to meet investor expectations and the profit-maximization mentality of customers. A very large percentage (more than 70%) of customers of Islamic banks and finance companies are non-Muslims who are interested to earn the best rates on their deposits or lowest rate for financing, irrespective of the mode of the banking system. Furthermore, lengthy due diligence for PLS instruments and absence of Islamic secondary market makes it more challenging for Islamic banks and finance companies to operate fully on the PLS paradigm.

The findings imply that Islamic banks are not different from conventional banks as far as the profit rates offered are concerned except for different branding to cater for different category of clients. The disparity in the expectation and practice of Islamic banks will increase

the reputational risks and negatively impact the future of Islamic banking industry globally. The main challenge for the policy makers and regulators is to instill public awareness of the importance of this unique banking system and their role in providing the infrastructure to promote the Islamic banking industry locally and on a global scale. The issue of awareness is to correct the public perception that currently Islamic banks and finance companies cannot fully operate on the PLS paradigm in a conventional infrastructure, but are gradually working towards full compliance.

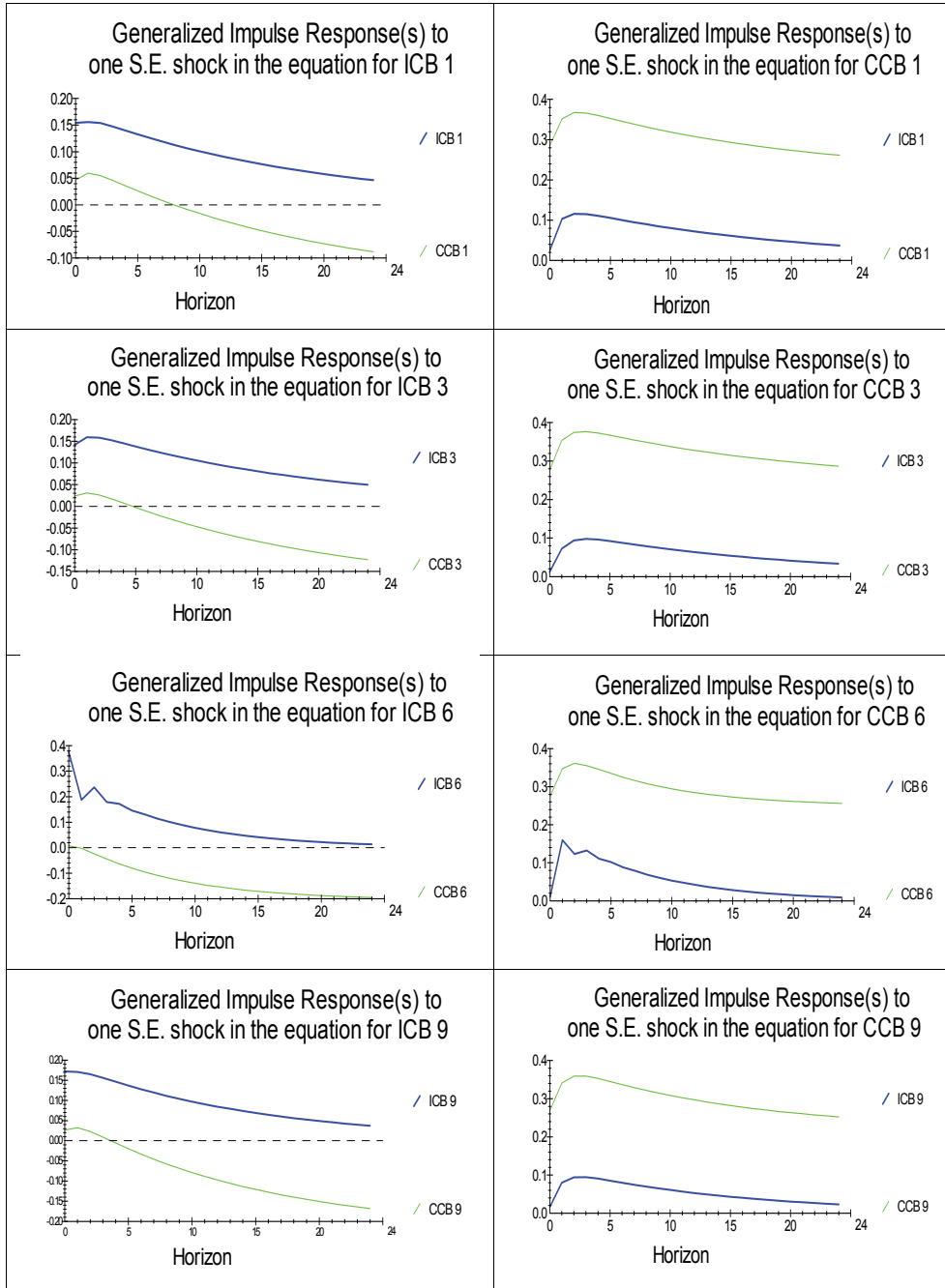
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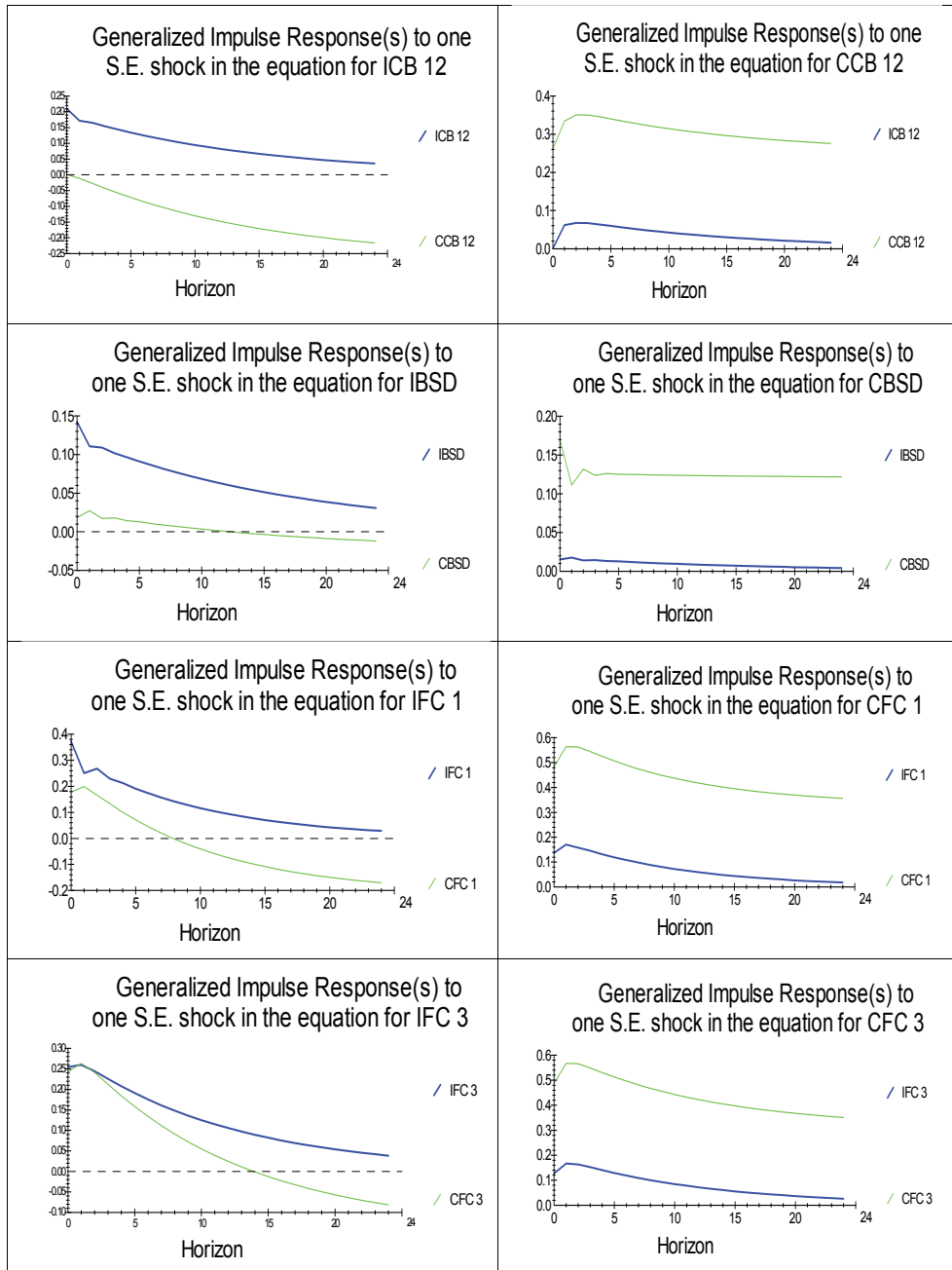
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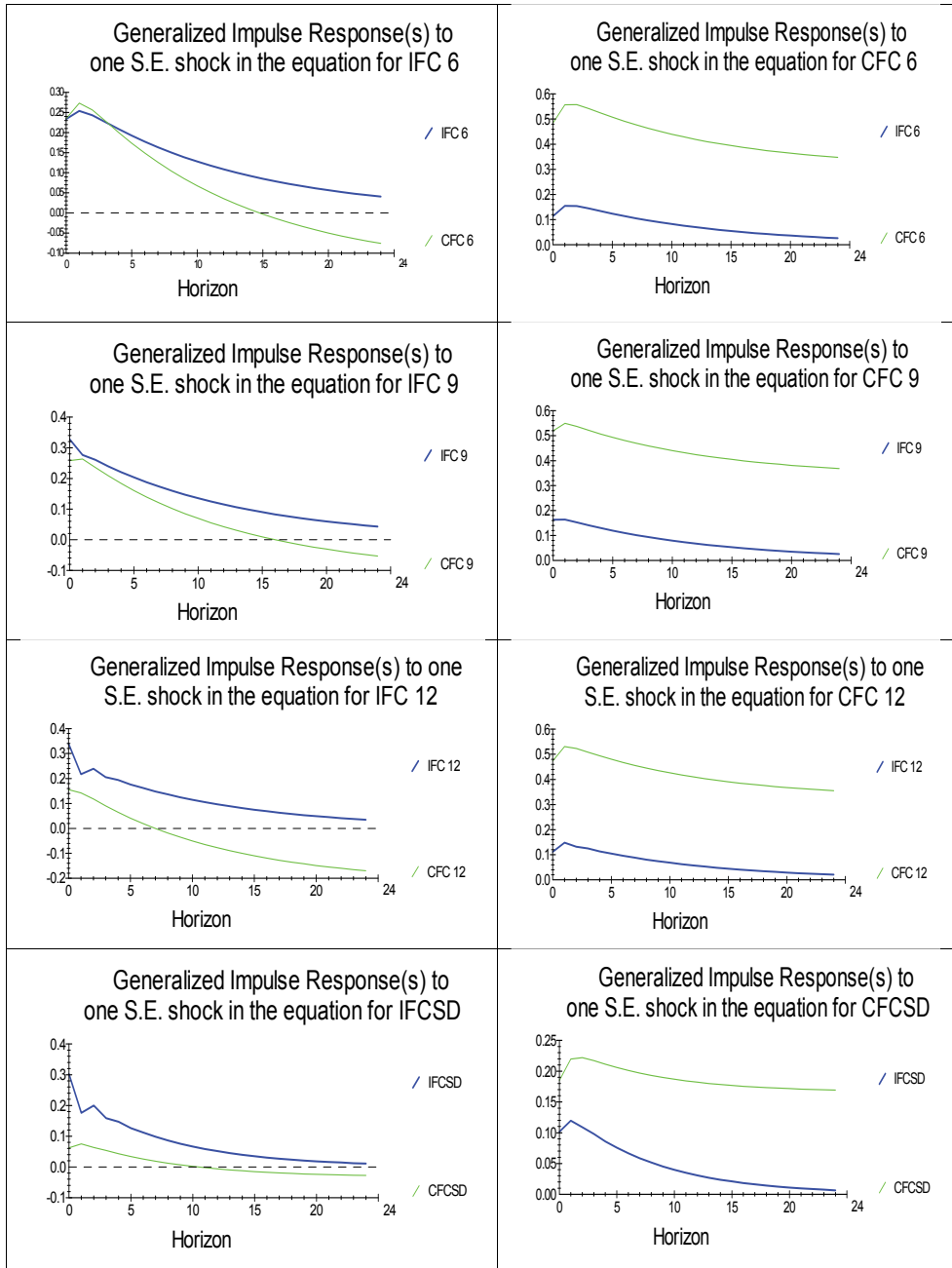
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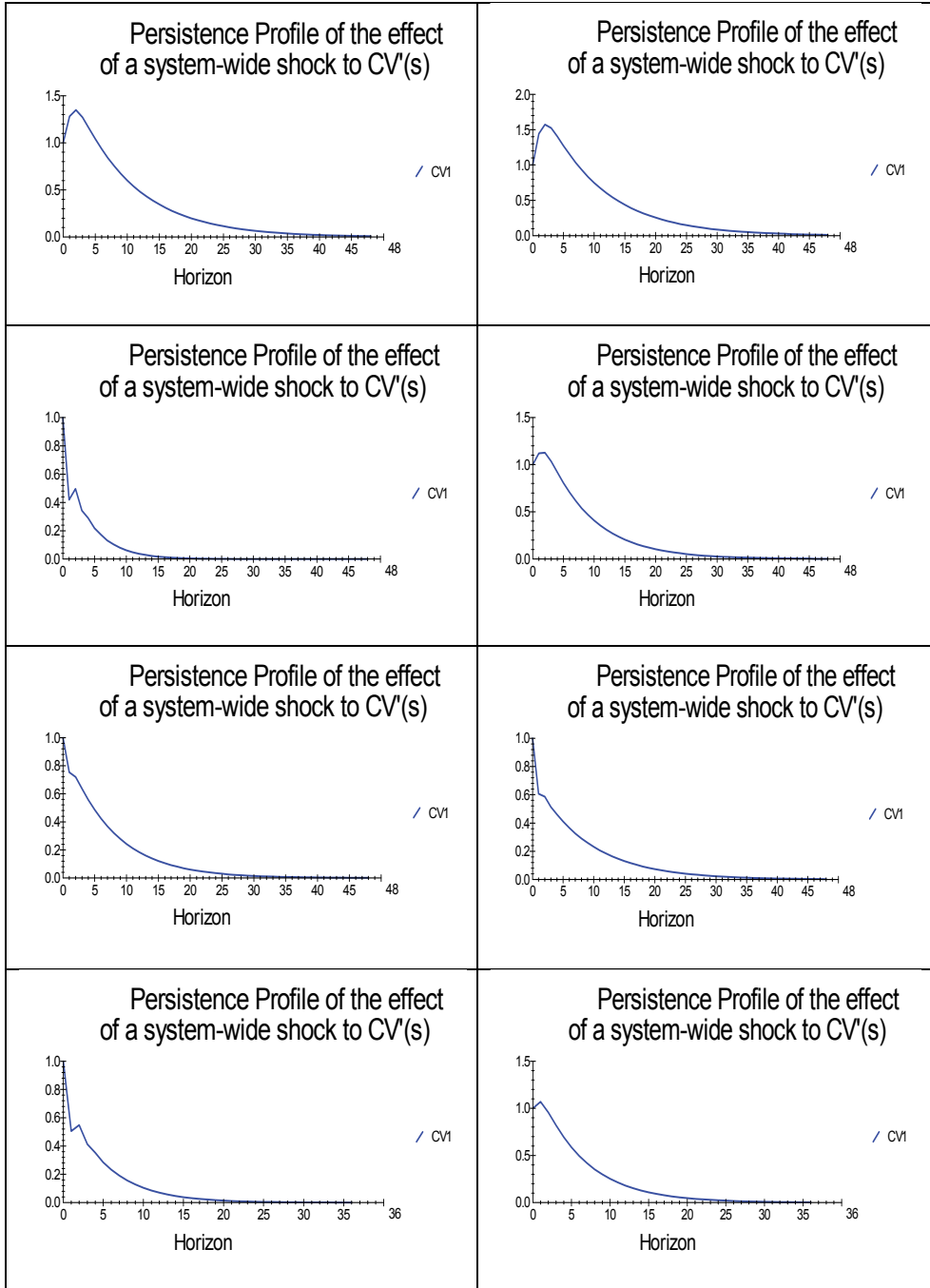
**Appendix – Figures**

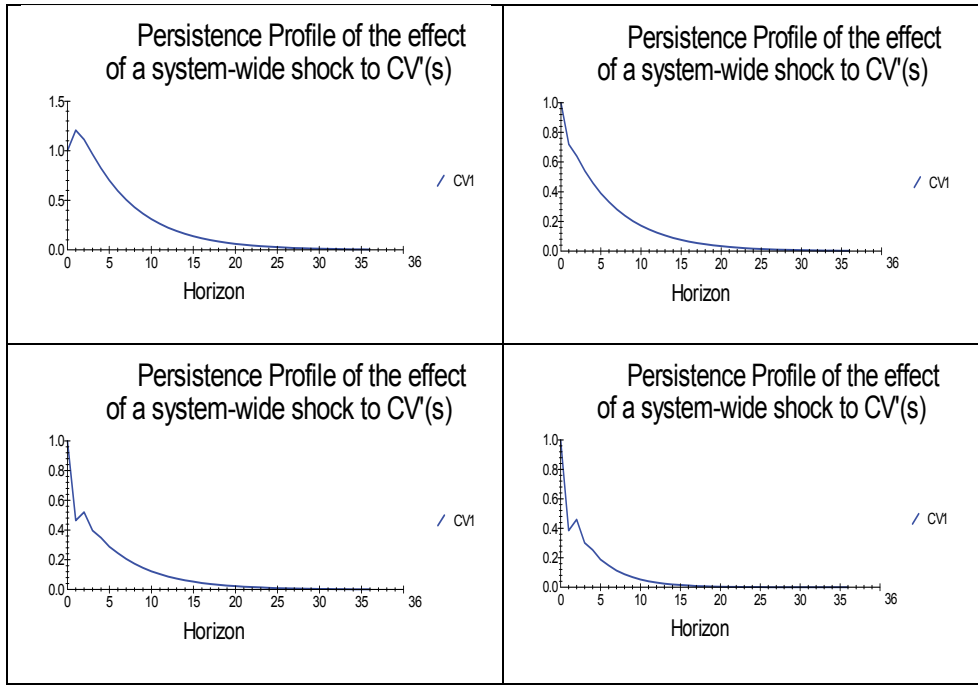












(Rosly, 1999; Zaman and Movassaghi, 2002; Kuran, 2005; Chung and Liu's (2009); Khan, 2010; Ariff and Rosly, 2011).

## هل ودائع وحسابات الاستثمار في البنوك الإسلامية في ماليزيا غير قائمة أو خالية من الفائدة؟

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المركز العالمي لتعليم التمويل الإسلامي

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المستخلص. تقدم المصرفية الإسلامية والتمويل الإسلامي منتجات وخدمات متوافقة مع أحكام الشريعة الإسلامية. ولذا، فإنه يفترض أن تكون تلك المنتجات مختلفة عن نظيراتها التقليدية؛ إلا أنه في الآونة الأخيرة ظهرت مخاوف من أن البنوك الإسلامية لا تختلف جوهرياً عن نظيرتها التقليدية؛ حيث أن معظم ممارساتها تحاكي الممارسات المصرفية التقليدية وتتعامل بالربا في شكل مقنع. من الناحية النظرية، فعلى سبيل المثال ينبغي أن تكون نسب الأرباح على الودائع "الإسلامية" مختلفة عن أسعار الفائدة (الربا) على الودائع التقليدية. معدلات الأرباح في المصرفية الإسلامية من المفترض أن تكون أقل مخاطرة بسبب سمة المشاركة في المخاطر، تلك السمة المتضمنة في هيكله المنتجات الإسلامية، مقارنة بأسعار الفائدة على المنتجات ذات المخاطر المماثلة في المصارف التقليدية. تتناول المقالة هذه القضية من خلال دراسة الفروق بين أسعار الفائدة على الودائع الشهرية الثابتة على الودائع الاستثمارية التقليدية، ونسب الأرباح على الودائع الاستثمارية في المصارف الإسلامية ومؤسسات التمويل الإسلامي في ماليزيا خلال الفترة من يناير ١٩٩٤م حتى ديسمبر ٢٠١٢م، لتحديد العلاقة السببية بين معدلات الأرباح وأسعار الفائدة على هذه الاستثمارات. تشير النتائج إلى أن معدلات الأرباح في المصارف الإسلامية ترتبط بشكل كبير مع أسعار الفائدة في المصارف التقليدية على المدينين القصير والبعيد. وقد لوحظت نتائج مماثلة لشركات التمويل. وتشير النتائج أيضاً إلى أن معدلات أرباح المصارف الإسلامية، ومؤسسات التمويل الإسلامي تتأثر بتحركات أسعار الفائدة في المصارف التقليدية، ومؤسسات التمويل التقليدية وليس العكس. هذه النتائج تعني أن هناك فجوة بين النظرية والتطبيق في المصرفية الإسلامية. إن عدم وجود البنى الأساسية للالتزام الكامل وعدم الصرامة في تنفيذ المتطلبات التنظيمية هي الأسباب المحتملة لمثل هذا السلوك للمؤسسات المالية الإسلامية في ماليزيا.

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