

**DETERMINANTS OF CREDIT RISKS IN ISLAMIC BANKS
IN MALAYSIA**

By

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ABSTRACT

The concept of risk was well known to most of us. It has become an important tool in making decision when it is possible to measure it and to assign values to different situations. However the changes in the global finance environment has make Islamic banking institutions are more vulnerable to risks. Many theoretical studies on Islamic banking were conducted with the focus on Islamic modes of financing and their ability to perform financial intermediation for catering to the needs of people. This paper examines the determinants of credit risk in Islamic banks in Malaysia. The study uses secondary data obtained from the annual report of selected Islamic banks during the period from 2008 to 2013. Al the selected banks were local Islamic banks in Malaysia. This study uses non-performing financing (NPFs) as a proxy for credit risk which is dependent variable. The independent variables consists of three macroeconomic variables Gross Domestic Product (GDP), Base Financing Rate (BFR) and Consumer Price Indicator (CPI). There are also six other variables (bank specific) that are used as internal variables. These are Bai' Bithaman Ajil (BBA), Murabahah, al-Ijarah Thumma al-Bai' (AITAB), total assets, other contract (OCONT) and Profit Margin (PM). In this study it has been found that GDP is significant and negatively related to credit risk, making the finding similar with past studies.

ABSTRAK

Pengenalan kepada konsep dan pengurusan risiko adalah diketahui umum oleh kebanyakan kita. Ia merupakan satu kaedah yang penting dalam membuat keputusan dengan memberikan nilai kepada situasi yang berbeza. Walau bagaimanapun, perubahan dalam persekitaran kewangan global telah membuat institusi perbankan Islam adalah lebih terdedah kepada risiko. Banyak kajian teori mengenai perbankan Islam telah dijalankan dengan tumpuan diberikan kepada kaedah pembiayaan Islam dan keupayaan mereka untuk melakukan pengantaraan kewangan untuk memenuhi keperluan pengguna. Kajian ini mengkaji penentu risiko kredit di bank-bank Islam di Malaysia. Kajian ini menggunakan data sekunder yang diperolehi daripada laporan tahunan bank Islam yang terpilih merangkumi tempoh dari 2008 hingga 2013. Bank-bank terpilih adalah bank-bank Islam tempatan di Malaysia. Kajian ini menggunakan pembiayaan tidak berbayar (NPF) sebagai proksi untuk risiko kredit yang merupakan pembolehubah bersandar. Pembolehubah bebas terdiri daripada tiga pembolehubah makroekonomi iaitu Keluaran Dalam Negara Kasar (KDNK), Kadar Pembiayaan Asas (BFR) dan Harga Pengguna Indicator (IHP). Terdapat juga enam pembolehubah lain (bank tertentu) yang digunakan sebagai pembolehubah dalaman. Ini adalah Bai 'Bithaman Ajil (BBA), Murabahah, al-Ijarah Thumma Al-Bai' (AITAB), jumlah aset, kontrak lain (OCONT) dan Margin Keuntungan (PM). Dalam kajian ini, didapati bahawa KDNK memberi impak negatif kepada hal yang berkaitan dengan risiko kredit, bertepatan dengan keputusan kajian-kajian lepas.

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LIST OF ABBREVIATIONS

AITAB	Al-Ijarah Thumma al-Bai'
BBA	Bai' Bithaman Ajil
BFR	Base Financing Rate
BIMB	Bank Islam Malaysia Berhad
BMMB	Bank Muamalat Malaysia Berhad
BNM	Bank Negara Malaysia
CPI	Consumer Price Indicator
GCC	Gulf Cooperation Council
GDP	Growth Domestic Product
IBF	Islamic Banking And Finance
INCEIF	International Centre for Education in Islamic Finance
ISRA	International Shariah Research Academy
KLSE	Kuala Lumpur Stock Exchange
MIFC	Malaysia International Financial Centre
NSAC	National Shariah Advisory Council
NPF	Non-Performing Financing
NPL	Non-Performing Loans
OCONT	Other Contract
OIC	Organization of Islamic Conference
PLS	Profit-Loss Sharing
PM	Profit Margin
SAB	Shariah Advisory Board
SAC	Shariah Advisory Council
SPTF	Skim Perbankan Tanpa Faedah
VAR	Value at Risk
VIF	Variance Inflation Factor

CHAPTER ONE

INTRODUCTION

1.0 Introduction

Islamic banks operate based on the stringent *Shariah* regulation, as it well justified by Masood (1995) that Islamic banking operations aim at safeguarding the interest of the public, or in Islam particularly known as *maslahah*. The cornerstone or the core scruples of Islamic banking is the prohibition of *riba* while it enjoins the trade and commerce activities of banking operations.

One of the main features of Islamic banking is regarding the variety of financing contracts and facilities they offer. Different types of financial contracts which have been advanced by Islamic banks are based on two principles; the profit loss-sharing principle and the mark-up principle. The profit loss-sharing principle includes the contract of *mudarabah* (venture capital) and *musharakah* (partnership contract) while the instrument based on the mark-up principle is *murabahah* (resale with pre-agreed profit), *bay as-salam* (forward sale contract), *ijarah* (leasing) and *ijarah wa iqtina* (operating and financial lease). Based on these principles, Islamic banks offer financing products without contravene *Shariah* and ethics principles in order to remain competitive in the market which is dominated by conventional banks.

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