

**THE RELATIONSHIP AND CAUSAL EFFECTS OF
DETERMINANT FACTORS OF ISLAMIC HOME
FINANCING IN MALAYSIA**

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FINANCING IN MALAYSIA**

by

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LIST OF SYMBOLS

β_0	Intercept and estimation parameters
ε_t	Error term or Disturbance term
t	Period or Duration
Δ	Difference operator
m	Number of lags
δ	Estimated parameters
Y_1	Dependent variable
H_0	Null hypothesis
H_1	Alternative hypothesis
-p	Probability value
EC_t	Speed of adjustment
$\sum_{i=1}^p$	First Lagged value of the error term in co-integration regression
α	Intercept
k	Number of independent variables
S	Skewness coefficient
K_u	Kurtosis coefficient
\bar{X}	Mean of residuals
J – B	Jarque Bera
z_t	Vector of regressors
ln	Logged value

LIST OF ABBREVIATIONS

BIMB	Bank Islamic Malaysia Berhad
ADF	Augmented Dickey-Fuller
AIC	Akaike Information Criterion
ARDL	Autoregressive Distributed Lag
ASEAN	Associates of Southeast Asian Nations
BBA	Bay Bithaman Ajil
BBC	A model introduced by Banker, Chamer and Cooper in 1984
BGG	Breusch Pagan Godfrey
BLR	Base Lending Rate
CAP	Capital
CCR	Chames Cooper and Rhodes Model
COVID-19	The Coronavirus Disease 2019
CPI	Consumer Price Index
CRS	Constant Return to Scale
CUSUM	Cumulative Sum
CUSUMSQ	Cumulative Sum Square
DEA	Data Envelopment Analysis
DFA	Distribution Free Approach
DFGLS	Dickey Fuller Generalized Least Square
DSR	Debt Service Ratio
E/TA	Equity divided by Total Assets
ECM	Error Correction Model
EDF	Expected Default Frequency

EQU	Equities
ERS	Elliot, Rothenberg and Stock Point Optimal test
EXP	Government Expenditure
GRDP	Gross Regional Domestic Product
GDP	Gross Domestic Product
GLS	Generalized Least Square
GMM	Generalized Method of Moments
GOVEXP	Government Expenditure
HF	Home Financing
IPI	Industrial Price Index
IPO	Initial Public Offering
KPSS	Kwiatkowski-Philips-Schmidt-Shin test
LIAB	Liabilities
LM	Lagrange Multiplier
M2	Money Supply
MM	Musyarakah Mutanaqisah
NP	Ng and Pherron test
NPL	Non-performing Loan
OECD	The Organization for Econometric Co-Operation and Development
OLS	Ordinary Square Method/ Ordinary Least Square
OPR	Overnight Policy Rate
PMM	Primary Mortgage Market
PP	Philips-Pherron test
ROA	Return on Asset
SEA	Southeast Asia

SFA	Stochastic Frontier Analysis
SIC	Schwarz Information Criterion
SMM	Secondary Mortgage Market
SPTF	Skim Perbankan Tanpa Faedah
TFA	Thick Frontier Approach
TFP	Total Factors Productivity
UK	United Kingdom
USD	United State Dollar
VAR	Vector Autoregression
VECM	Vector Error Correction Model
VRS	Variable Return to Scale
WAEMU	West African Economic and Monetary Union

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HUBUNGAN DAN KESAN SEBAB AKIBAT FAKTOR PENENTU DALAM PEMBIAYAAN PERUMAHAN ISLAM DI MALAYSIA

ABSTRAK

Berdasarkan tempoh penubuhan, bank konvensional lebih awal ditubuhkan sebelum bank Islam di Malaysia. Banyak aspek menyumbang kepada kestabilan dalam bank konvensional. Namun, dalam Islam, kriteria yang ditawarkan oleh bank konvensional adalah bertentangan dengan prinsip Syariah. Oleh itu, bank Islam ditubuhkan untuk mempromosikan perkhidmatan dalam perbankan mengikut prinsip Syariah. Kajian ini ingin menilai hubungan dan kesan sebab akibat faktor penentu dalam pembiayaan perumahan Islam di Malaysia. Faktor yang terlibat dikategorikan sebagai faktor dalaman dan faktor makroekonomi. Objektif pertama ialah untuk mengkaji hubungan jangka panjang faktor yang mempengaruhi pembiayaan perumahan Islam di Malaysia. Diikuti dengan objektif kedua, untuk mengkaji hubungan jangka pendek faktor yang mempengaruhi pembiayaan perumahan Islam di Malaysia. Objektif ketiga adalah untuk menilai kesan dan akibat faktor yang mempengaruhi pembiayaan perumahan Islam di Malaysia. Metodologi kajian ini menggunakan reka bentuk kajian kuantitatif. Pengumpulan data adalah berdasarkan data sekunder yang diperoleh melalui penelitian dokumentasi dan data statistik melalui laman sesawang Bank Negara Malaysia. Data statistik terdiri daripada data suku tahunan dari suku pertama 2007 hingga suku keempat tahun 2021. Data analisis dijalankan dengan menggunakan pendekatan ekonometrik pada data siri masa iaitu ujian kointegrasi *Autoregressive Distributed Lag* (ARDL) dan ujian Granger *Causality*. Dapatan kajian ini menganalisis hubungan dan kesan pembolehubah Granger *Causality* makroekonomi ke atas pembiayaan perumahan Islam. Antara

lapan pembolehubah yang diuji, lima pembolehubah mempunyai hubungan yang signifikan terhadap pembiayaan perumahan Islam di Malaysia dalam jangka masa panjang. Tiga daripada pembolehubah ialah faktor dalaman yang terdiri daripada jumlah aset, jumlah deposit dan liabiliti. Sementara itu, dua pembolehubah makroekonomi yang memberi kesan signifikan kepada pembiayaan perumahan Islam dalam jangka panjang ialah IB dan M3. Dalam jangka pendek, tiga pembolehubah menunjukkan hubungan yang signifikan ke atas pembiayaan perumahan Islam di Malaysia. Faktor tersebut ialah jumlah aset, jumlah deposit dan M3. Terdapat dua faktor dalaman dan satu faktor makroekonomi yang mempengaruhi pembiayaan perumahan Islam di Malaysia dalam jangka masa pendek. Kesan sebab akibat menunjukkan sembilan hubungan kesan akibat Granger antara pembolehubah dalam model. Pembiayaan perumahan mempunyai hubungan sebab akibat terhadap jumlah aset, modal, liabiliti dan KDNK. Manakala, modal mempunyai hubungan sebab akibat dengan KDNK. Selain itu, kesan sebab akibat deposit ke atas dua pembolehubah iaitu jumlah aset dan liabiliti. M3 mempunyai hubungan sebab akibat kepada KDNK. Akhir sekali, CPI mempunyai hubungan sebab akibat terhadap modal. Menerusi penemuan ini, impak faktor dalaman dan faktor makroekonomi terhadap pembiayaan perumahan Islam dikenal pasti dan strategi meningkatkan penawaran pembiayaan perumahan Islam di Malaysia boleh dipertingkatkan pada masa hadapan. Kajian ini juga menekankan bahawa pihak yang meningkatkan strategi dasar monetari juga dapat mempengaruhi pembiayaan perumahan Islam. Walaupun faktor makroekonomi mempunyai kesan ke atas pembiayaan perumahan Islam di Malaysia, faktor dalaman juga menunjukkan pengaruh yang signifikan terhadap pembiayaan perumahan Islam. Oleh itu, dengan mengurus dan memantau

faktor-faktor yang diketengahkan melalui kajian ini, hal ini dapat menggalakkan pertumbuhan pembiayaan perumahan Islam di Malaysia.

**THE RELATIONSHIP AND CAUSAL EFFECTS OF DETERMINANT
FACTORS OF ISLAMIC HOME FINANCING IN MALAYSIA**

ABSTRACT

Based on the period of establishment, conventional banks were established long before Islamic banks in Malaysia. Many aspects can contribute to the stability in conventional banks. However, in Islam, the criteria offered by conventional banks are opposed from Shariah principle. Therefore, Islamic banks were established to promote services in banking according to Shariah principle. In accordance with this matter, this study would like to assess the relationship and causal effects of factors determinant in Islamic home financing service. The factors are categorized into internal factors and macroeconomic factors. The first objective is to examine the long-run relationship of determinant factors in Islamic home financing in Malaysia. Follows by second objective, to examine the short-run relationship of determinant factors in Islamic home financing in Malaysia. Third objective is to assess the causality effect of determinant factors in Islamic home financing in Malaysia. The methodology of this study is quantitative research design. The data collection is based on secondary data which is retrieved through documentations review and statistical highlights from Bank Negara Malaysia. The statistical data comprise of quarterly data from the first quarter of 2007 until the fourth quarter of 2021. Analysis data is conducted by using econometric approach on time series data which is Autoregressive Distributed Lag (ARDL) cointegration test and Granger Causality test. The findings of this study would highlight the relationship and the causality effects of macroeconomic variables on Islamic home financing. Among eight variables tested, five variables have significant relationship on Islamic home

financing in Malaysia in the long-run. Three of the variables are internal factors comprised of total assets, total deposit and liabilities. Meanwhile, two macroeconomic variables that significantly affect Islamic home financing in the long-run are IB and M3. In the short run, three variables exhibit significant relationship on Islamic home financing in Malaysia. The factors are total assets, total deposit and M3. There are two internal factors and one macroeconomic factor that influencing Islamic home financing in Malaysia in short-run estimation. The causality effect shows nine existence of Granger causal relationship among the variables in the model. Home financing has a causal link to total assets, capital, liabilities and GDP. Capital has a causal link with GDP. While deposit causal effect on two variables which is total assets and liabilities. M3 has a causal link to GDP. Lastly, CPI has a causal link to capital. Through the findings, the impact of internal factors and macroeconomic factors on Islamic home financing are identified and the strategy on enhancing the supply of Islamic home financing in Malaysia can be improved in the future. This study also implied that policy makers would enhance the monetary policy to encourage the growth of Islamic home financing. Although macroeconomic has an impact on Islamic home financing in Malaysia, internal factors also shown significant influence on Islamic home financing. Therefore, by managing and monitoring the factors highlighted through this study, it will encourage the growth of Islamic home financing in Malaysia.

CHAPTER 1

INTRODUCTION

1.1 Introduction

The purpose of this study is to identify the relationship and causal effects of determinant factors of Islamic home financing in Malaysian Islamic banks. Islamic home financing is a component of services provided by financial institutions such as Islamic banks. This study focuses specifically on Islamic home financing through Islamic banks. Furthermore, this study highlights the factors that have an impact on Islamic home financing in Malaysia.

This study aims to focus more on a specific yet important area in banking institutions. This is to provide a clearer view of banking institutions and to highlight the factors that may lead to the growth of Islamic home financing in Malaysia. Islamic home financing consists of debt financing and equity financing. Based on a Bank Negara Malaysia statistics report, Islamic home financing is the largest revenue contributor in Islamic banks (Bank Negara Malaysia, 2023). Hence, this research would like to investigate the determinant factors of Islamic home financing in Malaysia.

This chapter consists of the background of the study, the problem statement, the research objectives, the research questions, the operational definition,

the significance of the study, the contribution of the study, the scope of the study, the limitations of the study, and lastly, the organisation of the thesis.

1.2 Background Of The Study

This subtopic comprises the history of Islamic banking globally, and specifically in Malaysia. The background of Islamic banking services and Islamic home financing are explained, respectively.

1.2.1 Islamic Banking Services

Islamic banking is rapidly expanding and becoming a success in Islamic countries. It can be seen during the 1980s and 1990s, when Islamic banking became a global phenomenon. Al-Rajhi Corporation, which conducted foreign money exchange and trading assets, received an Islamic Banking licence from the Saudi Arabian government based on their performance, especially in profit management (Mustafa, 2005). This proved that the success of Islamic banking and finance had been acknowledged by the Saudi Arabian government.

In history, Islamic finance has been practised since the dawn of Islam. In the first century of Islam, AD 600, the collection and transaction of dinar in the community were conducted (Wan Shahdila et al., 2017). Throughout the years, Islamic finance has developed, and Islamic banking is expanding beyond the countries of the Middle East. The Islamic banking system has its own set of criteria and principles that differ from those of conventional banks. The criteria defined are

that all activities of Islamic banking must be in accordance with Shariah principles. As financial intermediaries, Islamic banking must offer the services according to the contracts. On the other hand, the balance between economic profit and social welfare must be emphasised. These Islamic banking criteria demonstrate the importance of Islamic practice in balancing the welfare of the community while also improving the country's economic condition (Endang Pilatoka et. al., 2022; Polyzos et. al., 2023). This leads to the growth of Islamic banking around the world, where non-Muslim majority countries also offer Islamic banking as an alternative to conventional banking.

In non-Islamic countries, the International Islamic Bank of Denmark was founded. In 1978, Islamic Banking International Holding was established in Luxembourg (Ausaf, 1995). These banks were created in order to create Islamic banking in areas that are populated by Muslims as well as for investment in other countries. On the other hand, Islamic finance was introduced to the United Kingdom (UK) in the 1980s, when the first Islamic bank in the UK, known as Al Baraka International, launched in 1982 (Engzell, 2008). This is one of the early establishments of Islamic banking in non-Islamic countries, especially in European countries.

The development of Islamic banking in Southeast Asia began in the 1970s, when the first country to establish Islamic banking was the Philippines, which established Philippine Amanah Bank on August 2nd, 1973 (Abdul Azim Islahi, 2018; Anderson, 2001). Although Muslims are a minority, the establishment of an Islamic banking at the time was due to an insurgency by Muslims in the southern Philippines.

Insurgency by Muslim communities in the southern Philippines occurred as a result of rebellion from a few parties, and the Islamic banking was established to assist the people (Abdul Azim Islahi, 2018).

Later in Malaysia, Bank Islamic Malaysia Berhad (BIMB) was established on March 1st, 1983. In 1981, National Seminar on the Concept of Development in Islam (*Seminar Kebangsaan Tentang Konsep Pembangunan Dalam Islam*) took place at the Universiti Kebangsaan Malaysia. It entailed resolutions regarding the banking act that are in line with Shariah principles (Fathullah Asni, 2019). This demonstrates that Muslim scholars were aware of the financial system that has been practised in the country. All banks operating in Malaysia were once conventional banks. In Malaysia, Muslims are the majority population; therefore, it is important for the authorities to implement Islamic financial services that are in line with Shariah principles (Fathullah Asni, 2019; Akbar Komijani & Farhad Taghizadeh-Hesary, 2018). Islamic banking grows rapidly in other countries in Southeast Asia because of the demand for interest-free services and Muslim communities in the country (Akbar Komijani & Farhad Taghizadeh-Hesary, 2018).

Following that, Bank Islam Malaysia Berhad (BIMB) was established on March 1st, 1983, and officially began operating four months later, on July 1st, 1983. For 10 years, BIMB had been the only bank that offers services based on Shariah principles in Malaysia (Bank Negara Malaysia, 2008; Fathullah Asni, 2019; Rika Nakagawa, 2009). This granted exclusive rights to BIMB in developing products that are based on Shariah concepts. Furthermore, BIMB obtained the privilege of having the monopoly on offering Islamic banking services in Malaysia at that time. The

increase in BIMB's performance took place dramatically and was measured through their growing branches. In 10 years, the capital resources of BIMB reached \$53 million (Khiyar Abdalla Khiyar, 2012). As an example, in 2003, there were 84 BIMB outlets throughout Malaysia, compared to only 6 outlets in 1984 (Bank Negara Malaysia, 2008).

Based on the improving performance of BIMB, the government attempted to develop a more comprehensive and advanced Islamic banking system in line with the needs of Malaysian communities, whether Muslims or non-Muslims (Khalid, 1996). Therefore, Bank Negara Malaysia introduced *Skim Perbankan Tanpa Faedah* (SPTF), known as the banking scheme without interest, on March 4th, 1993. The implementation of SPTF has enabled conventional banks to offer Islamic banking services, as implemented by BIMB.

There are three conventional banks that participate in offering Shariah-based services. Malayan Banking Berhad, Bank Bumiputera Malaysia Berhad, and United Malayan Banking Corporation are among them (Joni Tamkin Borhan, 2001). In 1999, a bank with the full concept of Shariah was established, which is Bank Muamalat Malaysia Berhad. Bank Muamalat Malaysia Berhad is the second bank that offers full services in compliance with Shariah principles after BIMB. Bank Muamalat Malaysia Berhad is the result of a merger between two banks: Bank Bumiputera Malaysia Berhad and Bank of Commerce Malaysia Berhad. This indirectly caused BIMB to lose its monopoly power on Islamic banking services in Malaysia (Hanim & Musa, 2007).

Consequently, in 2004, the Malaysian government implemented a policy under which foreign Islamic banks could operate their businesses in Malaysia. As a result, few foreign Islamic banks entered the banking market in Malaysia. Among them are Kuwait Finance House, Al-Rajhi Banking and Investment Corporation, and Qatar Islamic Bank. Other than that, conventional banks in Malaysia that offer an Islamic window are encouraged to create an Islamic subsidiary that operates as an Islamic bank. This shows Islamic banking operations, which were conducted by conventional banking, are still under the same management, yet with separate capital (Zeti Akhtar Aziz, 2005).

The growth of Islamic banking is expanding every year, both in Malaysia and around the world (Akbar Komijani & Farhad Taghizadeh-Hesary, 2018). In Malaysia, there are conducive environment supports that affect the innovation and diversity of the offered products by Islamic investment instruments, which more or less create a positive effect on the development of Islamic banking in Malaysia. Furthermore, emphasising human capital development alongside the development of the Islamic financial industry is a value that constructs Malaysia as one of the developments of Islamic banking marketing in Malaysia (Akbar Komijani & Farhad Taghizadeh-Hesary, 2018; Bank Negara Malaysia, 2023). This case can be examined through Islamic banking assets in Malaysia, which reach USD 65.6 billion with a growth rate of 18 percent to 20 percent every year. Until now, Malaysia has a large number of Islamic banks providing services based on the full Shariah concept, in addition to existing banks that have established subsidiaries (Bank Negara Malaysia, 2018).

According to the International Financial Services (2022), the 100 largest Islamic banks in the world are from 22 countries, including Malaysia. A total of \$903.0 billion in assets were recorded, with \$583.4 billion in net loans. For deposits, the 100 largest Islamic banks gathered \$662.4 billion and \$12.9 billion in net profit. Malaysia, the United Arab Emirates, Qatar, Saudi Arabia, and Kuwait are the largest markets for Islamic banking assets. Islamic banks in Malaysia, which included both domestic and foreign Islamic banks, held six of the top 20 positions. In addition, 16 Islamic banks were ranked among the top 100. The rankings were based on financial data retrieved in 2018 (International Financial Services, 2022).

As of 2023, there are 16 Islamic banks that have been established as fully pledged Islamic banks in Malaysia. The list of Islamic banks in Malaysia is as follows:

Table 1.1 List of Islamic Banks in Malaysia

No	Name	Ownership
1.	Affin Islamic Bank Berhad	Local
2.	Al Rajhi Banking & Investment Corporation (Malaysia Berhad)	Foreign
3.	Alliance Islamic Bank Berhad	Local
4.	AmBank Islamic Berhad	Local
5.	Bank Islam Malaysia Berhad	Local
6.	Bank Muamalat Malaysia Berhad	Local
7.	CIMB Islamic Bank Berhad	Local
8.	HSBC Amanah Malaysia Berhad	Foreign
9.	Hong Leong Islamic Bank Berhad	Local
10.	Kuwait Finance House (Malaysia) Berhad	Foreign
11.	MBSB Bank Berhad	Local
12.	Maybank Islamic Berhad	Local
13.	OCBC Al-Amin Bank Berhad	Foreign
14.	Public Islamic Bank Berhad	Local
15.	RHB Islamic Bank Berhad	Local
16.	Standard Chartered Saadiq Berhad	Foreign

Note. Source from Bank Negara Malaysia (2023)

Table 1.1 displays the list of Islamic banks in Malaysia. These Islamic banks consist of foreign and local banks, of which 11 are local banks and the other five are foreign banks.

The factors within Islamic banks or internal factors such as total assets, capital, liabilities and deposits are included in this study in order to determine the relationship of these internal factors on Islamic home financing in Malaysia. In addition, macroeconomic factors also have been identified as the variables that may influence Islamic home financing in Malaysia. The macroeconomic factors are CPI (inflation), Gross Domestic Product (GDP), Islamic Interbank Rate (IB) and money supply (M3).

1.2.2 Islamic Home Financing

Islamic home financing is divided into equity-based financing and debt-based financing. Equity based financing is a profit-sharing concept between Islamic banks and customers. Meanwhile debt-based financing is a contract and concepts comprise of sale and payment between Islamic banks and customers (Rofiul Wahyudi et. al., 2019). There are few instruments that are used in Islamic home financing. Among the instruments are *Bay' al-Inah* (sale and purchase), *Bay' Bithaman Ajil (BBA)* (sale at deferred price), *Musyarakah Mutanaqisah* (profit-sharing) and *Tawarruq* (deferred payment). These instruments have a few weaknesses and strengths (Mustika Rahmi et al., 2020; Mohamad Zaim Ismail et al., 2013; Mzee Mustafa & Ahmad Azam Othman, 2020). However, every type of instrument provides a variety

of choices for Islamic banks customers to choose Islamic home financing and, subsequently, avoid *Riba* (interest) that exists in conventional home loan.

One of the instruments of Islamic home financing offered in Malaysia is *Tawarruq*. *Tawarruq* is a hybrid concept derived from credit and cash sales. This concept is similar to the concept of *'Inah*. The *Tawarruq* concept involves the purchase of commodities by a party with the payment in instalments. Afterwards, the buyer of the commodity will resell the commodity to the bank in order to obtain the cash immediately. This concept slightly differs from the *'Inah* concept as it involves three parties, while *'Inah* only involves two parties in the agreement. Banks acts as an agent in dealing with third parties or representatives involved with the *Tawarruq* agreement (Muhammad Faruq Roslan et al., 2020; Nasrun Mohamad@Ghazali, 2014).

As of 2020, 62.5% of Islamic banks offered the *Tawarruq* concepts for Islamic home financing services (Norhazlina Ibrahim et al., 2022; Safeza Mohd Sopian, 2022). *Tawarruq* concepts offered by Islamic banks are expected to grow each year. Islamic banks tend to prefer *Tawarruq* concepts in Islamic home financing as they are less risky in nature compared to other concepts (Norhazlina Ibrahim et al., 2022; Yustiardi et al., 2019).

Bay' al-inah involves sale and purchase transactions involving two parties, which are the bank and customers. The concept of *Bay' al-inah* concept shows that the commodities involved in the agreement will be returned to the bank or customers. In Islamic home financing, the customer purchases a house from the bank on

deferred terms, with the purchase price including cost and profit. Following that, the customer will resell the house to the bank on a cash basis. The selling price is lower than the purchase price, which only includes the cost value (Bank Negara Malaysia, 2020; Tita Nusyamsiah & Saim Kayadibi, 2012).

The *Bay' Bithaman Ajil* home financing contract refers to the purchase and sale transaction involving an agreed-upon instalment payment at the beginning of the agreement. The price of the sale covers the agreed-upon profit margin between the bank and the customer (Bank Islam Malaysia Berhad, 2018; Wan Nazjmi Mohamed Fisol et al., 2020). *Bay' Bithaman Ajil* home financing contract combines three contracts: *Bay' al-inah*, which involves the sale and purchase of property, *Bay' al-Murabaha*, which covers the profit from the early agreement, and *Bay' al-Ajil*, which is a deferred payment. Subsequently, the *Bay' Bithaman Ajil* contract combines multiple different contracts into a single contract (Wan Nazjmi Mohamed Fisol et al., 2020).

The *Bay' Bithaman Ajil* process begins with the bank selling the house to the customer at a higher price after the two parties reach an agreement. The customer then purchases the house with a deferred payment plan. Following that, the bank will buy the customer's house in cash. However, the cash value is less than the deferred payment that the customer purchased at the beginning of the agreement. The customer will repurchase the house in monthly instalments using the cash earned from the bank (Aishath Muneeza et al., 2020; Wan Nazjmi Mohamed Fisol et al., 2020).

Musyarakah Mutanaqisah home financing contract is a home financing contract based on a partnership concept, also known as equity-based financing. This contract combines two contracts. First, the customer joins a partnership (*Musyarakah*) with the bank under the concept of *Syirkat al-Milk* (joint ownership). Second, the bank will share a portion of the home ownership with the customer under the *Ijarah* concept (leasing) (Agung Abdullah, 2022; Noorhaslinda Abdul Aris et al., 2012).

The *modus operandi* of *Musyarakah Mutanaqisah* home financing involves an established procedure. Firstly, the customer will identify the property that they want to purchase and enter into a sale and purchase agreement with the bank. The agreement will use the *al-Bay'* or *al-Istina'* contract. Secondly, the bank and the customer will sign a *Musyarakah Mutanaqisah* home financing agreement contract. The contract proves that both parties agreed to buy the house together based on the amount of the specified financing (Agung Abdullah, 2022; Nur Aeda et al., 2022). The agreed ownership equity is in accordance with the agreement between the two parties. For example, ownership equity between the bank and the customer is 90:10. Deposits paid by the customer are accounted for as payments to the customer's ownership equity, while the balance of payments payable by the bank is the equity of the bank's ownership. This agreement employs the *al-Shirkah* contract (Abdul Hadi bin Ismail et al., 2013; Fathullah Asni, 2019; Nur Aeda et al., 2022).

Next, the customer will make purchases of the equity of bank ownership from time to time according to the agreed period using the *Al-Wa'd* element. The bank will agree to give a lease to the customer for the established period in the agreement using the *al-Ijarah* contract. After the payment period from the customer's end, the entire

ownership equity of the home will be transferred to the customer. In this stage, the *Musarakah Mutanaqisah* agreement contract will end, and the bank will no longer have rights to the property (Agung Abdullah, 2022; Abdul Hadi bin Ismail et al., 2013; Fathullah Asni, 2019; Nur Aeda et al., 2022).

For 2023, the contract has been identified through research on the websites of 16 Islamic banks in Malaysia. The following concepts are mentioned in the product disclosure sheets (PDS) based on Islamic home financing:

Table 1.2 Home Financing Concepts in Islamic Banks

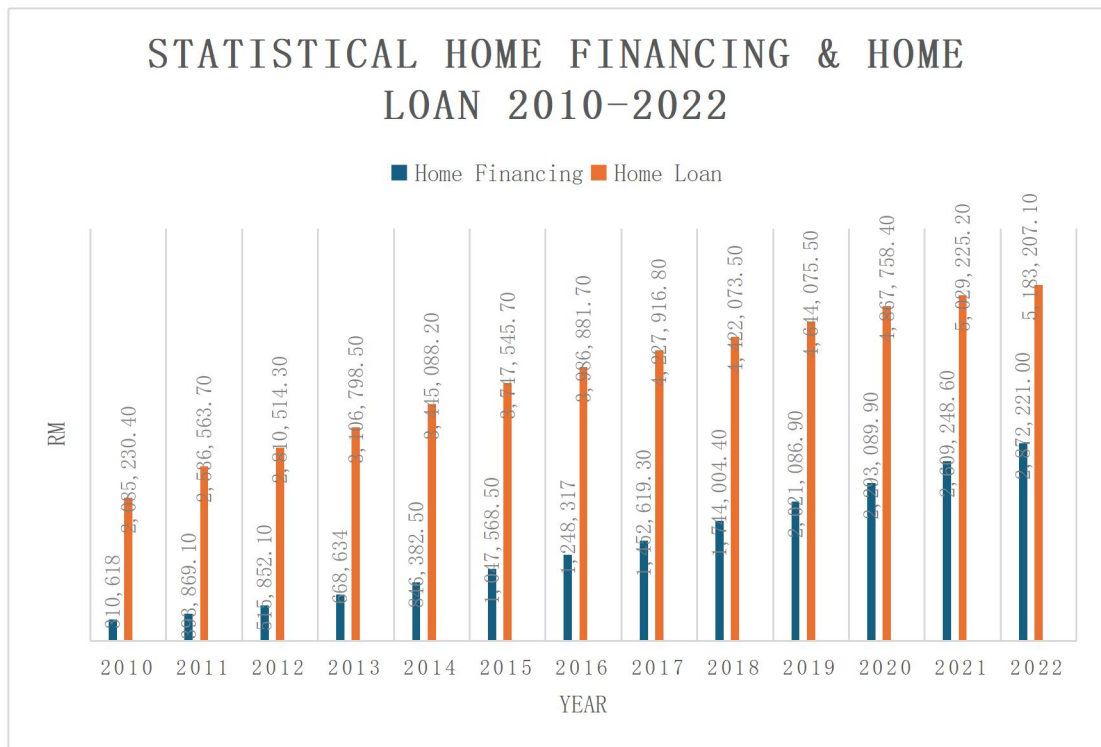
Islamic Banks	Home Financing Concepts
1. Affin Islamic Bank Berhad	<i>Tawarruq & Musarakah Mutanaqisah</i>
2. Al Rajhi Banking & Investment Corporation (Malaysia) Berhad	Commodity <i>Murabahah</i>
3. Alliance Islamic Bank Berhad	<i>Bay' Bithaman Ajil (BBA)</i>
4. AmIslamic Bank Berhad	<i>Tawarruq, Murabahah, Wakalah & Wa'd</i>
5. Bank Islam Malaysia Berhad	<i>Tawarruq</i>
6. CIMB Islamic Bank Berhad	Commodity <i>Murabahah</i>
7. Hong Leong Islamic Bank Berhad	<i>Tawarruq</i>
8. Bank Muamalat Malaysia Berhad	<i>Tawarruq, Murabahah, Wakalah & Wa'd Mulzim (a binding promise)</i>
9. HSBC Amanah Malaysia Berhad	<i>Musarakah Mutanaqisah</i>
10. Kuwait Finance House (Malaysia) Berhad	<i>Ijarah Muntahiah Bi Tamlik, Wa'd, & Ijarah Mausufah Fi Zimmah</i>
11. Maybank Islamic Berhad	Commodity <i>Murabahah</i>
12. MBSB Bank Berhad	<i>Tawarruq</i>
13. OCBC Al-Amin Bank Berhad	<i>Ijarah Muntahiah Bi Tamlik</i>
14. Public Islamic Bank Berhad	<i>Musarakah Mutanaqisah, Ijarah Ijarah Mausufah fi al-Zimmah & Wa'd</i>
15. RHB Islamic Bank Berhad	<i>Musarakah Mutanaqisah, Ijarah, Commodity Murabahah or Tawarruq, Rahn, Musawamah, Kafalah & Wakalah</i>
16. Standard Chartered Saadiq Berhad	<i>Musarakah, Ijarah & Tawarruq</i>

Sources: Bank Negara Malaysia, 2023

Note. The concepts are according to the concepts stated in PDS, for instance commodity *Murabahah* is stated rather than *Tawarruq*.

Out of 16 Islamic banks in Malaysia, 11 of them apply the *Tawarruq* or Commodity *Murabahah* concept in their home financing contracts. The banks are Affin Islamic Bank Berhad, Al Rajhi Banking Berhad, Bank Islam Malaysia Berhad, AmIslamic Bank Berhad, CIMB Islamic Bank Berhad, Hong Leong Islamic Bank Berhad, Bank Muamalat Malaysia Berhad, Maybank Islamic Berhad, MBSB Bank Berhad, and RHB Islamic Bank Berhad. Meanwhile, the second most common concepts used in Islamic banking is *Musyarakah Mutanaqisah*, which is practised by four Islamic banks. In addition, one Islamic bank, Standard Chartered Saadiq Berhad, uses the *Musyarakah* concept. Other concepts used in home financing contracts are BBA, *Wakalah*, *Wa'd Mulzim*, *Ijarah Muntahiah Bi Tamlik*, *Ijarah Mausufah Fi Zimmah*, *Rahn*, *Musawamah*, and *Kafalah*.

Following the home financing types offered by Islamic banks in Malaysia, the growth of Islamic home financing throughout the country has shown an increasing pattern each year. Although the growth of Islamic home financing is still lower than that of home loans, the growth of Islamic home financing is significantly increasing. The differences between Islamic home financing and conventional home loans contributions to banking are shown in Figure 1.1 as follows:



Source: Bank Negara Malaysia, 2023

Figure 1.1 Statistical of Islamic Home Financing and Home Loan by Central Bank of Malaysia

Figure 1.1 displays the statistics of home loans and Islamic home financing in the year 2010 until 2022. The graph indicates the increasing numbers of home loans and Islamic home financing gained by conventional banks and Islamic banks in 12 years. Conventional banks obtain a large number of home loans compared to Islamic banks. This is due to the fact that conventional banks have more experience than Islamic banks. Despite that, the growth of Islamic home financing in Malaysia is thriving, and enhancements to boost the supply of Islamic financing in Malaysia are needed. The factors in that will be discussed in this study are important as it will encourage the supply and growth of Islamic home financing in Malaysia

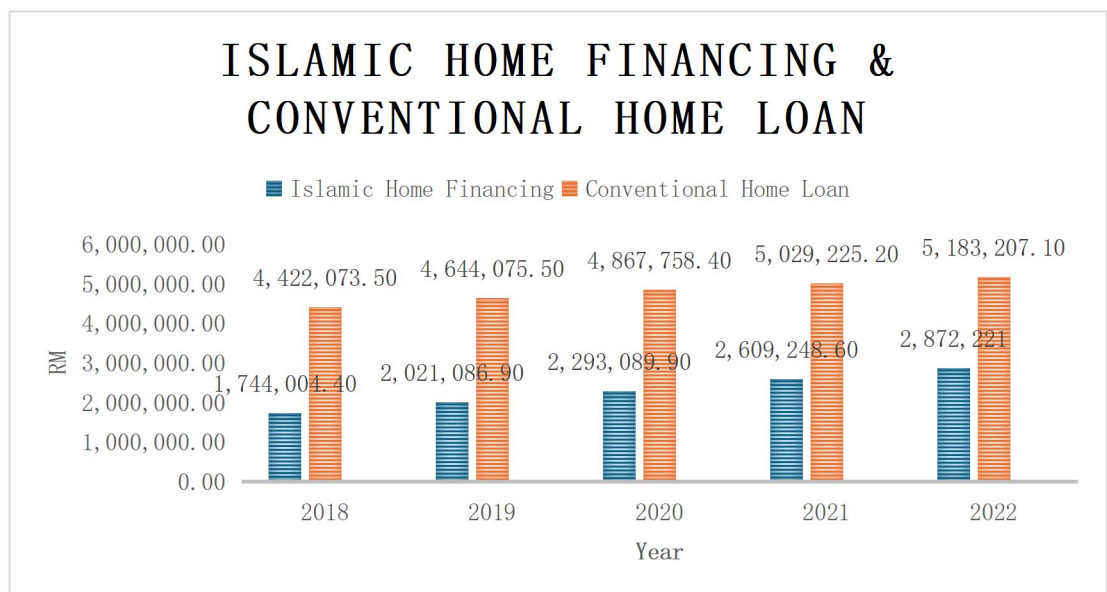
For instance, in 2022, Islamic home financing recorded a value of RM2,872.221, while conventional home loans recorded a value of RM5,183,207.10. The difference between the two banks implied that Islamic home financing accounts for half of all conventional home loans. However, the significant increases of value in Islamic home financing indicates that home financing has consistent growth. This study aims to investigate the issue relies on Islamic home financing and what indicator would contribute to the growth of Islamic home financing in Malaysia in the following subtopics.

1.3 Problem Statement

The comparison of Islamic banks and conventional banks is common in various studies. The studies usually focused on the revenue of both banks and how they differed from each other. According to previous studies, some authors indicate that Islamic banking is less efficient compared to conventional banking (Mohd Azmi et al., 2006; Hanim et al., 2007; Nor Aiza, 2007). Based on the period of establishment, conventional banking was established long before Islamic banking in Malaysia. Many aspects can contribute to the stability of conventional banking (Fathullah Asni, 2019). However, in Islam, the criteria offered by conventional banking are contrary to Shariah principles. Therefore, Islamic banking was established to promote banking services according to Shariah principles.

The problem relies on theories that state conventional banking tend to be more efficient than Islamic banking. Do these theories apply to a general review of both banks and to certain services provided by each bank? As a matter of fact,

Islamic home financing is one of the services provided by Islamic banks shows significant growth. The growth indicates that Islamic home financing is developed and it also encourages the development of Islamic banks. Bank Negara Malaysia's statistics show that Islamic banking service such as Islamic home financing is increasing over time. The statistics are shown in figure 2 as follows:

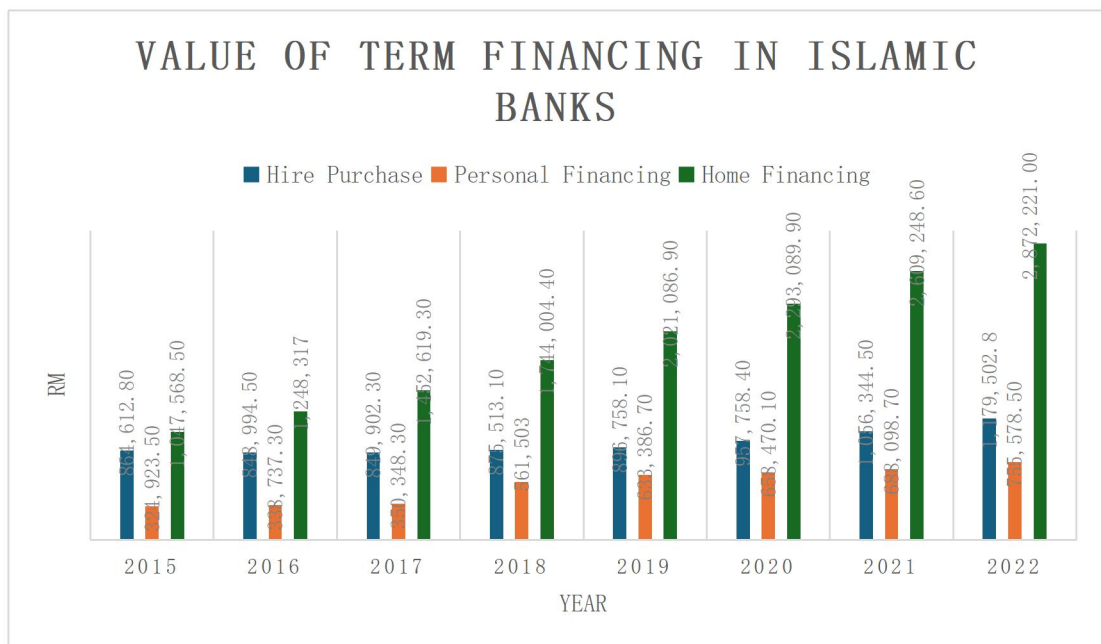


Source: Bank Negara Malaysia, 2023

Figure 1.2 The Value of Islamic Home Financing and Conventional Home Loan from 2018 until 2022

Figure 1.2 display the value of Islamic home financing and conventional home loan in 2018 until 2022. Although the value of Islamic home financing in Malaysia is lower than conventional home loan, a significant increase in Islamic home financing is shown over the year. As Islamic home financing recorded RM1,128,216.6 increase in five years between 2018 until 2022.

As Islamic home financing in Malaysia strives to grow rapidly, there must be a factor that has contributed to this growth. The study of factors that may influence the growth of services in Islamic banking is important as it can improve the services offered. There are many services provided by Islamic banking that contribute to the growth of Islamic banking in Malaysia. One of the services is Islamic home financing. Based on monthly statistical data, Islamic home financing has been recorded as the highest contributor of financing in Islamic banking in Malaysia (Bank Negara, Malaysia, 2023). The graph below displays the value of term financing in 2022.



Sources: Bank Negara Malaysia, 2023

Figure 1.3 The Value of Term Financing in Islamic Banks in Malaysia

Figure 1.3 indicates the value of home financing is higher than other term financings such as hire purchase financing and personal financing. This proves that home financing is highest contributor of financing in Islamic banking in Malaysia.

Thus, the purpose of this study is to delve deeper into Islamic home financing and the factors that contribute to its growth.

The growing value Islamic home financing significantly contribute to the growth of Islamic banking in Malaysia. Despite studies on efficiency that emphasise on different perspectives, the purpose of this study is to investigate the growth of Islamic home financing in Malaysia by identifying the relationship and causal effects of Islamic home financing factors. The result of this study discloses which factors significantly affect Islamic home financing, and it is useful for Islamic banks to apply better management to Islamic home financing based on this result, as the enhancement of Islamic home financing services in Islamic banking would contribute to a better efficiency level.

Islamic home financing displays an increasing performance as the number steadily increases month after month. It proves that the growth of Islamic home financing in Malaysia is increasing each month (Bank Negara Malaysia, 2023), as Islamic banking practises Shariah principles and its operations are free from prohibited elements such as *Gharar*, *Riba*, and *Maysir*. It could be one of the reasons why Islamic home financing is growing and accepted in Malaysia's Muslim-majority community. Islam has emphasised the importance of justice and welfare in any business transaction. Allah SWT mentioned in Surah Al-A'raf, verse 85, as follows:

“And to [the people of] Madyan [We sent] their brother Shu'ayb.

He said, "O my people, worship Allah; you have no deity other than Him.

There has come to you clear evidence from your Lord. So, fulfill the

measure and weight and do not deprive people of their dues and cause not corruption upon the earth after its reformation. That is better for you, if you should be believers.”

(Al-A'raf: 85)

Based on the verse, one cannot be involved in any kind of corruption and must be considerate towards other people. This statement is in line with Islamic ways of doing business, which focus on improving the livelihood of human beings and do not solely rely on profit. This is the difference between Islamic and conventional practices. Therefore, Islamic home financing is seen as the best choice for the community in Malaysia.

As Islamic home financing is one of the main forms of financing in Islamic banking, the importance of these service cannot be denied. The growth of Islamic home financing over time suggests that it can be expanded further in the future. As a result, the factors that contribute to the growth of Islamic home financing must be examined. The factors in Islamic banking, such as assets, deposits, capital, and liabilities, are related to Islamic home financing. Therefore, the relationship between internal factors in Islamic banking and Islamic home financing in Malaysia has to be studied.

Other than that, macroeconomic factors such as inflation, money supply (M3), Islamic interbank money market (IB), and gross domestic product (GDP) are also included to identify the relationship between macroeconomic variables and Islamic home financing in Malaysia. The long-run and short-run relationships between

economic factors and Islamic home financing in Malaysia highlight the importance of which factors affect Islamic home financing in Malaysia. The inclusion of macroeconomic factors are determined to explore the effect of external factors towards Islamic home financing. As economic condition would contribute to the changes of Islamic banks operation as well as Islamic home financing.

In addition, the causality between assets, deposits, capital, liabilities, inflation, money supply (M3), Islamic interbank money market (IB), and GDP needs to be addressed in this study. This matter emphasises the factors that have significant causal effects on Islamic home financing, as well as identify the important factors that need to be monitored in order to enhance the growth of Islamic home financing. As the variables that have a significant causal relationship with Islamic home financing, they can be used to forecast the value of Islamic home financing in Malaysia in the future.

Furthermore, time series data analysis which involves more than 30 observations can display a significant change of the internal factors in Islamic banking and macroeconomic factors towards Islamic home financing in Malaysia. Through the time series data, long-run and short-run relationship can be identified. Hence, the positive or negative relation between the factors on Islamic home financing would give an insight on which factors that have significant impact on Islamic home financing in Malaysia in long-run and short-run estimation.

The question is, what is the long-run and short-run relationship of Islamic home financing in Malaysia? Which are the internal and macroeconomic factors that

affect Islamic home financing in the long and short run? Another question raised is, what are the causal effects of the factors in Malaysian Islamic home financing? Therefore, the purpose of this study is to investigate the relationship and causal effects of determinant factors of Islamic home financing in Malaysia. This is to determine the factors that may influence the growth of Islamic home financing in Malaysia.

1.4 Research Objectives

The objectives of the study comprise of three objectives that focus on the factors of Islamic home financing. The objectives comprise of:

1. To examine the long-run relationship of determinant factors in Islamic home financing in Malaysia
2. To identify the short-run relationship of determinant factors in Islamic home financing in Malaysia
3. To assess the causality effect of determinant factors in Islamic home financing in Malaysia.

1.5 Research Questions

In order to fulfil the objectives stated, a few questions are in posed.

- i. What is the internal variable exhibits a long-run relationship in Islamic home financing in Malaysia?

ii. What is the macroeconomic variable exhibits a long-run relationship in Islamic home financing in Malaysia?

iii. Which internal variables exhibits a short-run relationship in Islamic home financing in Malaysia?

iv. Which macroeconomic variables exhibits a short-run relationship in Islamic home financing in Malaysia?

v. What the effect and cause of variables influencing the Islamic home financing in Malaysia?

vi. What will be the direction of indicators in Islamic home financing in Malaysia?

Table 1.3 Summary of Research Objectives and Research Questions

Research Objectives	Research Questions
1. To examine the long-run relationship of determinant factors in Islamic home financing in Malaysia	<p>i. What is the internal variable exhibits a long-run relationship in Islamic home financing in Malaysia?</p> <p>ii. What is the macroeconomic variable exhibits a long-run relationship in Islamic home financing in Malaysia?</p>
2. To identify the short-run relationship of determinant factors in Islamic home financing in Malaysia	<p>iii. Which internal variables exhibits a short-run relationship in Islamic home financing in Malaysia?</p> <p>iv. Which macroeconomic variables exhibits a short-run relationship in Islamic home financing in Malaysia?</p>
3. To assess the causality effect of determinant factors in Islamic home financing in Malaysia	<p>v. What the effect and cause of variables influencing the Islamic home financing in Malaysia?</p> <p>vi. What will be the direction of indicators in Islamic home financing in Malaysia?</p>

Table 1.3 displays the study's research objectives and research questions. There are a total of three research objectives and six research questions regarding factors influencing Islamic home financing in Malaysia.

1.6 Operational Definition

There are two important concepts in this study. The operational definitions of these concepts are discussed in this part of the chapter. The explanation of these concepts is based on the scope of the study to ensure that the definition is in the same field as this study. The concepts used in this study are Islamic home financing, the relationship between Islamic home financing, the causal effects of Islamic home financing, and Islamic banking.

1.6.1 The Relationship Of Islamic Home Financing

The relationship of Islamic home financing in Malaysia is discussed in this study. The discussion of the relationship of Islamic home financing in Malaysia consists of the long-run relationship and the short-run relationship between the variables towards Islamic home financing in Malaysia. The long-run relationship exhibits the long-term link between variables and Islamic home financing, where the variables may or may not be significant towards Islamic home financing based on a long period of time.

The co-integration test is used to determine the long-run information in the modelling time series (Engle & Granger, 1987; Granger, 1981). This is necessary to

identify the existence of a long-run relationship in the model. Therefore, the Autoregressive Distributed Lag (ARDL) approach to co-integration or bound test for long-run relationship is used to examine the long-run relationship between the determinant factors and Islamic home financing in Malaysia (Pesaran et al., 1996; Pesaran & Shin, 1995).

On the other hand, the short-run relationship shows the relationship between the variables involved in Islamic home financing over a short period of time. The variables that exhibit a significant result in the short-run estimation test may differ from the long-run relationship estimation test result. The ECM test ID derived through the ARDL bound test is used to examine both the short-run and long-run relationships between the variables towards Islamic home financing in Malaysia. Short-run parameters are identified, and the error correction term is computed based on the result (Pesaran et al., 2001). Therefore, both periods need to be studied to identify which factors contributed to the changes in Islamic home financing in Malaysia during both terms.

Both periods are studied to examine the relationship of the variables involved in Islamic home financing in Malaysia. The difference between long-run and short-run, is the estimation test conducted in this study. Long-run estimation test is used to determine the long-run relationship between variable towards Islamic home financing in Malaysia. Whereas short-run estimation test used to determine the existence of short-run relationship between variables on Islamic home financing in Malaysia. The distinction between long-run and short-run relationships emphasises the importance of significant variables during both time periods. For instance, the