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Does The Covid-19 Pandemic Affect Financing of Islamic Banks in Indonesia?

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ABSTRACT

Introduction: This study investigates the influence of macroeconomic and bank-specific variables on financing activities in Indonesian Islamic banks, particularly during the COVID-19 pandemic, to assess the sector's financial resilience and alignment with sustainable finance principles.

Methods: This research employs a quantitative approach using dynamic panel data analysis covering the period from 2011 to 2023, with variables including Gross Domestic Product, inflation, interest rates, non-performing financing, bank size, profitability, and a pandemic indicator.

Results: The findings reveal that while the COVID-19 pandemic did not significantly affect financing, interest rates and bank size had a significant positive impact. Other variables such as GDP, inflation, non-performing financing, and profitability did not exhibit statistically significant effects. The resilience observed in Islamic banks is attributed to their reliance on ethical principles, risk-sharing mechanisms, and asset-backed financing structures.

Conclusion and suggestion: The study concludes that Indonesian Islamic banks-maintained stability during the pandemic, reinforcing their role in promoting long-term financial sustainability and economic resilience. Policymakers and regulators are encouraged to support the Islamic banking sector as a key component of sustainable finance frameworks, leveraging its unique characteristics to contribute to broader development goals.

Keyword: Financing, Indonesia, Islamic Bank, Pandemic.

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A. INTRODUCTION

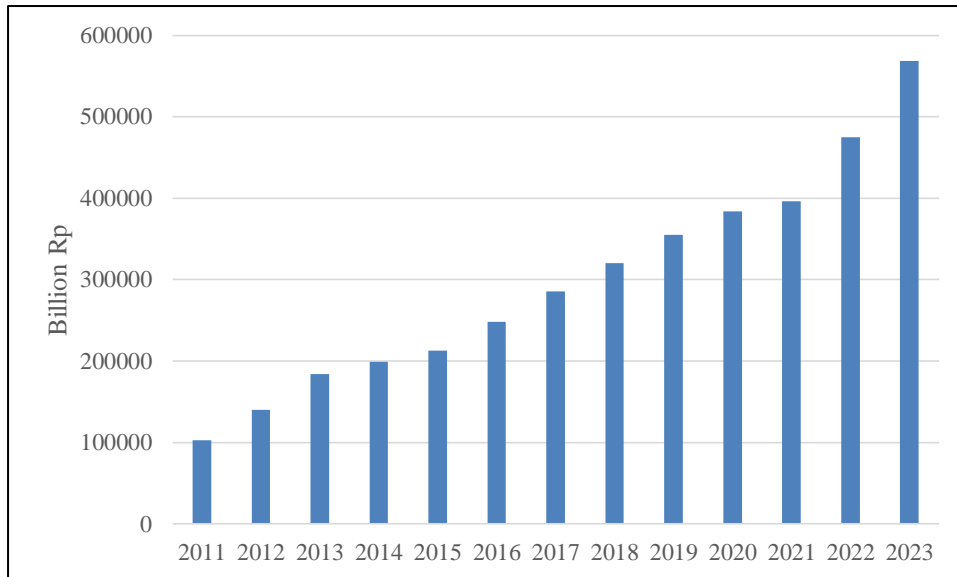
Islamic banks offer a distinct approach to financing by emphasizing risk-sharing and asset-backed transactions, in contrast to interest-based lending. This unique structure is vital not only for economic development but also for promoting sustainability. Islamic banking prioritizes investments that foster long-term social, environmental, and economic stability, thus supporting sustainable and equitable growth. By focusing on ethical investments, avoiding speculative activities, and financing real, productive assets, Islamic banks play a critical role in building a more resilient and sustainable financial system one that is less prone to the risks and instabilities often associated with conventional banking models. Furthermore, Islamic banks emphasize social responsibility, financing projects that contribute to both financial and social well-being. They also integrate environmental, social, and governance (ESG) factors into their investment decisions, aligning their financial activities with broader

sustainability goals (Andespa et al., 2024). As noted by Yusuf et al., (2024), the growing adoption of corporate governance and integrated reporting within Islamic banks further supports their commitment to sustainability. Studies suggest that Islamic banks are central to fostering innovation and advancing economic sustainability, particularly in regions like the GCC (Alhammadi, 2024). With an increasing focus on sustainability, these institutions are evolving to meet the challenges of a changing global economy while remaining true to their core ethical principles. Consequently, Islamic banking not only strengthens financial systems but also contributes significantly to the global shift toward responsible and sustainable finance s

Recently, the world has been grappling with a crisis originating from a health emergency, known as the coronavirus pandemic. Economic growth has been severely restrained globally due to policies implemented to curb COVID-19, such as movement restrictions. As a result, businesses and industries have faced disruptions, with many unable to maintain operations at normal levels. One of the significant economic consequences of the pandemic has been a widespread credit crunch, which has limited access to financing, particularly for small and medium-sized enterprises (SMEs). The lack of credit availability has slowed down investment in critical sectors, hindering economic recovery and growth. Dyahpialoka & Riyanti (2023) emphasize that the credit crunch has forced businesses to reconsider their expansion plans and investment strategies, thus affecting their financial stability. Similarly, Qori'atul Septiavin et al., (2022) highlight that the credit squeeze has diminished both demand and supply of credit, leading to reduced investments in growth and innovation. This credit crunch poses a considerable threat to sustainability, as decreased financing limits the ability of businesses and governments to invest in projects that promote long-term economic, social, and environmental stability. When financing options dry up, the ability to fund projects aligned with sustainability goals, such as renewable energy and sustainable infrastructure, becomes severely constrained. This ultimately exacerbates vulnerabilities in the economy and slows down efforts to achieve sustainable development. Without adequate financing, the progress toward sustainability becomes increasingly difficult, with critical investments in environmental and social projects facing significant delays, thereby threatening the long-term stability of economies and societies. Conventional banks faced substantial challenges, with many experiencing reduced lending growth. Temesvary & Wei (2021) stated that U.S. banks with heavier foreign COVID exposure cut their U.S. lending, raised their lending rates, and tightened lending standards and terms substantially more, and this effect is particularly strong for lower-capitalized banks. Susanto et al., (2023) found that Indonesian rural banks reduced their lending activities to a lesser extent, maintained more favorable lending terms during the COVID-19 pandemic.

However, Islamic banks, with their unique operational frameworks based on Sharia principles, demonstrated resilience in previous economic crises, raising questions about their performance during the COVID-19 pandemic. Boubakri et al., (2023) found that lending by Islamic banks grew approximately 2.5% faster than that of conventional banks during the crisis, while Beck et al., (2008) show that Islamic banks intermediate more funds than conventional banks, particularly during times of crisis. Bilgin et al., (2021) recently found that economic uncertainties significantly decrease credit growth for conventional banks rather than Islamic banks. It is crucial to evaluate whether Islamic banking's ability to maintain

financing during past crises extended to the COVID-19 pandemic, or if the unique challenges presented by the pandemic impacted its financing operations. Given its focus on ethical investments, risk-sharing, and ESG goals, Islamic banking plays a key role in enhancing the resilience of financial systems, ensuring continued economic stability, and contributing to sustainable growth even amid global disruptions.



Source: (Indonesian Financial Service Authority, 2023)

Figure 1. Indonesian Islamic Bank Financing, 2011-2023

Figure 1 illustrate financing of Indonesian Islamic banks from 2011 to 2023. Overall, the number of financing disbursed increased over the period given. The highest number of financing can be seen in 2023. In 2011, the number of financing reached more than 100,000 billion Indonesian Rupiah and then rose steadily until the end of period. During the COVID-19 pandemic, financing in Indonesian Islamic banks demonstrated notable growth. This growth can be attributed to the resilience of Islamic banks' operational principles, which emphasize risk-sharing, asset-based transactions, and a focus on real economic activities. Despite global economic uncertainties and disruptions caused by the pandemic, Islamic banks adapted effectively by leveraging these principles. The pandemic period presents a unique opportunity to evaluate whether the operational and structural features of Islamic banking provided a buffer against the economic shocks caused by COVID-19.

The majority of the literature on the effects of the COVID-19 pandemic on bank lending explores various banking models, ownership structures, and government interventions. Dursun-de Neef & Schandlbauer (2022) show that banks with stronger liquidity positions were better able to continue lending despite economic disruptions. Temesvary & Wei (2021) further explore how international exposure affected U.S. banks' lending decisions, suggesting that banks with higher foreign risk reduced lending more significantly. However, other studies present contrasting findings, such as Beck & Keil (2022), who argue that while government interventions stabilized lending in the short term, banks became more cautious, reducing lending to certain sectors. Bin Amir & Choudhury (2023) also highlight that non-performing loans (NPLs) had a significant impact on private commercial banks in Bangladesh, affecting their willingness to extend credit. Regarding

fiscal policy responses, studies by Loi & Dang (2023) and Naiborhu & Ulfa (2023) emphasize the effectiveness of targeted interventions, with Loi and Dang finding that the transmission of monetary policy weakened during the pandemic.

From the Indonesian Islamic banking perspective, it is stated that Islamic banks demonstrated greater resilience in their lending behavior due to their reliance on profit-and-loss sharing contracts rather than interest-based income. This aligns with Susanto et al., (2023) who note that state-owned banks in Indonesia maintained lending activity better than privately-owned banks during the crisis. Anggraini et al., (2023) highlighted the stability of leasing syariah compared to conventional leasing, showing how asset-based financing structures in Islamic finance mitigate risks during crises. Zaharman et al., (2022) pointed out that Islamic banks in Indonesia faced slower asset and financing growth but maintained trust with their customers. Together, these studies demonstrate a clear trend: Islamic banks' unique structures provided stability during the pandemic, though challenges like digital transformation and liquidity management persisted.

While numerous studies have investigated the implications of the COVID-19 pandemic on banking, they have primarily focused on short-term effects either during the pandemic or in the immediate aftermath. These studies often examine changes in bank performance, lending capacity, or credit risk, without directly assessing whether the pandemic itself had a significant and measurable impact on Islamic bank financing. To date, no research has explicitly analyzed whether the COVID-19 pandemic truly affected the financing activities of Islamic banks in Indonesia. This leaves a critical gap in the literature, especially given the unique characteristics of Islamic banking that emphasize risk-sharing and asset-backed transactions. To address this gap, this study aims to examine whether the COVID-19 pandemic has significantly affected the financing of Islamic banks in Indonesia by using a dynamic panel data approach. It also seeks to analyze the influence of selected macroeconomic variables and bank-specific characteristics on Islamic bank financing over the period of 2011–2023. By focusing specifically on financing behavior rather than overall bank performance, this research provides a novel contribution to the empirical understanding of Islamic banking resilience. Furthermore, the findings are important not only for filling a theoretical void but also for offering empirical evidence of Islamic banks' resilience in the face of systemic crises, thereby providing practical insights for regulators and policymakers in designing inclusive and sustainable financial strategies. This study thus contributes theoretically by advancing knowledge on financing behavior in Islamic banking and practically by offering evidence-based recommendations for policy and regulatory development.

B. THEORETICAL STUDY

Islamic economic theory provides a foundational framework for understanding the role of Islamic banks during periods of crisis, particularly through the principles of *maqashid syariah*, which emphasize the protection of religion (*din*), life (*nafs*), intellect ('*aql*), lineage (*nasl*), and wealth (*mal*) (Chapra, 2016). These five dimensions serve as the objectives of Islamic law, aiming to ensure human well-being through a balanced and just socio-economic system. In the context of Islamic banking, *maqashid syariah* encourages financial practices

that not only comply with Shariah but also enhance public welfare, especially during times of systemic shock such as the COVID-19 pandemic. In line with this, Islamic banking emphasizes financial intermediation that upholds *‘adl* (justice) and *ihsan* (benevolence), particularly through instruments that avoid exploitative and destabilizing elements. One of the core principles is the prohibition of *riba*, which refers to unjustified, predetermined interest charged on loans, seen as leading to inequality and wealth concentration. *Gharar*, or excessive uncertainty, is also prohibited to prevent unfair advantage in transactions, typically arising in ambiguous contracts or speculative ventures. Likewise, *maysir*, or gambling, is banned because it promotes wealth acquisition through chance rather than productivity, which contradicts Islamic values of labor-based earning and mutual benefit (Siddiqi, 2006). By avoiding these elements, Islamic finance ensures that economic transactions are rooted in transparency, justice, and real asset productivity principles that are particularly critical during crisis conditions when financial stability is under threat. These theoretical underpinnings directly relate to the resilience of Islamic bank financing practices examined in this study, especially in the context of macroeconomic uncertainty and regulatory responses during the COVID-19 crisis.

These mechanisms are closely aligned with the objectives of sustainable development and inclusive growth, as they seek to channel funds to productive sectors while protecting the interests of all stakeholders, including small enterprises and vulnerable communities. Unlike conventional banking, which often prioritizes profitability and risk transfer, Islamic banking promotes shared risk and real-sector linkage, making it naturally inclined toward counter-cyclical and socially responsible finance. This alignment becomes particularly evident during economic downturns, where Islamic banks' focus on tangible assets and ethical contracts can foster greater financial stability and resilience (El-Gamal, 2006). As such, Islamic banking performance during the COVID-19 pandemic can be examined not only through empirical metrics such as financing volume, asset growth, or risk exposure but also in light of its consistency with these normative economic ideals. In doing so, this study contributes not only to understanding the statistical impact of the pandemic on financing behavior but also to assessing whether Islamic banks remain true to their foundational principles under stress, thereby reaffirming their relevance in achieving long-term socio-economic objectives.

While the existing literature provides extensive evidence of Islamic banks' performance during the COVID-19 pandemic, a critical comparison across contexts reveals key patterns, differences, and limitations that shape the current understanding. The majority of banking literature on the pandemic highlights that Islamic banks' inherent ethical investment principles, such as risk-sharing, asset-backed financing, and a focus on real economic activities, have provided them with a more resilient framework compared to conventional banks during the COVID-19 crisis. These features align with broader trends in sustainable finance, where the integration of environmental, social, and governance (ESG) factors is becoming increasingly important (Umam, 2022). The pandemic has underscored the importance of sustainability-focused strategies in banking, with Islamic banks playing a crucial role in promoting economic stability and contributing to the achievement of sustainable development goals. A number of studies have explored how Islamic banks have responded to the pandemic compared to conventional banks. Akkas & Al Samman (2022) highlighted the relative resilience of Islamic financial institutions in the GCC countries

during the pandemic, emphasizing that Islamic banks, due to their asset-backed and risk-sharing nature, showed more stability compared to their conventional counterparts. Similarly, El-Chaarani (2023) found that Islamic banks in the GCC region were less impacted by the COVID-19 shock in terms of financial structure and performance, largely due to their focus on long-term financing and risk management strategies. However, these findings contrast with those of Umam (2022), who reported a decline in profitability for Islamic banks in Indonesia, driven by disruptions in sectoral financing, indicating that Islamic banks were not immune to the broader economic downturn caused by the pandemic.

A similar pattern emerges when comparing Islamic and conventional bank performance, although the operational differences between the two systems create divergent outcomes during crises. Shah et al., (2023) examined the profitability impact on both Islamic and conventional banks and found that Islamic banks performed better in terms of profitability preservation, owing to their diversified portfolios and ethical investment principles. This was also reflected in studies by Fakhri & Nuriyah (2022) and Risfandy & Pratiwi (2022), who observed that Indonesian Islamic banks showed more resilience compared to conventional counterparts, as Islamic banks' operations are less susceptible to speculative financial practices. In contrast, conventional banks, heavily dependent on interest-based income, faced a more substantial negative impact on their profitability (Yunita, 2022). These contrasting outcomes highlight a fundamental difference in the operational models of Islamic and conventional banks, with Islamic banking's risk-sharing and ethical financing models providing a more stable foundation during periods of crisis. In terms of liquidity creation, Viverita et al., (2023) found that Islamic banks were more effective in providing liquidity during the pandemic, reflecting their role in supporting the economy through asset-backed financing. However, liquidity constraints were a common challenge faced by both banking models, with conventional banks showing sharper declines in credit supply due to risk aversion and tighter lending standards (Yudaruddin, 2023). On the other hand, Islamic banks, due to their focus on financing real economic activity and tangible assets, were less affected by liquidity shortages, making them key players in maintaining financial stability during the crisis.

The literature also shows a general consensus that Islamic banks maintained stronger financing continuity amid crisis conditions, though institutional capacity and sectoral focus varied across countries. Bin Amir & Choudhury (2023) found that Islamic banks remained steadfast in their lending behavior during the pandemic, largely due to their focus on ethical investments and asset-backed financing, which enabled them to continue supporting key sectors despite economic disruptions. Similarly, Doruk (2023) emphasized that Islamic banks were well-positioned to support small and medium-sized enterprises (SMEs) by providing financing without relying on interest-based income, a key advantage during financial instability. Additionally, Loi & Dang (2023) noted that Islamic banks, relying on profit-and-loss sharing models, showed greater stability in their lending practices, ensuring continued financing despite the challenging circumstances. Temesvary & Wei (2021) also found that Islamic banks, with their asset-backed financing models, maintained stronger financial positions, preserving their ability to lend during the crisis. This body of literature consistently underscores how Islamic banks successfully navigated the pandemic, supporting critical sectors while maintaining their financing operations amidst global economic challenges.

In the Indonesian context, however, the findings are more mixed, reflecting institutional diversity, regulatory responses, and market maturity. Basmar et al., (2022) explored the dilemmas faced by Indonesian banks during the pandemic, noting that credit supply was constrained due to heightened risk aversion and uncertainty in the financial cycle, which affected lending behavior. Naiborhu & Ulfa (2023) examined the impact of funding for lending schemes in Indonesia and found that such policies aimed at stimulating lending were crucial in maintaining credit flow, though the effectiveness was limited by banks' reluctance to lend due to the uncertain economic environment. Similarly, Susanto et al., (2023) highlighted how public ownership influenced the lending capacity of local banks during the pandemic, suggesting that state-backed institutions were better equipped to continue lending compared to private counterparts, which were more cautious. Toni & Goh (2022) discussed the influence of banking credit growth on economic stability in Indonesia during the pandemic, emphasizing the critical role of financing in supporting sectors hit hardest by the crisis. Yudaruddin (2023) added that the adoption of alliances and digital strategies by Indonesian banks during the pandemic helped mitigate some of the negative impacts on lending, allowing for more flexible and efficient credit distribution. Collectively, these studies illustrate how the Indonesian banking sector responded to the COVID-19 pandemic, with a focus on maintaining lending activity despite economic turmoil, highlighting the importance of strategic policies, digital solutions, and public sector involvement in sustaining credit flows.

When focusing specifically on Islamic banks in Indonesia, the literature highlights their adaptability, but also reveals a lack of empirical testing on long-term impacts. Anggraini et al., (2023) examined the rise and fall of Islamic leasing (leasing syariah) during the pandemic, noting that while the demand for Islamic leasing services initially decreased due to the economic downturn, there were efforts to adapt financing models to address emerging needs. Boubakri et al., (2023) discussed how Islamic banks, compared to conventional banks, were more resilient in their lending practices during the pandemic, particularly due to their reliance on asset-backed financing and ethical investment principles, which helped them navigate the crisis with less disruption. Zaharman et al., (2022) analyzed the performance of Islamic banks in Indonesia during the pandemic, highlighting growth in assets, financing, and third-party funds despite the economic challenges, suggesting that Islamic banks had managed to maintain stability by focusing on sustainable and ethical financial practices. Collectively, these studies underscore the adaptability and resilience of Islamic banks in Indonesia during the pandemic, demonstrating their ability to continue financing key sectors, especially by leveraging their unique operational frameworks based on risk-sharing and tangible assets, which helped mitigate the impact of economic instability. Nevertheless, there remains a gap in the literature regarding whether the COVID-19 pandemic had a statistically significant and lasting effect on Islamic bank financing, thus necessitating empirical investigation using dynamic panel methods, as this study intends to provide.

The existing literature on the impact of the COVID-19 pandemic on bank lending, particularly in the context of Indonesian Islamic banks, has highlighted their resilience due to their reliance on asset-backed financing and profit-and-loss sharing models. However, gaps remain in understanding the long-term effects of the pandemic on Islamic bank financing, as most studies focus on the immediate impact, with limited attention to sustained changes over

time. Furthermore, there is a lack of research using panel data analysis to examine dynamic shifts in financing behavior across different Islamic banks and macroeconomic variables during and after the crisis. This study seeks to address these gaps by utilizing a panel data approach to assess the broader and more nuanced effects of the pandemic on Islamic bank financing in Indonesia, accounting for factors such as economic conditions and bank-specific characteristics. By focusing on financing as the dependent variable, rather than performance, and employing dynamic panel data methods to overcome methodological issues such as heteroscedasticity and endogeneity, this research aims to provide robust, reliable findings. The results will contribute to a deeper understanding of the pandemic's long-term effects on Islamic bank lending behavior, offering insights for policymakers and regulators to refine policies that support financial stability and sustainable growth in the Islamic banking sector in Indonesia. This study thus contributes theoretically by advancing knowledge on financing behaviour in Islamic banking and practically by offering evidence-based recommendations for policy and regulatory development.

C. METHODOLOGY

The data is taken from various sources such as the annual reports of Islamic commercial banks in Indonesia, publications from the Financial Services Authority (Otoritas Jasa Keuangan), Bank Indonesia, and international databases such as the World Bank. The data collection involved systematic extraction of annual financial indicators from bank reports and official regulatory statistics, followed by data tabulation and cross-verification to ensure consistency and completeness.

Table 1. Factors of Influencing Non-Performing Financing

No	Variables		References
1	Financing	FIN	Abusharbeh (2020), Setyowati (2019), Ibrahim and Sufian (2014)
2	Gross Domestic Product	GDP	Abusharbeh (2020) Setyowati (2019) Ibrahim and Sufian (2014)
3	Consumer Price Index	CPI	Abusharbeh (2020), Ibrahim and Sufian (2014), Setyowati (2019)
4	Interest Rate	IR	Abusharbeh (2020), Ibrahim and Sufian (2014), Adebola, Yusoff, and Dahalan (2011)
5	Non-Performing financing	NPF	Jiménez and Saurina (2006)
6	Bank Size	LNASSET	Abusharbeh (2020), Adzis, Sheng, and Bakar (2018)
7	Return on Asset	ROA	Abusharbeh (2020) Alihodzic and Eksi (2018)
8	COVID-19 Outbreak	PAND	

The study covers the period from 2011 to 2023, which was selected based on the availability and reliability of the data. The analysis uses annual data and employs a dynamic panel data method to capture temporal effects. The sample includes all full-fledged Islamic commercial

banks operating in Indonesia, excluding rural Islamic banks (BPRS). The operational definitions, measurement sources, and variable classifications are detailed in Table 1.

The operational definitions of the variables used in this study are as follows: Financing (FIN) refers to the total annual financing disbursed by each Islamic bank, measured in billion Indonesian Rupiah, and serves as the dependent variable. Gross Domestic Product (GDP) represents the annual real GDP of Indonesia, capturing the overall economic condition and demand for financing. Consumer Price Index (CPI) is used as a proxy for inflation, reflecting the general price level changes that may influence borrowing costs and repayment capacity. Interest Rate (IR) refers to the annual benchmark interest rate set by Bank Indonesia, indicating the cost of borrowing in the conventional banking system. Non-Performing Financing (NPF) represents the percentage of problematic financing in the bank’s portfolio, indicating asset quality. Bank Size (LNASSET) is measured by the natural logarithm of total assets, used to control for bank-level scale effects on financing decisions. Return on Asset (ROA) measures bank profitability as the ratio of net income to total assets. COVID-19 Outbreak (PAND) is a dummy variable that takes the value of 1 for years affected by the pandemic (2020–2022), and 0 otherwise, to capture the impact of the crisis on financing behavior. Following prior studies on panel data like Jimenez and Saurina (2006) and Abusharbeh (2020), and in order to take into account the time persistence of non-performing financing, the econometric model, used in our study, is the GMM dynamic panel data model. Sample of the data used in this study is Islamic banks in Indonesia excluding the rural banks. The equation could be written as follow:

$$FIN_{it} = \alpha FIN_{it-1} + \beta_1 GDP_{it} + \beta_2 CPI_{it} + \beta_3 IR_{it} + \beta_4 NPF_{it} + \beta_5 SIZE_{it} + \beta_6 ROA_{it} + \beta_7 PAND_{it} + \eta_i + \alpha_{it} \dots \dots \dots (1.)$$

Where FIN refers to financing, GDP refers to gross domestic product, INF refers to inflation, SIZE refers to bank size which is represented by the asset of the bank, ROA refers to return on asset and PAND refers to Covid-19 pandemic which is a dummy variable. For the long-run relationship between the coefficient of independent variables and the dependent variable, the equation could be written as follow:

$$FIN_{it} = \alpha FIN_{it-1} + \bar{\beta}_1 GDP_{it} + \bar{\beta}_2 CPI_{t-1} + \bar{\beta}_3 IR_{it} + \bar{\beta}_4 NPF_{it} + \bar{\beta}_5 SIZE_{it} + \bar{\beta}_6 ROA_{it} + \bar{\beta}_7 PAND_{it} + \eta_i + \alpha_{it} \dots \dots \dots (2.)$$

$$\bar{\beta}_1 = N^{-1} \sum_{i=1}^N \beta_1, \dots, \bar{\beta}_n = N^{-1} \sum_{i=1}^N \beta_n \dots \dots \dots (3.)$$

Therefore, based on the previous discussion, the following hypothesis are formulated:

- (H₁) There is a positive relationship between gross domestic product and financing
- (H₂) There is either a negative or a positive relationship between inflation and financing
- (H₃) There is a negative relationship between interest rate and financing
- (H₄) There is a negative relationship between non-performing financing and financing
- (H₅) There is a positive relationship between bank size and financing
- (H₆) There is a positive relationship between profitability and financing
- (H₇) There is a negative relationship between profitability and financing

D. RESULT

The objective of this section is to give an overview analysis for the study in terms of scope of the data and variables. Table 2 summarizes the descriptive statistics of the variables, illustrated by its mean, median, minimum, maximum, and standard deviation values. The descriptive include sample size mean, standard deviation, minimum and maximum values for panel data on 8 Indonesian Islamic banks from 2011 to 2023.

Table 2. Descriptive Statistics

	Mean	Standard Deviation	Minimum	Maximum
FIN	31078,79	5539,647	214	240316
GDP	3511411	100304	2015393	5302543,6
CPI	125,39	1,182634	105,68	146,84
IR	5,43	0,150472	3,5	8,34
NPF	7,47	0,209383	0,08	12,52
ASSET	48849,69	8258,171	642.03	353624,1
ROA	1,04	0,166514	-10.77	6.93
PAND	0,30	0,045477	0	1

Financing (FIN) as the dependent variable has a mean of 31,078.79 with a standard deviation of 5,539.65, a minimum value of 214, and a maximum of 240,316. Gross Domestic Product (GDP) as the first independent variable has a mean of 3,511,411 with a standard deviation of 100,304, a minimum of 2,015,393, and a maximum of 5,302,543.6. Consumer Price Index (CPI) has a mean of 125.39 with a standard deviation of 1.18, a minimum value of 105.68, and a maximum of 146.84. The Interest Rate (IR) has a mean of 5.43 with a standard deviation of 0.15, a minimum of 3.5, and a maximum of 8.34. Non-Performing Financing (NPF) has a mean of 7.47 with a standard deviation of 0.21, a minimum value of 0.08, and a maximum of 12.52. Bank Size, represented by total assets (ASSET), has a mean of 48,849.69 with a standard deviation of 8,258.17, a minimum value of 642.03, and a maximum of 353,624.1. Profitability, represented by Return on Assets (ROA), has a mean of 1.04 with a standard deviation of 0.17, a minimum value of -10.77, and a maximum of 6.93. Finally, Pandemic (PAND), as a binary variable, has a mean of 0.30 with a standard deviation of 0.05, a minimum of 0, and a maximum of 1.

Table 3. Correlation Matrix Among Independent Variables

	GDP	CPI	Int Rate	Asset	ROA	NPF	Pandemic
GDP	1						
CPI	0.39	1					
Int Rate	0.33	0.68	1				
BS	-0.11	-0.31	-0.19	1			
ROA	0.07	-0.11	-0.05	0.10	1		
NPF	-0.01	-0.16	0.08	0.01	-0.61	1	
Pandemic	-0.48	-0.65	-0.65	0.23	0.12	-0.12	1

Table 3 shows the result for the correlation among the independent variables in this study. While correlations among variables are desirable, higher correlation coefficients indicate multicollinearity problems. The degree of collinearity regarded as a multicollinearity problem has set as strict as 0.7 (Tabachnick, 2007) and as general as 0.8-0.9 (Gujarati & Porter, 2009). However, multicollinearity assumption is not an indicator of Gauss-Markov condition which

makes the model not valid or not robust. Unlike autocorrelation and heteroskedasticity problem, multicollinearity problem only disturbs the result of the regression in terms of significance. Based on the correlation matrix, it is indicated that there is no multicollinearity problem.

Table 4. Variance Inflation Factor

Variable	VIF	1/VIF
GDP	1.29	0.78
Inflation	1.17	0.85
Interest Rate	1.25	0.80
NPF	1.35	0.74
BS	1.01	0.99
ROA	1.31	0.76
PAND	1.28	0.98

The test of multicollinearity is extended to variance inflation factors (VIF) as presented in table 4. The VIF result shows value of less than 6 and higher that 0.15. These results contradict with the previous result indicating an absence of multicollinearity problem as the values are less than the VIF threshold of 10 and higher than the tolerance threshold of 0.10 (Gujarati & Porter, 2009). Based on the table 4, it is indicated that there is no multicollinearity problem.

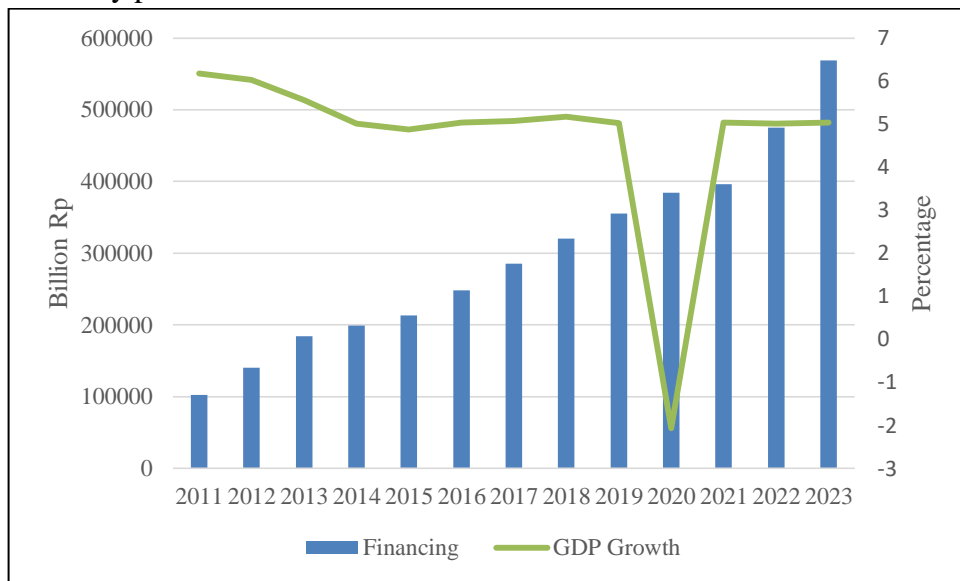


Figure 2. Islamic Bank Financing and GDP growth in Indonesia 2011-2023

Financing and gross domestic product is stated to have a positive relationship by previous literatures such as Abusharbeh (2020), Setyowati (2019), H. Ibrahim & Sufian (2014). This means that the higher the gross domestic product of Indonesia is, the higher number of financing is disbursed. In figure 2, the bar chart illustrates financing between 2011-2023 while the line chart shows the GDP growth of Indonesia. Overall, the financing trend is increasing from time to time while the GDP growth is stable except the end of the period. In 2011, the economy was in a recovery stage after the subprime mortgage crisis. At the recovery stage, the economy and financing of Islamic bank was growing. The coronavirus pandemic in 2020 affected the GDP growth and financing. It can be seen that the GDP growth sharply decreased, reaching a contraction of -2% in 2020 due to widespread lockdowns, reduced economic activity, and global disruptions. In 2021, the recovery phase

for GDP growth gradually bounced back from the pandemic-induced contraction, with GDP growth showing signs of recovery. However, Islamic bank financing faced a different trajectory. While the economy began to improve, Islamic bank financing grew at a slower pace in 2021, as businesses and consumers continued to grapple with financial uncertainty. It wasn't until 2022 that Islamic bank financing began to regain momentum, aligning more closely with the recovery of the broader economy.

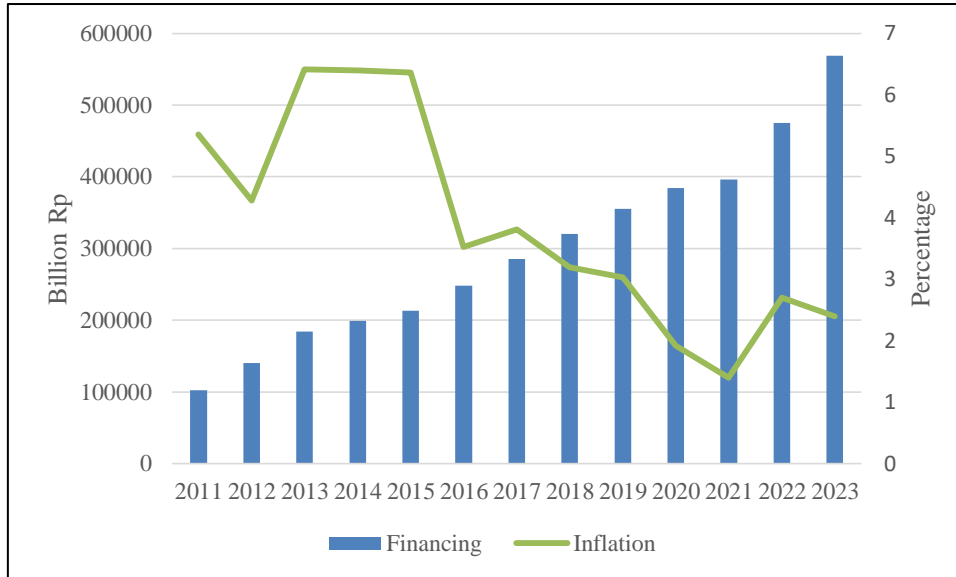


Figure 3. Islamic Bank Financing and Inflation in Indonesia 2011-2023

Financing and inflation are stated to have a positive or a negative relationship by previous literatures such as H. Ibrahim & Sufian (2014). This means that the higher the gross domestic product of Indonesia is, the higher or the lower number of financing is disbursed. In figure 3, the bar chart illustrates financing between 2011-2023 while the line chart shows the inflation of Indonesia. Overall, the financing trend is increasing from time to time while the inflation is fluctuating. Throughout the period, inflation is stable below 7% which indicates that the economy of the country is in stable position. Alongside the stable inflation, the trend of financing is also increasing in a stable way.

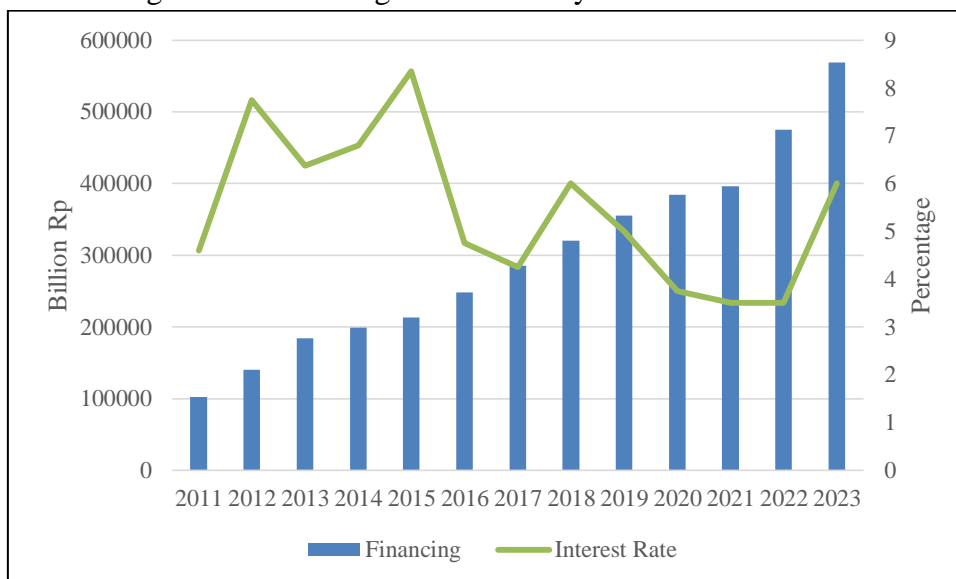


Figure 4 Islamic Bank Financing and Interest Rate in Indonesia 2011-2023

Financing and interest rate are stated to have a negative relationship by previous literatures such as Adebola Solarin et al., (2011). This means that the higher the interest rate of Indonesia is, the lower number of financing is disbursed. In figure 4, the bar chart illustrates financing between 2011-2021 while the line chart shows the interest rate of Indonesia. Overall, the financing trend is increasing from time to time while the interest rate is fluctuating. Throughout the period, inflation is fluctuating. Alongside the fluctuating interest rate, the trend of financing is also increasing in a stable way.

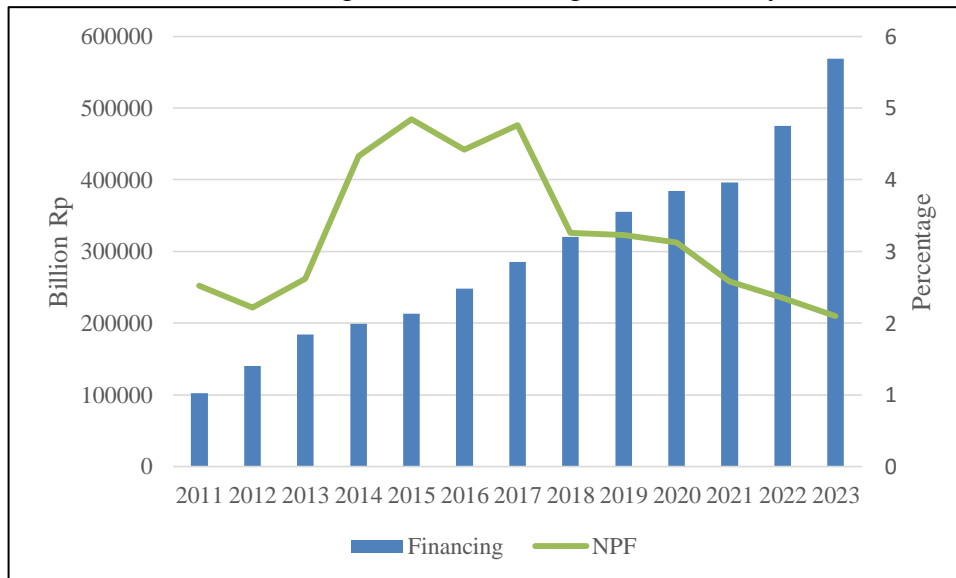


Figure 5 Indonesian Islamic Bank Financing and Non-Performing Financing 2011-2023

Financing and non-performing financing are stated to have a negative relationship by previous literatures such as Jesus & Gabriel (2006). This means that the higher the number of non-performing financing is, the lower number of financing is disbursed. In figure 5, the bar chart illustrates financing between 2011-2023 while the line chart shows non-performing financing of Indonesian Islamic banks. Overall, the financing trend is increasing from time to time while the non-performing financing is fluctuating. Throughout the period, non-performing financing is stable below 5% which indicates that the Islamic banking industry in Indonesia is managing problematic financing in a proper way. Alongside the stable non-performing financing, the trend of financing is also increasing in a stable way.

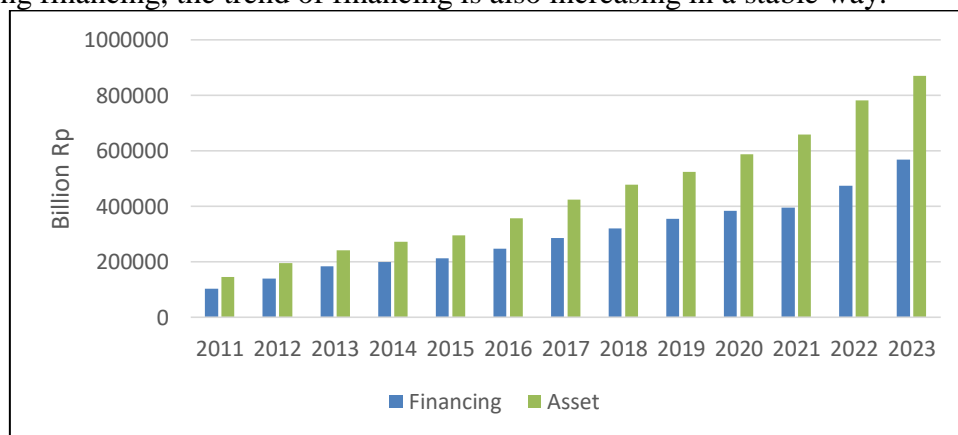


Figure 6 Indonesian Islamic Bank Financing and Asset 2011-2023

Financing and asset are stated to have a positive relationship by previous literatures such as Abdul Adzis et al., (2018). This means that the higher the number of asset it, the lower number of financing is disbursed. In figure 6, the blue bar chart illustrates financing between

2011-2023 while the blue bar chart shows the asset of Indonesian Islamic banks. Overall, the financing trend is increasing from time to time and so is the asset trend. The same trend between financing and asset throughout the period indicate that majority of asset of a bank are actually financing.

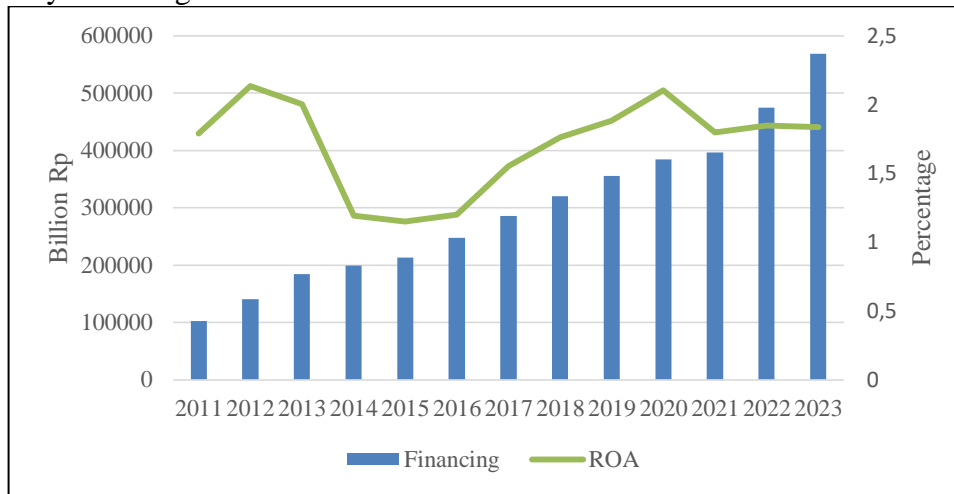


Figure 7 Indonesian Islamic Bank Financing and Return on Asset 2011-2023

Financing and return on asset are stated to have a positive relationship by previous literatures such as Alihodžić & Ekşi, (2018). This means that the higher the number of return on asset is, the lower number of financing is disbursed. In figure 7, the bar chart illustrates financing between 2011-2023 while the line chart shows return on asset of Indonesian Islamic banks. Overall, the financing trend is increasing from time to time while the return on asset is fluctuating. The highest number of return on asset in the period is reported in 2012 reaching 2.13% while the lowest number is recorded in 2015 reaching 1.14%.

Table 5. Estimated Result Based on Panel Models

Variable	PLS (1)	FEM (2)	REM (3)	FD - GMM (4)	SYS -GMM (5)
C	3.14		3.59		
Financing (-1)				0.27***	0.33***
GDP	-0.28*	-0.64***	-0.38**	-0.68***	-0.13
IHK	0.01	0.25	0.12	0.22	0.28
Interest Rate	0.04*	0.04*	0.04*	0.03	0.04*
NPF	-0.00	0.02	0.02	0.00	-0.01
Bank Size	1.04***	1.20***	1.07***	0.95***	0.68***
ROA	-0.03	-0.01	-0.01	-0.00	-0.01
Pandemic	0.03	0.04	0.04	0.06	0.06
R-Square	0.96	0.92	0.94		
Chow Test		0.02			
Hausman Test		0.00			
M1 Statistics				0.13	NA
M2 Statistics				0.43	0.97
Sargan Test				1	1

Signif. codes: 0 '***' 0.001 '**' 0.01 '*' 0.05 '.' 0.1 ' ' 1

Table 5 reports the GMM results with its specification test along with the result of Pooled Least Square, Fixed Effect Model and Random Effect Model for comparison purposes. According to the test of the static panel data models which are Pooled Least Square, Fixed Effect Model and Random Effect Model, Random Effect Model method is

chosen compared to the other static panel method. According to the Chow test, FEM is better than PLS where the p-value is 0.02. According to the Hausman test, Fixed Effect Model is better than Random Effect Model where the test reveals the significance in the p-value. The test on dynamic panel data model did reveal a robust method. The robustness of the GMM method is evidenced by the significance of lag dependent variable used as an independent variable, confirmation of validity and unbiased from the Sargan test, P-value of AR2 and the coefficient of First Difference GMM lag dependent which is between Fixed Effect Model GMM lag dependent and Panel Ordinary Least Square GMM lag dependent. Systemic GMM fulfill the criteria of a robust dynamic panel model in terms of the coefficient of First Difference GMM lag dependent which is between Fixed Effect Model GMM lag dependent and Panel Ordinary Least Square GMM lag dependent. According to the test of the static panel data models which are Pooled Least Square, Fixed Effect Model and Random Effect Model, the result in Table 5 showed that Systemic GMM method is chosen compared to the other panel method.

E. DISCUSSION

Out of six variables, only two of them affect financing significantly. Specifically, interest rate and bank size were found to have statistically significant effects on Islamic bank financing, while the remaining variables including GDP, inflation, return on asset, non-performing financing, and the COVID-19 pandemic did not show significant influence in the model. Regarding the effect of pandemic, the result is in line with Boubakri et al., (2023). Islamic banking and finance (IBF) adapted swiftly to the digitalization trend, not only to comply with pandemic-related restrictions. For instance, three leading Islamic banks in Indonesia Bank Syariah Mandiri, BRI Syariah, and Maybank Syariah achieved higher efficiency scores by adopting digital solutions. Key initiatives by these banks included the implementation of internet banking, mobile banking, SMS banking, electronic payroll systems, e-money services, and online financing facilities for small and medium enterprises (Ikhwan & Rusydiana, 2022). These results underscore the critical role of Islamic banks in fostering long-term financial stability, economic resilience, and socially responsible investments, offering valuable insights for policymakers and regulators to strengthen strategies that enhance the sustainability and growth of the Islamic banking sector while contributing to global sustainable development goals. This finding is consistent with Sopingi et al., (2023), who demonstrated that subsidized Islamic homeownership credit financing grounded in the principle of *maslahah* can effectively improve individual welfare, social status, and economic inclusion, thereby reinforcing the value-based impact of Islamic financial institutions on community well-being.

Interest rate is stated to be affecting the financing of Islamic banks significantly with a positive relationship. Financing will increase 0.03 unit if the interest rate increases 1 unit. This result is in line with Adebola Solarin et al., (2011) but contrary with Abusharbeh (2020). This finding implies a substitution effect between Islamic and conventional banking. When interest rates rise, the cost of borrowing from conventional banks becomes less attractive, encouraging customers especially those in overlapping market segments to shift toward Islamic financing alternatives that are perceived to be more stable or affordable. This is because an increase in conventional banks financing rate will increase the cost of borrowing

in the conventional banks and customers move to Islamic bank financing since both type of banks are targeting the same market.

Bank size affect financing significantly in a positive relationship. Financing will increase 1.04 unit if the asset increases 1 unit. This is in line with Abdul Adzis et al., (2018) indicating that big banks with larger asset tends to provide more financing. Large banks are more diversified and more capable to support higher demand of financing from the public. This finding suggests that scale advantages in Islamic banks, such as broader customer reach, stronger capital base, and better operational infrastructure, allow them to expand financing activities more effectively compared to smaller institutions. The high coefficient indicates that majority of bank asset are actually financing. This finding is supported by (Aprilia & Maika, 2023), who found that financing significantly affects operational profit in Islamic banks, reinforcing the idea that effective fund utilization is crucial for financial performance. This is consistent with the findings of Huda (2022), who emphasized the mediatory and supervisory role of the Financial Services Authority (OJK) in resolving disputes and ensuring regulatory compliance within the Islamic banking system, thereby enhancing institutional stability and consumer trust. This is further reinforced by Suib & Pradana (2023), who highlighted that structured risk assessment methods such as the 7P approach and financial ratios like DBR and DSR are essential tools used by Islamic banks to minimize non-performing financing and ensure sustainable lending. In line with this, Iltiham & Apriliyah (2022) demonstrated how Sharia-compliant insurance and collateral mechanisms in Murabahah financing are implemented to safeguard both banks and heirs, ensuring ethical risk-sharing and financial continuity when customers pass away.

GDP is not affecting financing significantly. This result is in line with Ibrahim & Sukmana (2011) but contrary to Ivanovic (2016). Islamic banking still represents a relatively small proportion of the overall banking sector in Indonesia. Consequently, its clientele may not mirror the broader economic activity reflected in GDP. Islamic banks may also cater to specific market segments, such as religiously motivated individuals or sectors like housing and small-scale enterprises, whose financing needs are not strongly tied to macroeconomic fluctuations like GDP growth. Instead, Islamic banks often attract clients with specific needs, such as housing which are not necessarily aligned with short-term GDP fluctuations.

In line with the result of GDP, inflation is also not affecting financing significantly. The relatively small market share of Islamic banks within Indonesia's dual-banking system means they have less exposure to macroeconomic variables like inflation. Conventional banks dominate corporate and high-volume lending markets that are more susceptible to inflation-driven cost and pricing dynamics. Islamic banks' niche focus allows them to operate relatively independently of such macroeconomic fluctuations. This result is in line with Oyebowale (2020) but contrary with Nursyamsiah (2017) and Abusharbeh (2020).

Non-performing financing, return on asset and pandemic are not affecting financing significantly. This is contrary with some literatures such as Tuyen & Diep (2018) and Alihodžić & Ekšić (2018). This suggests that, despite concerns over asset quality and profitability during economic downturns, Islamic banks in Indonesia managed to maintain stable financing performance. Their emphasis on ethical risk-sharing contracts, such as Musyarakah and Mudharabah, may distribute financial risk more equitably, reducing the immediate impact of profitability shocks or problematic financing on lending capacity. In this

study, strong banks' balance sheet in terms of profitability and problematic financing suggests that Indonesian Islamic banks are resilient and capable of maintaining financing activities despite the presence of non-performing financing or variations in profitability. This resilience can be attributed to the unique operational principles of Islamic banking, which emphasize ethical finance, risk-sharing, and asset-backed structures, as well as proactive risk management practices that mitigate the impact of financial challenges on lending activities. Almost 50% of the financing disbursed by Islamic banks in 2023 is based on Musyarakah contracts, which are categorized as profit-sharing financing arrangements (Indonesian Financial Services Authority, 2023).

F. CONCLUSION

This study provides significant insights into the determinants of financing in Indonesian Islamic banks during a period marked by economic uncertainty, with a focus on their implications for sustainable finance. Key findings demonstrate that bank size and interest rates significantly influence financing, reflecting the importance of asset scale and market dynamics in shaping lending behavior. However, variables such as GDP, inflation, non-performing financing, profitability, and the pandemic did not exhibit significant effects, emphasizing the unique operational characteristics of Islamic banks. Theoretically, this study contributes to the literature by shifting the analytical focus from general performance indicators to the specific drivers of financing behavior in Islamic banks, using a dynamic panel data approach that accounts for endogeneity and time persistence an approach still rarely applied in this context. The resilience of Islamic banks, driven by their reliance on ethical finance, risk-sharing, and asset-backed structures, underscores their alignment with sustainability principles by promoting real economic activities and avoiding speculative practices.

Practically, the results offer actionable insights for regulators, policymakers, and bank managers. The identification of bank size and interest rates as key determinants can inform regulatory policies that promote bank capitalization and competitive financing instruments, especially in response to changing interest rate environments. Moreover, the insignificant impact of pandemic-related shocks signals the potential of Islamic banking frameworks to maintain credit flow and support SMEs even during crises, which can be integrated into national financial resilience strategies. Despite its contributions, the study is limited by its exclusive focus on Islamic commercial banks, excluding rural Islamic banks (BPRS) and conventional banks, which constrains the generalizability of the findings across Indonesia's dual banking system. It also relies solely on secondary data spanning 2011–2023, which may not fully capture recent structural shifts post-pandemic. Future research should expand to include comparative analyses with conventional banks and assess the long-term effects of the pandemic on financing behavior.

Additionally, investigating the role of digital transformation, environmental, social, and governance (ESG) integration, and sustainability-oriented products in Islamic banking could provide valuable insights. Such research could further enrich the understanding of how Islamic banks can be positioned as systemic enablers of inclusive and sustainable finance in both normal and crisis conditions. Policymakers should leverage these findings to strengthen strategies that enhance the sustainability and resilience of Islamic banks, ensuring they continue to contribute to economic stability, equitable growth, and the achievement of global sustainable development goals.

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