

**THE RELATIONSHIP BETWEEN ISLAMIC STOCK PRICES AND SELECTED
MACROECONOMIC VARIABLES**



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TABLE OF CONTENTS

ACKNOWLEDGEMENT	i
TABLE OF CONTENTS.....	ii
LIST OF TABLES	iv
LIST OF FIGURES.....	v
ASBTRACT.....	vi

CHAPTER	PAGE
INTRODUCTION.....	2
1.1 Background of Study.....	2
1.2 Statement of Problem.....	7
1.3 Objectives of Study.....	8
1.4 Organization of Study.....	9
LITERATURE REVIEW.....	10
EMPIRICAL FRAMEWORK AND DATA.....	14
3.1 Empirical Approach and Data.....	14
3.2 Test for Stationary.....	16
3.3 Cointegration Test.....	17
3.4 Granger Causality Test and Vector Error Correction Model	18
3.5 Impulse Response Function and Variance Decomposition	20

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Abstract

This study examine the long-run and short-run dynamic interactions among macroeconomic variables and Islamic stock prices for the Malaysian case using time series techniques of cointegration and Vector Autoregression. The study reveals that the macroeconomic variables are cointegrated with the stock prices, suggesting potential inefficiency in the long-run. We observe that variations in Kuala Lumpur Shari'ah Index (KLSI) are predominantly attributed to its own innovations, Price Level (CPI) and Money Supply (MS) variations. The money supply exerts a positive effect on the stock prices in both long- and short-run, while the price level exerts a negative effect on the stock prices. The negative association between KLSI and CPI seems does not support the view that the stock prices are good hedge against inflation. In addition, we also note the importance of the Malaysian exchange rate to variations in Malaysian in Malaysian macroeconomic performances.

Field of Research: Macroeconomic variables, Kuala Lumpur Shari'ah Index (KLSI), Cointegration, Vector Autoregression

CHAPTER 1

INTRODUCTION

1.1 Background of Study

There are about 1.5 billion Muslims worldwide. Muslim countries per se are home to one-fifth of the world's population. Recently, there are 150 million Muslims living in non-Muslim countries, and the ten largest Muslim states have a combined GDP value of US\$1.2 trillion. A study conducted in 1996 by Merrill Lynch, one of the largest financial institutions in the US, estimates a US\$800 billion market potential for Islamic assets management. Recently, the Standard and Poor's Ratings Services reported that the growth rate of Islamic banking outpaced that of conventional banking during the past decade, making it one of the most dynamic areas in international finance.¹

The emergence of Islamic banking in modern times is related to the revival of Islam and the desire of Muslims to live all aspects of their lives in accordance with Shari'ah. Thus, there are always been a demand among Muslims for financial products and services that conform to Shari'ah. The concept of Islamic banking started during the time of Prophet Muhammad (p.b.u.h) in the sixth century and continued until the early period of caliphate during the rule of Muslim empires and kingdom in the middle ages. However, the advent of the Industrial Revolution and the consequent emergence of the Western supremacy, virtually all Muslim countries come under the colonial rule for centuries until their liberalization after the World War II. Throughout this period, the Western laws in all fields replaced Shari'ah, including commerce and finance. Under the Western-oriented capitalism, interest was introduced in commercial banks and investment financial institutions, which were under the control of non-Muslim financier, entrepreneurs and business magnates.

¹ Ahmed, S. (2006), *Islamic Banking and Finance and Insurance: A Global Overview*.