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The Effect of Macroeconomic Factors on The Financial Performance of Banking in Indonesia

Iqbal Firdausi
Sekolah Tinggi Ilmu Ekonomi Indonesia Banjarmasin
Email: iqbal@stiei-kayutangi-bjm.ac.id

Abstract

This study aims to determine the effect of short-term and long-term macroeconomic factors on the financial performance of Islamic banking in Indonesia. The dependent variables in this study are Return on Assets (ROA), Financial to Deposit Ratio (FDR) and Operating Costs of Operating Income (BOPO) as proxies of financial performance. While the independent variables are industrial production index (IPI), inflation, BI rate, composite stock price index (CSPI) and exchange rates. The analytical method used is Vector Error Correction Models (VECM). The data used in this study are monthly time series data from January 2010 - December 2015. The results of the study state that in the long term the influence of the Industrial Production Index (IPI), inflation and exchange rates have a negative and significant effect on Return on Assets (ROA) and Financial to Deposit Ratio (FDR). Meanwhile, the BI rate and the Composite Stock Price Index (JCI) have a positive and significant impact on Return on Assets (ROA) and Financial to Deposit Ratio (FDR). Industrial Production Index (IPI), inflation and exchange rates have a positive and significant influence on the Operating Cost of Operating Income (BOPO). Meanwhile, the BI rate and the Composite Stock Price Index (JCI) have a negative and significant effect on the Operating Cost of Operating Income (BOPO). The short-term effect of macroeconomic variables on financial performance (ROA, FDR and BOPO) does not show a significant relationship.

Keywords: Inflation, BI Rate, Exchange Rate

INTRODUCTION

The financial system is dominated by banks which hold 79 percent of financial sector assets (compared to 50 percent in Malaysia, for example), leaving little room for other financial institutions (Afonso & Sousa, n.d.). On the other hand, insurance companies hold about 10 percent of financial sector assets, and less than 3 percent are held by pension funds (Haifa & Syofyan, n.d.).

The informal development of the Islamic finance industry began before the issuance of the formal legal framework as the operational basis of Islamic banking in Indonesia. Prior to 1992, several non-bank financing business entities had been established that had implemented the profit-sharing concept in their operational activities (Nurlaily et al., n.d.). These results show the community's need for the presence of financial institutions that can provide sharia-compliant financial services. UU no. 7 of 1992 concerning banking has implicitly opened up opportunities for banking business activities that have an operational basis for profit sharing which is detailed in Government Regulation no. 72 of 1992 concerning Banks Based on Profit Sharing Principles (Kiganda, 2014).

Responding to the needs of the community for the realization of a sharia-compliant banking system, the government has included this possibility in the new law. The enactment of Law no. 21 of 2008 concerning Islamic Banking which was issued on July 16, 2008, the development of the national Islamic banking industry has an adequate legal basis and will encourage even faster growth. With the impressive development progress that has reached an average asset growth of more than 65 percent per year in the last five years, it is hoped that the role of the Islamic banking industry in supporting the national economy will be increasingly significant (VIPHINDRARTIN et al., 2021).

Based on the background that has been described, it is necessary to further investigate the effect of the uncertainty of macroeconomic conditions on the financial performance of Islamic banking in Indonesia. Therefore, researchers are interested in continuing the research which is then outlined in a thesis with the title: "The Effect Of Macroeconomic Factors On The Financial Performance Of Banking In Indonesia".

RESEARCH METHOD

This study uses a combination of research data (mixed methods). The combination research method is an approach in research by combining or connecting qualitative and quantitative research in a research activity so as to produce more comprehensive, valid, reliable and objective data (Creswell, 2009: 214-215). The research method used in this study is the concurrent embed method.

LITERATURE REVIEW

History of Islamic Banking

The initial effort to implement a profit-loss sharing system was recorded in Pakistan and Malaysia around the 1940s, namely efforts to manage non-conventional hajj pilgrims (Amzal, 2016). Another institutional pioneer was the Islamic Rural Bank in Mit Ghamr Village in 1963 in Cairo, Egypt. Islamic Rural Bank Institution with Mit Ghamr Bank assisted by Prof. Dr. Ahmad Najjar operates in rural Egypt and is small in scale, but the institution is able to become a very meaningful trigger for the development of the Islamic financial system and economy (Suseno, 2020).

Collectively, the idea of establishing an Islamic bank at the international level emerged at the conference of Islamic countries worldwide in Kuala Lumpur, Malaysia on 21-27 April 1969 which was attended by 19 participating countries. The conference decided several things, namely (Wahyudi et al., 2017):

1) Every profit must be subject to the law of profit and loss, otherwise it is included in usury and usury is a little or a lot of the law is haram.
2) It is proposed that an Islamic bank that is free from the usury system be formed as soon as possible
3) While waiting for the establishment of Islamic banks, banks that apply interest are allowed to operate, but only if they are really in an emergency.

There were many doubts about the formation of Islamic banks at first, among others because:

1) Many think that the interest-free banking system is an impossible and unusual thing
2) There are questions about how banks will finance their operations, but on the other hand Islamic banks are an alternative to the Islamic economic system

To further facilitate the development of Islamic banks in Muslim countries, there needs to be a joint effort among Muslim countries (Violeta, n.d.). So in December 1970, at the meeting of the Foreign Ministers of the Organization of Islamic Conference (OIC) countries in Karachi, Pakistan, the Egyptian delegation submitted a proposal to establish an Islamic bank. At the OIC Foreign Minister's Session in Jeddah in 1974, the draft for the establishment of an Islamic Development Bank (IDB) was approved with an initial capital of 2 billion dinars or equivalent to 2 billion SDR (special drawing rights) of the IMF (Putri & Hosin, n.d.).

Indonesia as a country with the largest Muslim population in the world, since 1989s began pioneering efforts to establish an Islamic bank to meet the demands of people who need alternative banking services with Islamic law (Dewi et al., 2019). After going through a long process, at the initiative of the Indonesian Ulema Council (MUI) finally, the first Islamic bank in Indonesia was established under the name Bank Muamalat Indonesia (BMI) in 1991. With the establishment of this BMI, banking began to be known by the Indonesian people. However, since operating on May 1, 1992, Islamic banks have not received optimal attention in the national banking system, so their growth is quite slow (Sugiharto, 2022).

In the period 1992 to 1998, there was only one Islamic Commercial Bank and 78 Sharia Rural Banks (BPRS) which had been operating. In 1998, Law no. 10 of 1998 was an amendment to Law no. 7 of 1992 concerning Banking which only provides a stronger legal basis for the existence of the Islamic banking system. In 1999, Law no. 23 of 1999 concerning Bank Indonesia which gives authority to Bank Indonesia to be able to carry out its duties based on sharia principles. The Islamic banking industry developed faster after the two sets of laws were enacted (Supiyadi et al., 2019).

Definition of Islamic Banking Industry

Banking is everything related to banks, including institutions, business activities, as well as procedures and processes in carrying out their business activities (Aviliani et al., 2015). Banking has a strategic position, namely as a supporter of the smooth running of the payment system, implementation of monetary policy, and achieving financial system stability, so a sound, transparent and accountable banking system is needed (Gizycki, n.d.).

When viewed in terms of definition, Article 1 point 1 of Law no. 10 of 1998 states that the term Bank means a business entity that collects funds from the public in the form of savings and distributes them to the public in order to improve the standard of living of the people at large (McKibbin & Fernando, n.d.). From this definition, it can be stated that a bank is a company that trades debts and receivables, both in the form of their own money and public money, and circulates the money for the public interest (Putra et al., 2020).

According to Law No. 21 of 2008 Sharia Bank is a Bank that carries out its business activities based on sharia principles and by type consists of Sharia Commercial Banks and Sharia People's Financing Banks. While the Sharia Business Unit according to Law no. 21 of 2008 is an office work unit from the head office of a Conventional Commercial Bank that functions as the main office of an office or unit that carries out business activities based on sharia principles or a work unit at a branch office of a bank domiciled abroad that carries out its business activities conventionally. which functions as the main office of the sharia subbranches and sharia business units (Utama & Selviana Agesy, 2016).

Characteristics of Islamic Banking

Islamic banks are not just interest-free banks, but also have a welfare orientation. Fundamentally, there are several characteristics of Islamic banks (Purnamasari & Ramayanti, 2020):

1) Elimination of Riba
2) Service to the public interest and realize the socio-economic goals of Islam
3) Islamic banks are universal which are a combination of commercial banks and investment banks
4) Islamic banks will conduct a more careful evaluation of financing applications oriented to equity participation, because Islamic commercial banks apply profit and loss sharing in consignment, venture, business or industry.
5) Profit sharing tends to strengthen the relationship between Islamic banks and entrepreneurs
6) The framework was built to help banks overcome their liquidity difficulties by utilizing Islamic interbank money market instruments and sharia-based central bank instruments.

According to (Cunningham, n.d.), there are several characteristics of Islamic banks that distinguish them from conventional banks:

1) Costs
   Costs that are mutually agreed upon at the time of the agreement are realized in nominal amounts which are not rigid and can be carried out with freedom to bargain within reasonable limits. These fees are only charged until the time limit according to the agreement in the contract.
2) Usage percentage
   The use of percentages in terms of the obligation to make payments is always avoided, because the percentage is attached to the remaining debt, even though the time limit of the agreement has expired so that the profit-sharing ratio is used.
3) Project financing contracts
   In project financing contracts, Islamic banks do not apply a calculation based on a definite profit that has been determined in advance. The profit level used is the actual profit level, if the actual profit rate is less than the projected profit rate, the actual profit rate is used.
4) Submission of funds is considered a deposit (wadiah)
   Submission of public funds in the form of savings deposits by the depositor is considered as a deposit (wadiah) while for the bank it is considered a deposit which is mandated as an investment in funds in projects financed by banks that operate according to sharia principles so that the deposit is not promised a definite return.
5) Sharia Supervisory Board (DPS)
   There is a Sharia Supervisory Board (DPS) in the organizational structure of Islamic banks whose task is to oversee the bank's operations from a sharia point of view. In addition, managers and leaders of Islamic banks must master the basics of Islamic muamalah. This element of the Sharia Supervisory Board is the main thing that

distinguishes the organizational structure between Islamic banks and conventional banks.

6) Institutional function
   In addition to bridging between the owners of capital and those who need funds, it also has a special function, namely the function of trust, meaning that it is obliged to maintain and be responsible for the security of funds stored and ready at any time if the funds are taken by the owner.

RESULT AND DISCUSSION

This chapter analyzes the data that will be used. The data used are return on assets, financial to-deposit ratio, the operational cost of operating income, industrial production index, inflation, BI rate, composite stock price index, exchange rate, and world crude oil prices. The object of this research is an Islamic commercial bank and sharia business unit. With the length of the study from January 2010 to December 2015.

Data processing in this study was carried out using Eviews v.8.0 software. and Microsoft Excel 2007, to process data and obtain results from the variables to be studied. The data used in this study were obtained from the official website of the Financial Services Authority, Bank Indonesia, the Central Bureau of Statistics, and other supporting sites. The following is a description of the data used:

Table 1.1 Data Return on Assets of Islamic Commercial Banks and Sharia Business Units

Month	ROA (in percent)					
	2010	**2011**	**2012**	**2013**	**2014**	**2015**
January	1.65	2.26	1.36	2.52	0.08	1.93
February	1.76	1.81	1.79	2.29	0.13	1.94
March	2.13	1.97	1.83	2.39	1.16	2.39
April	2.06	1.9	1.79	2.29	1.09	2.42
May	1.25	1.84	1.99	2.07	1.13	2.4
June	1.66	1.84	2.05	2.1	1.12	2
July	1.67	1.86	2.05	2.02	1.05	2.05
August	1.63	1.81	2.04	2.01	0.93	2.14
September	1.77	1.8	2.07	2.04	0.97	2.15
October	1.79	1.75	2.11	1.94	0.92	2.22
November	1.83	1.78	2.09	1.96	0.87	2.15
December	1.67	1.79	2.14	2	0.8	1.81

Source: Financial Services Authority (data processed)

In terms of profitability, Islamic banks tend to stagnate at a fairly low level, as indicated by a ROA that is far below the banking industry. From table 1.1 above, it is noted that the highest return on assets of Islamic Commercial Banks and Sharia Business Units occurred in January 2013 at 2.52 percent but this increase was not followed by the following months. Then the lowest return on assets occurred in January 2014 with a value of 0.08 percent, this is a sharp decline from the previous year in December 2013 with a value of 2.00 percent and is the lowest value during the research year.

Table 1.2 Financial to Deposit Ratio Data for Islamic Commercial Banks and Sharia Business Units

Month	FDR (in percent)					
	2010	**2011**	**2012**	**2013**	**2014**	**2015**
January	88.67	91.97	87.27	100.63	100.07	110.4
February	90.96	95.16	90.49	102.17	102.03	109.73
March	95.07	93.22	87.13	102.62	102.22	111.72
April	95.57	95.17	95.39	103.08	95.5	109.5
May	96.65	94.88	97.95	102.08	99.43	109.63
June	96.08	94.93	98.59	104.43	100.8	109.25
July	95.32	94.18	99.91	104.83	99.89	110.02
August	98.86	98.39	101.03	102.53	98.99	109.25
September	95.4	94.97	102.1	103.27	99.71	107.71
October	94.76	95.24	100.84	103.03	98.99	107.01
November	95.45	94.4	101.19	102.58	94.62	108.92
December	89.67	88.94	100	100.32	91.5	104.88

Source: Financial Services Authority (data processed)

According to Bank Indonesia, a bank is still considered healthy if its FDR ratio is between 85 percent - 110 percent, in table 1.2 the highest increase in FDR reached 111.72 percent in 2015 March, this indicates that the bank has not been able to carry out its function as a good intermediary. The total financing provided is more than 110 percent, which means that the financing provided exceeds the funds raised by the bank.

Table 1.3 Data on Operational Costs of Operating Income of Islamic Commercial Banks and Sharia Business Units

Month	BOPO (in percent)					
	2010	**2011**	**2012**	**2013**	**2014**	**2015**
January	84.87	75.75	86.22	70.43	80.05	82.51
February	79.73	79.56	78.39	72.06	83.77	82.28
March	76.27	77.63	77.77	72.95	91.9	78.76
April	77.15	78.78	77.77	73.95	84.5	79.97
May	85.79	79.05	76.24	76.87	76.49	79.79
June	79.99	78.13	75.74	76.18	71.76	82.06

July	79.77	77.13	75.87	76.13	79.8	81.43
August	80.36	77.65	75.89	77.87	81.2	80.37
September	79.1	77.54	75.44	77.98	82.39	80.06
October	78.94	78.03	75.04	79.06	75.61	79.96
November	77.7	77.92	75.29	78.59	93.5	79.99
December	80.54	78.41	74.75	78.21	79.28	83.41

Source: Financial Services Authority (data processed)

The stagnant performance of banking intermediation resulted in a decline in profitability and efficiency as reflected in the declining ROA ratio in table 1.1 and the increasing ratio of Operating Costs to Operating Income (BOPO). Table 1.3 shows the highest increase in the BOPO ratio in 2014 in November with a value of 93.5 percent and the lowest in January 2014 with a value of 70.43 percent.

The next data to be displayed is macroeconomic data for the period January 2010 to December 2015, which are as follows:

Table 1.4 Growth of Industrial Production Index in Indonesia

Month	**Large and Medium Industry Monthly Production Index**					
	2010	**2011**	**2012**	**2013**	**2014**	**2015**
January	96.59	101.66	102.76	113.91	117.32	123.33
February	97.28	98.06	105.63	112.31	116.60	119.67
March	101.37	105.86	102.46	112.58	116.80	125.46
April	101.44	102.19	103.38	114.12	117.25	127.11
May	100.90	105.63	108.31	115.78	120.16	123.03
June	104.72	107.23	109.79	113.34	120.22	126.26
July	100.93	109.45	111.41	115.28	117.05	122.21
August	101.12	103.10	100.78	113.37	120.13	127.01
September	92.32	104.12	109.61	116.36	127.74	130.31
October	100.77	107.59	118.17	118.05	124.37	131.09
November	101.72	101.35	114.13	116.20	121.73	128.64
December	100.83	102.89	114.12	117.36	124.94	126.22

Table 1.5 Inflation Growth in Indonesia

Month			**Inflation (in percent)**			
	2010	**2011**	**2012**	**2013**	**2014**	**2015**
January	3.72	7.02	3.65	4.57	8.22	6.96
February	3.81	6.84	3.56	5.31	7.75	6.29

March	3.43	6.65	3.97	5.90	7.32	6.38
April	3.91	6.16	4.50	5.57	7.25	6.79
May	4.16	5.98	4.45	5.47	7.32	7.15
June	5.05	5.54	4.53	5.90	6.70	7.26
July	6.22	4.61	4.56	8.61	4.53	7.26
August	6.44	4.79	4.58	8.79	3.99	7.18
September	5.80	4.61	4.31	8.40	4.53	6.83
October	5.67	4.42	4.61	8.32	4.83	6.25
November	6.33	4.15	4.32	8.37	6.23	4.89
December	6.96	3.79	4.30	8.38	8.36	3.35

Table 1.6 BI Rate Growth in Indonesia

Month			**BI Rate (in percent)**			
	2010	**2011**	**2012**	**2013**	**2014**	**2015**
January	6.50	6.50	6.00	5.75	7.50	7.50
February	6.50	6.75	5.75	5.75	7.50	7.50
March	6.50	6.75	5.75	5.75	7.50	7.50
April	6.50	6.75	5.75	5.75	7.50	7.50
May	6.50	6.75	5.75	5.75	7.50	7.50
June	6.50	6.75	5.75	6.00	7.50	7.50
July	6.50	6.75	5.75	6.50	7.50	7.50
August	6.50	6.75	5.75	7.00	7.50	7.50
September	6.50	6.75	5.75	7.25	7.50	7.50
October	6.50	6.50	5.75	7.25	7.50	7.50
November	6.50	6.00	5.75	7.25	7.75	7.50
December	6.50	6.00	5.75	7.50	7.75	7.50

Table 1.7 The Growth of the Composite Stock Price Index (JCI) in Indonesia

Month	**Composite Stock Price Index (JCI)**					
	2010	**2011**	**2012**	**2013**	**2014**	**2015**
January	2.61	3.41	3.94	4.45	4.42	5.29
February	2.55	3.47	3.99	4.80	4.62	5.45
March	2.97	3.68	4.12	4.94	4.77	5.52
April	2.80	3.82	4.18	5.03	4.84	5.09
May	2.91	3.84	3.83	5.07	4.89	5.22
June	3.07	3.89	3.96	4.82	4.88	4.91
July	3.07	4.13	4.14	4.61	5.09	4.80

August	3.08	3.84	4.06	4.20	5.14	4.51
September	3.50	3.55	4.26	4.32	5.14	4.22
October	3.64	3.79	4.35	4.51	5.09	4.46
November	3.53	3.72	4.28	4.26	5.15	4.45
December	3.70	3.82	4.32	4.27	5.23	4.59

Table 1.8 Exchange Rate Growth in Indonesia

Month	**Exchange Rate (in percent)**					
	2010	**2011**	**2012**	**2013**	**2014**	**2015**
January	95.57	98.82	99.44	92.29	73.2	70.89
February	95.88	101.44	98.51	92.58	76.93	69.58
March	98.19	102.77	97.49	92.09	78.48	68.4
April	99.31	104.39	97.39	92.06	77.61	69.18
May	97.49	104.84	93.57	91.31	77.08	67.75
June	98.54	104.11	94.41	90.14	74.78	67.13
July	99.98	105.2	94.36	87.08	77.22	66.39
August	98.99	104.34	93.62	81.93	76.38	63.81
September	100.29	101.44	93.35	77.07	73.29	61.06
October	100.25	101.3	93.08	79.67	74.08	65.62
November	99.3	97.6	93.18	74.73	73.38	64.67
December	99.54	98.7	92.55	73.43	71.95	64.88

CONCLUSION

Based on research that has been conducted with the aim of examining the effect of macroeconomic shocks on financial performance as seen from the return on assets, financial to deposit ratio and operating costs of operating income for the short and long term. By using time series data with vector error correction model (VECM) in reviews 8 software, the conclusions of this study are:

1. The effect of short-term macroeconomic conditions (Industrial Production Index, inflation, BI rate, Composite Stock Price Index, and exchange rate) on financial performance by looking at the ratio of profitability (Return on Assets), liquidity (Financial to Deposit Ratio), and efficiency (Operational Cost of Income) Operational) together show a positive but not significant relationship.
2. The long-term effect that describes macroeconomic conditions on the financial performance of Islamic banking in Indonesia generally shows a significant relationship. The ones that have a positive influence are the BI Rate and the composite stock price index (CSPI) on the profitability and liquidity ratios, the industrial production index, inflation and exchange rate variables have a positive influence on the efficiency ratio, the world crude oil price variable has a positive effect on the profitability ratios. Then if you look at the negative and significant relationship, it is shown by the industrial production

index, inflation, and exchange rate variables on the profitability ratio (ROA) and liquidity (FDR), the BI Rate, and JCI variables on the efficiency ratio (BOPO).

3. In the results of the impulse response function, in general, shocks from macroeconomic conditions are responded to by the financial performance of Islamic banking as seen from the ratio of profitability (ROA), liquidity (FDR), and efficiency (BOPO) in Indonesia, both positively and negatively with a longer duration of the shock. granted permanently or not. As for the results of the variance decomposition in the forecast, the indicators of Islamic banking financial performance are not much influenced by macroeconomic conditions, possibly other variables outside of macroeconomics that have more influence on the financial performance of Islamic banking in Indonesia.

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