



Management

## **APPLICATION OF TOOLS OF THE MONETARY POLICY ON ISLAMIC BANKS IN MALAYSIA**

**Dr. Ghassan Farouk Ghandour \*<sup>1</sup>**

\*<sup>1</sup> College of Financial & Administration-Department of Accounting & IT, Cihan University/  
Sulaymani, Kurdistan Region Government/Iraq

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### **Abstract**

Monetary policy should be reformulated in a way that is in line with Islamic banking by studying monetary policy tools and their primary and intermediate objectives, which are used for conventional banks to reach final objectives, to know their applicability to Islamic banks, New monetary policy tools that are compatible with the principles of Islamic banking and are capable of achieving two sets of objectives:

- 1) The objectives of the final monetary policy determined by the monetary authority and choose to achieve rings of primary and intermediate objectives, and be linked to these tools that arm the monetary authority.
- 2) The objectives of Islamic banks, namely to preserve their capital and maximize their profits, by attracting savings and developing them, and investing them in the legally permissible fields in all sectors of agriculture, industry, trade and services, and providing all banking services with an Islamic template.

**Keywords:** Sukuk; Monetary Policy Tools; Islamic Banks; Intermediate Objectives.

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### **1. Introduction**

Monetary authorities in all countries of the world apply monetary policy, under a theoretical framework based on theories and research in the field of monetary policy, which in turn are influenced by the current trends of the economic mainstream, on the one hand, and events on the economic level in general, monetary and financial in particular, Back to the critical theories, we find them in general based on a basic hypothesis based on the traditional banking style, in the mechanism of work and principles and tools. Therefore, the introduction of Islamic banking as a key component of the banking system creates a problematic relationship between monetary

policy and Islamic banking in terms of the inadequacy of some of the tools used by monetary policy with the principles of Islamic banking.

**Research problem:** The inadequacy of some of the tools used by monetary policy with the principles and fundamentals of Islamic banking in Malaysia.

**Research objectives:** The research aims to devise new monetary policy tools that are compatible with the principles of Islamic banking and are capable of achieving the objectives of monetary policy and the objectives of Islamic banks in Malaysia.

**Research importance:** The importance of research is through the re-formulation of monetary policy in a way that is in line with Islamic banking by studying the tools of monetary policy and its primary and intermediate objectives which are used for conventional banks to reach the final objectives and to know the extent of their applicability to Islamic banks. Islamic Malaysia.

**Research hypotheses:** The ability of Islamic banks in Malaysia to adapt some of the tools used by monetary policy to the principles and fundamentals of Islamic banking.

## 2. Materials and Methods

The researcher used descriptive, analytical and historical methods in preparing the research.

## 3. Results and Discussions

### 3.1.First: Development of Islamic Banks in Malaysia

In the context of the success of the experience of Islamic banks and the Islamic financial system, the idea of Islamization of the economic system, the Islamization of banks and traditional financial institutions found their way to the state of Malaysia, and with reference to documented studies, the roots of this idea extend from the mid-sixties in the twentieth century, Hajj Fund which manages the funds of depositors wishing to perform Hajj through the investment of these deposits in accordance with Islamic Sharia. The Board of Directors of this fund was established in 1969. This fund has achieved a great success and the volume of deposits increased from 12 million ringgit To 388 million ringgit at the end of the 1970s. The number of depositors increased from 48,000 to 536,000 during the same period (Mustafa, 2005). Where many of the Islamic economic thinkers to urge the political leadership to think seriously in the establishment of Islamic banks and financial institutions, and indeed a prime minister Malaysia has formed the National Steering Committee for the establishment of the Islamic Bank. The Committee submitted its report on 01/07/1982, including several recommendations, including the need to establish a bank operating in accordance with the provisions of the Islamic Shariah, as well as the need to issue a law for Islamic banks to regulate their licensing and supervision, The Central Bank, and the need to form a supervisory board to oversee the legitimacy of the Islamic Bank's compliance in its operations of Islamic law, and the Central Bank was commissioned to prepare a detailed study on the feasibility of establishing Islamic Bank in Malaysia, has been positive recommendations in this regard ( Abdulghaffar, 2006: p7). After the approval of the

government's report on the previous committee, the Parliament and the Senate issued the Islamic Banks Law No. 276 at the end of 1982, and published in the State on 07/04/1983.

The law included a regulation of the process of authorization and supervision of Islamic banks by the Central Bank in a similar manner to what is done with other banks, with some modifications required by the nature of the activity of the Islamic Bank, noting the retention of this law as the Bank's net profit (after deduction of Zakat and Taxes) is an annual reserve until it reaches 100% of the paid-up capital ( Attia, 2014: p48).

The Malaysian government then approved the establishment of Malaysia's first Islamic bank, Malaysia Islam Bank Berhad BIMB, which started operations on June 1, 1983. It has a network of 68 branches. The authorities have adopted a phased program to achieve the objective of developing a system Islamic banking, so it was decided that for a period of ten years starting from 1983 there must be one Islamic bank is the bank mentioned above, and that with one bank is in service is easy to develop and test this system (yahya, 1996).

The State sought to make this experience a success by meeting the requirements of a real and successful banking system (Abdulqader, 1996):

- 1) A large number of dealers (institutions), and then achieved expansion to the banking system IBS.
- 2) A large number or variety of tools or products has been developed 21 Islamic tools successfully with the beginning of 1993.
- 3) Islamic money market between Islamic banks, and was actually introduced into the Malaysian banking system on 03/01/1994. After a period of ten years, in 1993, the Central Bank had three options for increasing the number of institutions offering Islamic banking services:
  - Allow the establishment of Islamic banks.
  - Allow existing financial institutions to establish branches to provide Islamic banking services.
  - Allow existing financial institutions to provide Islamic banking services using their existing structure and branches.

This option was developed after a thorough study by the Central Bank of the subject on the third option. Under this option, a project was developed allowing existing financial institutions that also offer traditional products to provide Islamic banking services. The project started on 4 March 1993, Banker of IBS (Jahongirbek, 2006: p147).

Malaysia has completed Islamic banking mechanisms by setting up a higher advisory body at the Central Bank of Malaysia (Supreme Shari'a Supervisory Board), which issues binding provisions for Islamic banks and Islamic windows in conventional banks ( Ahmed Ali, 2002: p150).

The number of Islamic banks since 1998 has increased to 11 Islamic banks with 132 branches at the end of 2009. At the same time, the number of commercial banks declined during the same period from 25 banks to eight banks, all of which have Islamic windows. This can be explained by the period of financial crisis which resulted in the bankruptcy of many conventional banks, and the ability of Islamic banks to deal with these crises, which increased the appeal by the

public. Observers believe that Islamic banking in Malaysia is experiencing steady success, achieving high growth rates of about 12% annually (<http://www.rusdbank.com/afb-ara.html>).

### **3.2.Second: Monetary policy in Malaysia**

#### **1) The final objectives of monetary policy in Malaysia**

The final objectives of monetary policy announced by the Bank of Niagara Malaysia in 2010 are to reduce inflation, stimulate real GDP growth and balance the flexibility and stability of the financial system (Global Financial, 2010).

#### **2) The intermediate objectives of monetary policy in Malaysia**

Since 1990, the Bank of Negara Malaysia has relied on monetary aggregates as an intermediate monetary policy target, moving from M1 to M3 because of its close correlation with inflation rates. However, the rapid development of the financial system and large capital inflows during 1992 and 1993 has made it difficult to predict M3 moves. The Interbank Rate (IBR) (Hang Puah, 2009: p3) as an intermediate target is determined through the Islamic Interbank Money Market (IIMM), which is managed by the Central Bank, where the average margin of lending is the weighted average daily rate of bank investments among them with Mudarabah form within the Islamic market cash transactions between banks IIMM (Gan, 2009: p166).

#### **3) Monetary Policy Tools in Malaysia**

##### **Indirect Tools of Monetary Policy**

- **Legal (statutory) reserve ratio** (BNM, 2009: p3)

The statutory reserve rate (SRR) is determined in Malaysia as a proportion of Eligible Liabilities (EL), which consists of demand deposits in Malaysian Rangit, deposits in the interbank liquidity system, and Bank Negara bank deposits to support liquidity. All banks submit their reports to the Central Bank in respect of EL twice a month. The Bank of Negara issues monthly reserve rates in the light of these reports, with a permitted flexibility of movement of 20% of the basic legal reserve ratio, With R The percentage of the statutory reserve shall be calculated, with a fine of one thousand times the amount of the deficit for each day in which the bank has a deficit.

- **Open Market Operations**

Since 1993, banking system without interest income to work, a system that the foundations for the establishment of an Islamic monetary market in Malaysia. And Malaysia is the first country to establish a financial market between Islamic banks in the world (Yahya, 1996) is treated within this market, short-term financial tools, namely:

- **Government Investment Issues (GII)** (Bacha, 2008: p5)

(GIC). The government investment law of 1983 allowed the government to issue interest-bearing certificates. The initial objective of the issuance was to facilitate the fulfillment of the liquidity requirements of Islam Malaysia Berhard Bank on the basis of its inability to purchase Or trading in government treasury bonds. At the same time, the central bank can use it as a tool of open market operations and a tool used by the Islamic bank to invest surplus cash flows.

These certificates, after being bought by any institution or individual, represent a good loan to the government to cover development expenses on a non-interest basis. The certificates are not to have a return, but the government usually decides to distribute dividends to the owners at the end of each year, The duration of these certificates is between one and five years.

It has been providing government investment versions in July 1983, according to the principle of the Qard al-Hasan (Ismail, 1996).

But the principle of the Qard al-Hasan does not meet the requirements of these versions as tradable bonds in the secondary market. In order to address this deficit, Nijara Malaysia Bank has opened the way to facilitate the sale and purchase of these securities to speculators with the Central Bank. The Bank determines the selling or buying price of speculators, which will maintain the system of recording any movement in government investment issues.

On June 15, 2001, the Malaysian government launched the three-year investment issue with a value of 2.0 billion RM in accordance with the principle of sale of equity and the principle of selling debt (Resolution of the international Islamic council, 2006).

The government investment certificates were not limited to "Bank Islam Malaysia", but were available to all other institutions in the Malaysian financial and banking system, in addition to individuals. The purpose of issuing these certificates is to determine the government's access to funds to finance their expenditure on development projects. These certificates shall be issued in accordance with the principle of good loan. A committee shall be formed in which governmental and religious entities shall participate, to determine a dividend to be distributed to the holders of certificates, The certificate is for one year, or the declaration of return after one year if the certificate is for more than one year. The government issues the certificates for one, two or five years, and there are certificates with longer terms. The balance of these certificates exceeded several billion dollars (Al Foley, 1996).

➤ **Sukuk Islamic Ijarah**

The Islamic Sukuk government in Malaysia witnessed a later development by issuing Islamic asset-backed Ijara Sukuk which yield variable returns. For example, in December 2014, Islamic Ijara Sukuks were issued for the Malaysian state of Sarawak. The amount required for issuance was USD 350 million, with about \$ 1.3 billion (Al-Musabi, 2015: p54).

➤ **Bank Negara Malaysia (Negotiable Notes) (BNNN)**

**BNNN** are short term bonds issued by the Bank to absorb excess liquidity in the system at a fixed rate of profit. It was first issued on 29 November 2000 and is traded on the secondary market on the principle of selling the debt. The term of use specified by the Bank is one year, These tools are also one of the means used by the bank to manage liquidity.

➤ **Sukuk Mudarabah Cagamas (SMC)** (chiquier, 1997: p13)

Gagamas Berhad (Malaysia National Mortgage Corporation) issued the Gagamas Mudaraba bonds on March 1, 1994 to finance the purchase of Islamic housing debt from financial institutions that provide Islamic housing finance to the local population. These bonds are based

on the Mudarabah principle whereby bondholders share profits with Gagamas according to the agreed rates.

➤ **Islamic Accepted Bills (IAB)** ( Nasir, 2009: p130)

Islamic bills of exchange, known as interest-free bills of exchange, were issued in 1991 to promote and promote domestic and foreign trade by providing Malaysian traders with Islamic financing. These bonds are based on two principles: sale of Murabaha and sale of debt. The Islamic Bank finances the purchase of the goods to local Murabaha merchants by buying and reselling them with the addition of a profit margin. The financing period is usually one year. During this year, the Islamic Bank can issue Islamic bills To obtain liquidity by selling them in accordance with the principle of selling debt.

➤ **Islamic Negotiable Tools (INI)** ( Bacha, 2008: p29)

Two types of financial tools fall under these bonds:

**Type 1: Islamic Negotiable Tools of Deposit (INID)**

These bonds represent the amounts deposited with the Islamic banking institutions on the principle of Mudarabah. These bonds are negotiable in the secondary market and mature on a specific date in the future so that the holder will be entitled to their nominal value plus the agreed share of the profit from the date of deposit until the maturity date.

**Type 2: Negotiable Islamic Debt Certificate (NIDC))**

This financial tool is based on the sale of Islamic assets by Islamic banking institutions to customers at a monetary price. These tools are a certificate of title to these assets, with the agreement to repurchase them at an agreed time and at an agreed price.

➤ **Islamic private debt securities**

The idea of Islamic private debt securities (IPDS) has been introduced in Malaysia since 1990. These bonds have been issued as primary market securities by Malaysian banking institutions based on the principles of long-term sale, Murabaha and Mudaraba, later to be traded in the secondary market.

• **Discount Rate Mechanism**

The discount rate mechanism has been replaced by a liquidity exchange system between Islamic banks or conventional banks offering Islamic banking services in the so-called IBS banking project. The liquidity exchange system relies on the financing of Islamic banks with deficits by investing the excess balances of Islamic banks on a speculative basis. All banks operating in the country participate in the clearing system. If there is still a deficit after the balance is supported, the central bank will finance it on a speculative basis. The duration of this financing is between one and twelve months, with a minimum investment amount of RM 50,000 (US \$ 20,000). Negotiations between the surplus banks and the banks with disabilities are governed by the percentage of participation in the profit and the amount and period under the supervision of Bank Negara Malaysia (Yahya, 1996). The liquidity exchange system is one of the mechanisms of the Islamic financial market integrated with the objectives of the Islamic banking system, which is primarily in providing facilities for Islamic financial institutions to provide financing for projects and settlement of short-term securities investments, as well as the role of the channel through which the implementation of monetary policy. It is known that interbank financial transactions and investments are working to allow banks with surplus to transfer some of their financial

balance to banks that suffer from cash shortage, thus necessarily maintaining the funding mechanism and liquidity in order to enhance stability in the banking system.

The system of exchange of liquidity between banks on a set of mechanisms that provide sufficient flexibility for the transfer of liquidity from banking institutions surplus to the institutions of banking deficit. The most important mechanisms:

➤ **Investment through speculation between banks**

This investment refers to one of the mechanisms by which any Islamic banking institution with a deficit (a bank that represents an investment vessel) can obtain investments from banking institutions with surplus (investment bank) on the basis of speculation (ie participation in profits). The investment period ranges from one to twelve months.

➤ **Acceptance of deposits between banks**

The acceptance of interbank deposits is one of the inter-bank transactions between Nijara Malaysia and other Islamic banking institutions. This transaction refers to the mechanism used by Islamic banking institutions to deposit excess funds at Nijara Malaysia Bank on the basis of the depositary guarantee.

➤ **Sales and Repository Agreements (SBBA)**

The sale and repurchase agreements are one of the commercial transactions in the Islamic financial market. They are executed between two parties where the seller sells some assets to the buyer at the agreed price the parties then conclude another separate agreement in which the buyer undertakes to sell the assets concerned to the seller again at a price agreed upon.

### **Direct Tools of Monetary Policy**

The adoption by the Bank of Negara Malaysia of indirect tools in monetary policy management and the efficiency of the Islamic financial market-based liquidity exchange system has reduced its use of direct tools, which may be limited to the credit limits used in liquidity absorption situations (Sharqawi, 2005: p149), as well as direct instructions on the sequence of operations Banking, and foundations Employment and training, which is focused and supervised by the Central Bank and Malaysia is similar to this procedure (Journal of Islamic economic, 1994: p7), and this may have helped to solve many of the issues that always arise between Islamic banks and central banks.

- **Third: Lessons learned from the Malaysian experience in guiding monetary policy for Islamic banks**

The Malaysian model in its dealings with Islamic banks was characterized by the gradual transition to the Islamic banking mode, with all the conditions suitable for the operation of Islamic banks. The relationship between the Central Bank of Malaysia and the Islamic banks was characterized by their reliance on indirect tools that are compatible with the Islamic banking style Through the development of a system to exchange liquidity between Islamic banks, and rely on the mature financial market to provide a wide range of Islamic financial tools and use in the framework of open market operations, as well as at the level of reserve The Malaysian

experience has some weaknesses or problems. The most important of which is the problem of the agreement on the legitimacy of the foundations of the Islamic finance industry in Malaysia, where a lot of Questions about the legitimacy of the foundations on which the basic elements of Islamic financial and banking work have been based in Malaysia. The Islamic Government Investment Certificates, the Islamic alternative to traditional bills and bonds, determine their return later on the basis of the good loan principle. But if this voluntary reward is turned into a constant condition and an essential element in the loan contract, many people object to its legitimacy (Foley, 2000: p90). Acceptable Islamic bills are based on the principles of speculation and the sale of debt. This latter principle there is also disagreement over its legitimacy (Al-Zuhaili, 2012: p21).

## **4. Conclusions & Recommendations**

### **4.1. Conclusions**

In order to implement the monetary policy on the Islamic banks in any country to benefit from the experiences of other countries in this area, especially countries that have transformed the entire banking system to the Islamic banking model as in Malaysia, and here highlights the Malaysian experience in the management of monetary policy towards Islamic banks, Which, despite the legal errors it has made, has provided a pioneering experience in the Islamic financial market, supported by a wide range of modern financial tools and the use of a sophisticated system for exchanging liquidity among Islamic banks as an alternative to the discount rate mechanism.

### **4.2. Recommendations**

The importance of rethinking the strategy of monetary policy in any country wishing to implement the Islamic banking style, and requires the use of new monetary tools compatible with the Islamic banking model, through the development of a system to exchange liquidity between Islamic banks and the Central Bank as an alternative to the mechanism of the opponent, and activate the open market by finding Islamic financial market, allowing Islamic banks to issue Islamic Sukuk with tight control by the Monetary Authority, to be actually representative of real assets or actual financing operations, and to use these Sukuk in open market operations towards Islamic banks, Here we take advantage of Malaysia's experience in creating new types of Islamic sukuk, provided that it avoids the legitimate mistakes it has made.

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\*Corresponding author.

E-mail address: [ghassan.ghandour@yahoo.com](mailto:ghassan.ghandour@yahoo.com)