International Journal of Scientific Research and Management (IJSRM)
||Volume||13||Issue||07||Pages||9340-9346||2025||
Website: https://ijsrm.net ISSN (e): 2321-3418
DOI: 10.18535/ijsrm/v13i07.em05

Islamic Banking And Financial Stability In Indonesia: A Systematic Literature Review Approach

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Abstract
This study aims to explore the financial stability of Islamic banks in Indonesia through a systematic literature review of empirical studies published between 2019 and 2024. Using a structured approach, six peer-reviewed studies were analyzed based on their models, variables, and findings. The results show that internal bank factors such as capital adequacy, operational efficiency, and credit risk are the most consistent determinants of stability. Macroeconomic variables, particularly inflation and exchange rate volatility, also play a significant role. Interestingly, Sharia-related factors—such as Islamicity performance—emerged as positive contributors to bank stability, highlighting the unique nature of Islamic finance. However, financial inclusion and GDP growth showed mixed or insignificant effects. This review suggests that improving internal management, strengthening Sharia compliance, and enhancing risk mitigation are essential for building a more stable Islamic banking sector in Indonesia.

Keywords: Islamic banking, financial stability, Indonesia, systematic literature review

Introduction

The global financial system has undergone significant transformation in recent decades, particularly following the 2008 global financial crisis which exposed fundamental weaknesses in conventional banking practices. In response to this instability, interest in alternative financial systems, particularly Islamic banking, has grown rapidly. Rooted in Sharia principles that prohibit interest (riba), promote risk-sharing, and encourage ethical investment, Islamic banking is considered by many scholars and practitioners to offer a more resilient and socially responsible financial framework (Alisic, Dinc, & Salihu, 2024). Globally, the Islamic finance industry has expanded its reach across regions including the Middle East, Southeast Asia, and Africa, with assets projected to surpass USD 3.69 trillion by 2024 (Islamic Financial Services Board, 2021). Amid this global growth, Islamic banking is increasingly recognized not only for its religious and ethical dimensions, but also for its potential contribution to financial stability, particularly in emerging economies.

In the Southeast Asian context, Indonesia has emerged as one of the fastest-growing Islamic banking markets. As the country with the largest Muslim population in the world, Indonesia holds immense potential for Sharia-compliant financial services. Significant structural reforms have been undertaken by the Indonesian government and financial authorities to strengthen this sector. One major milestone was the merger of three state-owned Islamic banks into Bank Syariah Indonesia (BSI) in 2021, creating one of the largest Islamic banks globally in terms of customer base and assets. Additionally, regulatory frameworks such as the Financial Services Authority (OJK)'s Roadmap for Sharia Banking have been instrumental in providing strategic direction for the sector. Despite these positive developments, the contribution of Islamic banks to the overall financial system in Indonesia remains modest—capturing only around 6–7% of total banking assets as of 2023 (Otoritas Jasa Keuangan, 2023). Concerns have also been raised regarding the sector's ability to weather economic shocks and ensure long-term financial stability.

At the core of these concerns is the question of **financial stability**, which refers to the ability of financial institutions to maintain solvency and operational integrity under both normal and stressed conditions. Several key indicators such as capital adequacy, credit risk, efficiency, and macroeconomic factors like inflation and exchange rates are often used to assess stability. In Indonesia, Islamic banks have at times recorded higher non-performing financing (NPF) and lower profitability ratios compared to their conventional counterparts, raising questions about their robustness (Widarjono, 2020; Maritsa & Widarjono, 2021). Moreover, the limited availability of Sharia-compliant liquidity instruments and the relatively underdeveloped risk mitigation frameworks have further complicated the picture.

Numerous empirical studies over the last five years have attempted to unravel the complex relationships between bank-specific characteristics, macroeconomic conditions, and the financial stability of Islamic banks in Indonesia. Widarjono (2020), for instance, employed an ARDL approach and found that variables such as bank size, capital adequacy ratio (CAR), efficiency, inflation, and exchange rates significantly influence stability metrics like the Z-score and NPF. Similarly, Maritsa and Widarjono (2021) reinforced these findings by confirming the adverse effects of inflation and exchange rate volatility on Islamic banking stability. More recent studies, such as Sururi and Kuntoro (2025), extended the analysis to Islamic rural banks and introduced additional variables like financial inclusion and profitability. In parallel, Mubarok et al. (2024) explored both short- and long-term effects of macroeconomic instability on profitability through a VECM framework, while Amaroh et al. (2024) incorporated Sharia compliance (measured through Islamicity performance) into the stability equation during the COVID-19 pandemic.

Despite these valuable contributions, a number of gaps remain in the existing literature. First, most studies have focused on large-scale Islamic commercial banks, while research on rural and community-based Islamic financial institutions is still limited. Second, there has been relatively little attempt to synthesize findings across multiple studies to identify consistent patterns and divergences, particularly in the Indonesian context. Third, although several studies have highlighted the importance of bank-specific and macroeconomic variables, the role of uniquely Islamic factors—such as Sharia governance, compliance structures, and the overall ethical orientation of Islamic banking—has not been thoroughly explored in stability analyses. Moreover, very few studies have explicitly adopted a systematic review methodology to consolidate and critically examine the current state of research on this topic.

Given these observations, this study aims to fill the gap by conducting a systematic literature review of empirical research from 2019 to 2024 related to the financial stability of Islamic banks in Indonesia. The review focuses on identifying the internal, external, and Sharia-related factors that influence stability, as well as assessing the methodological approaches used across studies. By integrating findings from various sources, this paper seeks to provide a comprehensive and up-to-date understanding of how Islamic banking contributes to financial stability in Indonesia and to offer informed recommendations for future research and policy development.

Methodology

This study employs a systematic literature review (SLR) approach to examine the recent body of research related to Islamic banking and financial stability in Indonesia. The systematic literature review is a research method that allows scholars to collect, organize, analyze, and synthesize available literature in a transparent and replicable manner (Ramey & Rao, 2011). It is particularly useful for identifying key trends, theoretical frameworks, and empirical findings within a focused area of study. In the context of this research, the SLR approach provides a comprehensive overview of how internal bank characteristics, macroeconomic variables, and Islamic principles have been empirically linked to financial stability outcomes in Indonesian Islamic banks between 2019 and 2024.

The review process followed four primary stages: (1) formulation of research questions, (2) identification of inclusion and exclusion criteria, (3) literature search and selection, and (4) data extraction and analysis. The guiding research question was: *What are the internal, external, and Islamic-specific factors that influence the financial stability of Islamic banks in Indonesia as revealed in empirical studies published between 2019 and 2024?*

To ensure the relevance and quality of selected articles, several inclusion and exclusion criteria were applied. Only peer-reviewed journal articles published between January 2019 and May 2024 were considered. The studies had to focus on Islamic banking in Indonesia, employ quantitative methods, and investigate financial stability either directly (using indicators such as Z-score, NPF, or ROA) or indirectly through risk-related variables. Studies written in English or Bahasa Indonesia were both included, as long as they met methodological rigor. Excluded from the review were conference papers without peer review, opinion articles, and conceptual or qualitative studies without empirical data.

The literature search was conducted across multiple academic databases including Scopus, Google Scholar, DOAJ (Directory of Open Access Journals), and SINTA (Science and Technology Index - Indonesia). Search terms included combinations of the following keywords: “Islamic banking,” “financial stability,” “Indonesia,” “Z-score,” “non-performing financing,” “profitability,” “macroeconomic,” “ARDL,” “VECM,” “GMM,” and “Sharia compliance.” Boolean operators such as AND and OR were used to refine the search. A total of 43 articles were initially retrieved. After applying the inclusion and exclusion criteria and removing duplicates, six empirical studies were selected for in-depth analysis.

Each selected study was then reviewed systematically using a structured data extraction matrix. Information extracted from each study included the authorship and publication year, research period, model used (e.g., ARDL, VECM, GMM), sample size and coverage (e.g., commercial Islamic banks or rural banks), dependent and independent variables, and key findings related to financial stability. The extracted data were compared across studies to identify recurring themes, methodological patterns, and gaps.

To ensure analytical consistency, a thematic synthesis approach was applied to the extracted findings. This involved grouping the variables into three main categories: internal bank factors (e.g., capital adequacy, bank size, operational efficiency), external macroeconomic factors (e.g., inflation, exchange rate, interest rates), and Islamic-specific factors (e.g., Sharia governance, Islamicity performance index). The analysis also considered whether these factors had a statistically significant, positive, negative, or neutral effect on financial stability.

This rigorous and structured methodology allows the study to present a consolidated view of how different empirical studies assess the financial stability of Islamic banks in Indonesia, making it possible to derive meaningful conclusions and identify directions for future research and policy formulation.

Results

This section presents the findings from six selected empirical studies published between 2019 and 2024. The studies investigate the determinants of financial stability in Islamic banks in Indonesia using various econometric models and cover a range of internal, macroeconomic, and Sharia-based variables. Table 1 below summarizes the methodological features and core findings of each study.

Table 1. Summary of Reviewed Studies on Islamic Banking and Financial Stability in Indonesia

Author(s) & Year	Model Used	Sample & Period	Stability Measure	Key Variables Studied	Key Findings
Widarjono (2020)	ARDL	Islamic commercial banks (2010–2018)	Z-score, NPF	Bank size, CAR, efficiency, inflation, exchange rate	Bank size and CAR have positive impact; inefficiency, inflation, and exchange rate volatility reduce stability.
Maritsa & Widarjono (2021)	ARDL	Islamic commercial banks (2015–2019)	Z-score	OER, NPF, inflation, IPI, exchange rate	NPF, inflation, and exchange rate negatively affect stability; efficiency improves stability.
Sururi & Kuntoro (2025)	ARDL	Islamic rural banks (2014–2024)	Z-score	Financial inclusion, CAR, bank size, profitability, inflation, exchange rate	Financial inclusion has no significant effect; CAR, profitability, and exchange rate strengthen stability, while inflation and bank size weaken it.

Mubarok et al. (2024)	VECM	Islamic banks (2007–2023)	ROA (profitability)	NPF, inflation, exchange rate, crisis dummy	NPF, inflation, and exchange rate reduce profitability both in short and long run, suggesting reduced stability.
Qolbi, Karisma, & Rosyadi, (2020)	GMM Panel	10 Islamic banks (2017–2023)	Z-score	NPF, FDR, CAR, inflation, GDP, interest rate	NPF significantly lowers stability; macroeconomic variables (GDP, inflation, interest) not significant.
Amaroh et al. (2024)	RE Panel	10 Islamic banks (2017–2023 Q1)	Z-score	Credit risk, efficiency, reserve ratio, Islamicity index, interest rate, inflation, GDP	Efficiency, interest rates, and Islamicity performance improve stability; credit risk, reserves, and inflation reduce it.

Descriptive Synthesis of Results

The selected studies reveal consistent evidence that internal banking variables such as **capital adequacy ratio (CAR)**, **operational efficiency**, and **bank profitability** play a crucial role in determining the financial stability of Islamic banks in Indonesia. For instance, both Widarjono (2020) and Sururi & Kuntoro (2025) found CAR to have a stabilizing effect, affirming its importance in enhancing solvency and investor confidence. Efficiency, measured by operational expense ratios, was also positively associated with stability in several studies (Maritsa & Widarjono, 2021; Amaroh et al., 2024).

Credit risk, often proxied by non-performing financing (NPF), consistently emerged as a significant negative determinant of stability across almost all studies. Mubarok et al. (2024) found that rising NPF levels not only lower profitability but also weaken the bank's financial resilience over time. Qolbi, Karisma, and Rosyadi (2020) confirmed this relationship, emphasizing that credit quality is one of the most critical threats to financial sustainability in Islamic banking.

From the **macroeconomic perspective**, variables such as **inflation** and **exchange rate volatility** frequently appear as destabilizing forces. These external shocks affect both loan performance and bank income, especially given the limited hedging instruments available in Sharia-compliant finance. Three studies (Widarjono, 2020; Maritsa & Widarjono, 2021; Sururi & Kuntoro, 2025) highlighted the negative role of inflation in eroding bank stability, while Mubarok et al. (2024) identified exchange rate fluctuations as a significant source of profitability volatility.

A novel dimension in the more recent studies is the incorporation of **Sharia-related performance indicators**, particularly in Amaroh et al. (2024), who introduced the **Islamicity Performance Index**. This index captures how closely the bank's operations align with Sharia principles, such as equitable profit-sharing, ethical investments, and social welfare contributions. Their study found that banks with higher Islamicity scores tended to exhibit greater financial stability—especially in the pre-pandemic period—suggesting that deeper adherence to Islamic ethics may buffer against external shocks.

Interestingly, some variables commonly assumed to impact stability, such as **financial inclusion** and **macroeconomic growth (GDP)**, were found to be statistically insignificant in certain models (e.g., Sururi & Kuntoro, 2025; Qolbi, Karisma, & Rosyadi, 2020). This may reflect limitations in how financial inclusion is operationalized, or the relatively short time frame in which macroeconomic changes influence bank-level stability.

Thematic Grouping of Stability Determinants

To summarize the insights from the six studies, the determinants of financial stability can be grouped into three main categories:

- **Internal Bank Factors**:
  - *Positive effects*: CAR, operational efficiency, profitability
  - *Negative effects*: Credit risk (NPF), high operating costs, low reserves
- **Macroeconomic Factors**:
  - *Positive effects*: Exchange rate stability (in some contexts), interest rate (only in Amaroh et al., 2024)
  - *Negative effects*: Inflation, exchange rate volatility
- **Sharia-Specific Factors**:
  - *Positive effects*: Islamicity index, good Sharia governance
  - *No significant effect*: Financial inclusion (in the context of Islamic rural banks)

These findings demonstrate that while many of the stability factors for Islamic banks mirror those of conventional banks, Islamic-specific dimensions such as Sharia compliance and ethical governance also play an important role. The consistency of some relationships (e.g., NPF and inflation as destabilizing forces) across various studies underscores their policy relevance.

Discussion

This section discusses the findings of the reviewed studies by comparing them with earlier global and regional research on Islamic banking and financial stability. It also explores the meaning and implications of the results, especially for the development of Islamic banking in Indonesia.

First, the results show that **internal factors** such as capital adequacy, efficiency, and credit risk are the most consistent and important variables in determining the financial stability of Islamic banks in Indonesia. This is in line with earlier global studies which confirm that well-capitalized banks are more stable and better able to absorb shocks (Čihák & Hesse, 2010). In the Indonesian case, studies like Widarjono (2020) and Sururi & Kuntoro (2025) found that the Capital Adequacy Ratio (CAR) strongly supports financial stability. A higher CAR means that banks have more capital to cover risks, which helps protect depositors and maintain trust in the financial system.

At the same time, **operational efficiency** also plays a major role in improving bank stability. When banks can manage their costs and operations effectively, they can stay profitable even during economic difficulties. This is supported by Maritsa and Widarjono (2021), who found that better efficiency improves the Z-score, a common indicator of bank stability. Amaroh et al. (2024) also found efficiency to be positively related to financial stability, even during the pandemic.

On the other hand, **credit risk**, usually measured by the Non-Performing Financing (NPF) ratio, was found to have a strong negative effect on stability. This is expected because when many borrowers fail to repay their financing, banks lose money and their financial condition becomes weak. All reviewed studies agreed that high NPF lowers bank stability. This supports global research, such as that by Salem, Usman, and Ezeani (2020), which shows that lower asset quality reduces the soundness of both conventional and Islamic banks.

Macroeconomic factors such as inflation and exchange rate volatility were also shown to be important in several studies. In particular, inflation was found to be harmful to financial stability in most models. Inflation can reduce the real value of repayments and increase costs for both banks and their clients. The negative effect of inflation in studies like Mubarok et al. (2024) and Sururi & Kuntoro (2025) shows that Islamic banks in Indonesia are still sensitive to macroeconomic instability. Exchange rate volatility also creates risk, especially for banks that are involved in international trade or hold foreign currency assets.

Interestingly, the role of **interest rates** in some models (e.g., Amaroh et al., 2024) showed a positive effect on Islamic banking stability, even though Islamic banks do not use interest in their operations. This may be due to the indirect impact of monetary policy on the banking system as a whole, including liquidity conditions and competition with conventional banks. However, this relationship needs further study to fully understand the mechanism.

A unique and promising finding came from the study by Amaroh et al. (2024), which introduced **Islamicity performance** as a variable. This index measures how closely Islamic banks follow Sharia principles, not just in financial contracts but also in ethical behavior, social justice, and governance. Their study found that banks with higher Islamicity scores tended to be more stable, especially before the COVID-19 crisis. This finding is very important because it shows that good Sharia compliance and strong Islamic ethics can strengthen financial health. It also supports the idea that Islamic banking is not only about avoiding interest but also about building a just and stable financial system.

Some results were less expected. For example, **financial inclusion**, which is often seen as a positive development goal, was found to have no significant effect on stability in the context of Islamic rural banks (Sururi & Kuntoro, 2025). This could be because financial inclusion in rural areas may target low-income populations who are more vulnerable to default, or because the inclusion programs are not yet supported by good financial education or risk management tools. It suggests that while inclusion is important, it needs to be implemented carefully to ensure it also supports financial stability.

Another interesting result is that **macroeconomic variables** like GDP growth or interest rates were not always significant, especially in the study by Qolbi, Karisma, and Rosyadi (2020). This may reflect the idea that Islamic banks in Indonesia are more influenced by their internal management and specific risks rather than broad economic trends. However, this could also be due to the short time period of the studies or differences in model design.

Comparing these findings with research in other countries, we see that many of the factors affecting Islamic banking stability in Indonesia are similar to those in countries like Malaysia, Pakistan, and the Gulf States. However, the Indonesian context also brings specific challenges, such as limited market share, lack of advanced Sharia-compliant instruments, and institutional weaknesses in governance. These challenges make it harder for Islamic banks to maintain stability, especially during economic shocks or periods of crisis like COVID-19.

In conclusion, the discussion shows that while Indonesian Islamic banks share many stability drivers with conventional and global Islamic banks, there are also unique features—especially in terms of Sharia performance and macroeconomic sensitivity—that deserve more attention. Strengthening both technical and ethical foundations will be important to build a more resilient and stable Islamic banking sector in Indonesia.

Conclusion

This study reviewed six empirical studies from 2019 to 2024 that examined the financial stability of Islamic banks in Indonesia. The findings show that internal factors—such as capital adequacy (CAR), operational efficiency, and credit risk (NPF)—play the most consistent role in influencing stability. Macroeconomic variables like inflation and exchange rate volatility also affect stability, but their impact can vary depending on the model and time period. A notable finding is the positive effect of Islamicity performance, showing that strong adherence to Sharia principles can enhance financial resilience. However, some expected factors such as financial inclusion and macroeconomic growth (GDP) were found to be insignificant in certain contexts, suggesting that the relationship between these variables and stability is complex and context-dependent.

Based on these findings, several recommendations can be made. First, Islamic banks in Indonesia should improve their credit risk management and maintain high capital reserves to better withstand economic shocks. Second, efficiency in operations must be prioritized to ensure long-term sustainability. Third, regulators and bank managers should invest more in developing tools to strengthen Sharia governance and transparency, as this could not only improve compliance but also enhance stability. Lastly, further research should explore newer areas such as the role of digital transformation, rural Islamic banking, and the long-term effects of Islamic social finance on bank stability. These steps can help Islamic banks in Indonesia grow stronger and more resilient in a changing economic environment.

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