

Islamic Stock Return Sensitivity to Exchange Rate and Inflation: Evidence from the Jakarta Islamic Index (2014 – 2023)

Dodi Siswanto^{1*}, Iwan Ardiansyah², Ermi Triaji³, Harland Yusuf⁴

¹Department of Management, Faculty of Economic, Al Ghifari University, Bandung, Indonesia.

²Department of Management, Faculty of Economic, Al Ghifari University, Bandung, Indonesia.

³Department of Management, Faculty of Economic, Al Ghifari University, Bandung, Indonesia.

⁴Department of Public Administration, Faculty of Social and Political Sciences, Pasundan University, Bandung Indonesia.

*Email: siswantododi88@gmail.com

Abstract. Islamic capital markets have grown globally with rising demand for sharia-compliant instruments. In Indonesia, this growth is reflected in the Jakarta Islamic Index (JII). However, studies on how macroeconomic variables affect Islamic stock returns remain limited, particularly during recent global volatility and the COVID-19 pandemic.

This study investigates the impact of exchange rate and inflation on JII stock returns using panel data regression. The sample covers 30 JII-listed companies with monthly data from 2014–2023. The Hausman test indicates that the Random Effect Model (REM) is appropriate.

The results show that the exchange rate positively and significantly affects returns (coefficient = 0.012701, $p = 0.0064$), suggesting that IDR depreciation enhances export competitiveness. Inflation has a negative and significant effect (coefficient = -0.009921, $p = 0.0112$), reflecting reduced returns due to weaker purchasing power. The model explains 78.83% of return variation ($R^2 = 0.788$).

These findings confirm that Islamic stocks are sensitive to macroeconomic shocks. The study contributes to Islamic finance literature and provides practical implications for investors and policymakers in strengthening Indonesia's Islamic capital market.

Acknowledgment: This paper is derived from a broader study previously published in DIALEKTIKA Journal of Social Sciences (2025), focusing specifically on exchange rate and inflation.

Keywords: Islamic stock return, exchange rate, inflation, Jakarta Islamic Index, macroeconomic variables, panel data.

Introduction

The Islamic capital market has an important role in supporting the achievement of the United Nations' Sustainable Development Goals (SDGs), particularly Goal 8 (decent work and economic growth) and Goal 12 (responsible consumption and production). In Indonesia, the Jakarta Islamic Index (JII) represents a benchmark for sharia-compliant investments that contribute to financial inclusion and sustainable economic development. However, JII performance is still relatively volatile and tends to underperform conventional indices, indicating that Islamic stocks are vulnerable to macroeconomic shocks such as exchange rate volatility and inflation (IDX, 2023). Similar vulnerabilities have also been observed in other emerging markets, where Islamic finance institutions face cyclical risks linked to global financial shocks (Alqahtani & Mayes, 2020). At the same time, Islamic finance has been recognized as a key driver in supporting the United Nations' Sustainable Development Goals (SDGs), particularly in fostering inclusive growth and financial stability (World Bank, 2022; Hassan, Rabbani, & Abdulla, 2021). Strengthening the resilience of Islamic equities is therefore critical to advancing sustainable finance and achieving SDG targets.

Several studies have examined the impact of macroeconomic variables on Islamic stock performance in Indonesia. Gunariah and Nurdiansyah (2025) found that inflation, gold prices, and the exchange rate jointly influence the JII, but the exchange rate alone was not statistically significant. Qurrota A'yun and Fatwa (2022), using a vector autoregression model, reported that inflation and the rupiah-USD exchange rate negatively affect JII performance. Meanwhile, Wahyudi and Qoyum (2023) applied an error correction model and showed that in the short run, the exchange rate and BI Rate significantly affect JII, while inflation is insignificant both in the short and long term. Furthermore, previous research by the author (Siswanto, 2025) demonstrated that exchange rate movements positively influence Islamic stock returns, while inflation exerts a negative impact.

Similar patterns and debates are also evident in international contexts. For instance, Zhang (2021) explained that inflation tends to reduce stock returns across both advanced and emerging markets, while Kyei Mensah and Werekoh (2020) showed that exchange rate volatility significantly affects stock market performance. Likewise, Salisu and Vo (2020) highlighted that macroeconomic shocks, including exchange rate fluctuations, strongly drive market volatility, especially during periods of global uncertainty. These international findings reinforce the importance of analyzing exchange rate and inflation in the case of the Indonesian Islamic capital market.

Taken together, these findings indicate inconsistencies regarding the role of exchange rate and inflation in shaping the dynamics of Islamic stock returns, which creates a clear gap in the literature.

The novelty of this study lies in several aspects. First, unlike the broader scope of previous research that examined multiple factors influencing Islamic stock returns, including risk and valuation (Siswanto, 2025), this paper specifically isolates exchange rate and inflation as the two most critical macroeconomic determinants. This focused approach provides a deeper understanding of how macroeconomic shocks shape the dynamics of sharia-compliant equities. Second, the study covers a longer and more recent period (2014–2023), which captures major global disruptions such as the COVID-19 pandemic and heightened rupiah volatility, offering updated empirical evidence compared to earlier works. Third, this research integrates the analysis within the framework of the United Nations' Sustainable Development Goals (SDGs), particularly Goal 8 and Goal 12, highlighting the relevance of Islamic capital market resilience to sustainable finance. Finally, by positioning the Indonesian evidence in dialogue with international literature (e.g., Zhang, 2021; Salisu & Vo, 2020; Kyei Mensah & Werekoh, 2020), this study contributes not only to the domestic discourse on Islamic finance but also to the broader global understanding of how Islamic equities respond to inflationary pressures and exchange rate volatility.

The objective of this research is to analyze the sensitivity of Islamic stock returns in the JII to fluctuations in the exchange rate and inflation during 2014–2023, thereby offering empirical evidence that enriches the body of knowledge in Islamic finance and provides practical recommendations for investors, policymakers, and regulators in strengthening the sustainability and resilience of Islamic capital markets.

This paper is part of a broader study previously published in *DIALEKTIKA Journal of Social Sciences* (2025). While the earlier research examined multiple factors influencing Islamic stock returns, the present study focuses specifically on exchange rate and inflation as key macroeconomic determinants.

Methods

This study is designed to analyze the impact of macroeconomic variables, namely exchange rate and inflation, on Islamic stock returns in Indonesia. The Jakarta Islamic Index (JII) was selected as the research context because it serves as a benchmark for sharia-compliant investments and reflects the dynamics of the Islamic capital market.

The population of this study comprises all companies consistently listed in the Jakarta Islamic Index (JII) from 2014 to 2023. Using purposive sampling, 30 firms were selected based on their continuous inclusion in the index during the observation period. This resulted in a balanced panel dataset of 120 monthly observations. The dependent variable is Islamic stock return, measured as the monthly logarithmic return of JII-listed firms. The independent variables are (1) exchange rate (IDR/USD), collected from Bank Indonesia, and (2) inflation, measured using the Consumer Price Index (CPI) from the Central Statistics Agency (BPS). Data were compiled from official publications and verified to ensure consistency and accuracy.

Panel data regression was employed to estimate the relationship between exchange rate, inflation, and Islamic stock returns. Three models were tested: Pooled Least Squares (PLS), Fixed Effect Model (FEM), and Random Effect Model (REM). The Hausman test was conducted to determine the most appropriate specification. Diagnostic tests, including multicollinearity and heteroskedasticity, were performed to validate the robustness of the model.

This study adopts a quantitative research design with an explanatory approach. By combining cross-sectional and time-series data, panel regression provides a comprehensive understanding of both firm-level variations and temporal dynamics. This method ensures reliable empirical evidence on how macroeconomic shocks influence sharia-compliant equities in Indonesia.

Result and Discussion

The estimation results based on the Random Effect Model (REM) reveal that the exchange rate has a positive and significant impact on Islamic stock returns, while inflation shows a negative and significant effect.

Tabel 1 (Regression Results)

Variable	Coefficient	p-value	Effect
Exchange Rate	0.012701	0.0064	Positive & Significant
Inflation	-0.009921	0.0112	Negative & Significant

Source: Author's calculation based on panel data regression (2025).

Specifically, rupiah depreciation enhances the competitiveness of export-oriented firms, which in turn improves Islamic stock performance. Conversely, rising inflation erodes purchasing power, increases production costs, and weakens investor confidence, thereby reducing returns. The model demonstrates a strong explanatory power with R^2 of 0.788, confirming the robustness of these findings.

To better understand these dynamics, the mechanisms behind the results can be explained as follows. When the rupiah depreciates, export-oriented firms experience a relative gain because their foreign revenues, when converted into local currency, increase in value. This strengthens profitability and eventually boosts stock returns. Many JII firms, particularly in plantation, mining, and consumer goods sectors, are exposed to global demand, making them more responsive to exchange rate movements. On the other hand, inflation reduces real purchasing power, raises production costs, and escalates uncertainty. For sharia-compliant companies, which are restricted from using conventional hedging instruments, the adverse impact of inflation is more pronounced, leading to weaker resilience compared to conventional firms.

These results highlight the sensitivity of Islamic equities to macroeconomic shocks. The positive association between exchange rate depreciation and stock returns is consistent with international findings (Kyei Mensah & Werekoh, 2020), which emphasize that currency fluctuations significantly influence market performance. Comparable evidence from recent crises also shows that Islamic stock markets react strongly to global currency movements, particularly during COVID-19 disruptions (Naqvi, Rizvi, & Shah, 2023). In the Indonesian context, this is particularly relevant for firms in the Jakarta Islamic Index (JII) that derive substantial revenues from export activities.

Meanwhile, the negative effect of inflation corroborates the view that persistent price increases undermine market stability and reduce real investment value (Zhang, 2021). Similar patterns were also found during the COVID-19 pandemic, where Islamic stocks failed to hedge against inflationary pressure in both advanced and emerging markets (Alam & Rizvi, 2021). This pattern has also been observed in Indonesian studies, where inflation consistently weakens sharia stock performance (Gunariah & Nurdiansyah, 2025; Wahyudi & Qoyum, 2023). Taken together, these findings confirm that inflation remains a critical challenge for sustaining the resilience of Islamic equities.

Trend of Exchange Rate and Inflation in Indonesia (2014–2023)

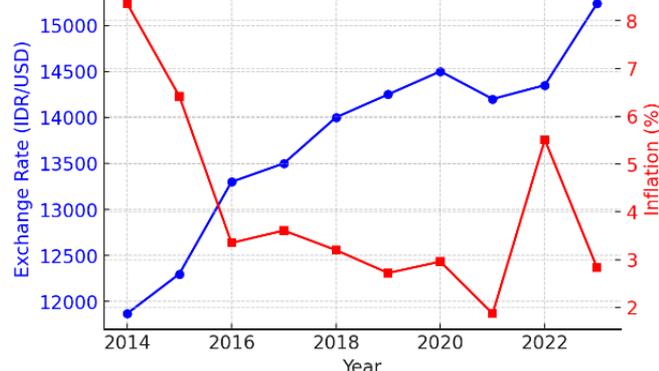


Figure 1 Trend Exchange Rate and Inflation 2014–2023

From a practical perspective, investors are advised to monitor exchange rate movements as potential opportunities for portfolio optimization, while adopting caution in periods of rising inflation. For policymakers, effective inflation management and the development of hedging instruments tailored for Islamic finance are essential to strengthen market stability. Furthermore, the results underscore the importance of aligning Indonesia’s Islamic capital market strategy with the United Nations’ Sustainable Development Goals (SDGs), particularly in promoting financial resilience (Goal 8) and sustainable investment (Goal 12).

Beyond the statistical significance of exchange rate and inflation, the findings carry important practical implications for market participants. For investors, close monitoring of currency fluctuations offers opportunities for portfolio optimization, particularly in export-oriented sectors that benefit from rupiah depreciation. At the same time, inflationary pressures must be treated as a warning signal, encouraging more defensive strategies and diversification to preserve real returns. Regulators and policymakers should prioritize inflation control and enhance the availability of Islamic-compliant hedging tools, such as currency swaps and sukuk-based derivatives, to mitigate exposure to macroeconomic risks and improve investor confidence.

From an international perspective, the Indonesian experience enriches the global discourse on the resilience of Islamic equities. The results align with studies in other emerging markets that highlight the dual role of exchange rate as both a risk and an opportunity, while confirming inflation as a persistent challenge to financial stability (Naqvi, Rizvi, & Shah, 2023; Alam & Rizvi, 2021). This suggests that lessons from Indonesia may be transferable to other Muslim-majority economies seeking to strengthen their Islamic capital markets. By integrating macroeconomic monitoring into Islamic finance strategy, Indonesia can position itself as a regional leader in sustainable Islamic investment aligned with the UN SDGs.

Conclusion

This study demonstrates that Islamic stock returns in the Jakarta Islamic Index (JII) are significantly influenced by macroeconomic variables, particularly the exchange rate and inflation. The findings show that rupiah depreciation tends to enhance stock returns, reflecting the benefit for export-oriented firms, while inflation reduces returns by eroding purchasing power and weakening market confidence.

The results confirm that Islamic equities are highly sensitive to macroeconomic shocks, underscoring the need for investors to closely monitor currency fluctuations and inflation trends in their decision-making. For policymakers and regulators, maintaining macroeconomic stability—especially through effective inflation control and the provision of sharia-compliant hedging instruments—will be essential to strengthen the resilience of Indonesia’s Islamic capital market.

By situating the Indonesian evidence within broader international literature, this study contributes to the ongoing discourse on Islamic finance and sustainable investment, while highlighting the strategic importance of aligning capital market development with the United Nations' Sustainable Development Goals (SDGs).

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