

Do Global Uncertainty Factors Affect Islamic Banking Stability? Evidence from Indonesia

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Abstract

Growing global uncertainty increasingly challenges banking stability, particularly in emerging economies vulnerable to external economic and geopolitical shocks. Although Islamic commercial banks are considered more resilient under Sharia principles, evidence on how different dimensions of global uncertainty affect their stability remains limited. This study investigates the long-run and short-run effects of global uncertainty on Islamic Commercial bank stability in Indonesia during 2016–2025 using the Vector Error Correction Model (VECM). Global uncertainty is proxied by U.S. Economic Policy Uncertainty (EPU), U.S. Geopolitical Risk (GPR), and the CBOE Volatility Index (VIX), while interest rates, exchange rates, and inflation serve as domestic control variables. In the long run, EPU and GPR positively affect Islamic bank stability, whereas inflation has a significant negative effect. The volatility index, interest rates, and exchange rates are insignificant,

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and no variables significantly influence stability in the short run. These findings indicate gradual long-run adjustment to external shocks. This study demonstrates that global uncertainty affects Islamic bank stability through distinct transmission mechanisms, implying that regulators should strengthen macroprudential policies while Islamic banks should enhance long-term resilience against external shocks.

Keywords: *Economic Uncertainty, Global Risk, Islamic Banking Resilience, Islamic Bank Stability, Macroeconomics.*

INTRODUCTION

In recent decades, global economic uncertainty has intensified due to recurring economic, geopolitical, and financial shocks. As the world's largest economy, the United States has become one of the primary sources of global uncertainty because changes in its economic policies, geopolitical environment, and financial markets frequently influence economic activity beyond its national borders (Bhattarai et al., 2020; Suh & Yang, 2021). These developments generate substantial spillover effects across countries, including Indonesia, through trade linkages, capital flows, and financial market integration (Lastauskas & Nguyen, 2024; Suwanprasert, 2022). Consequently, global uncertainty has become an increasingly important concern for preserving financial system stability, especially across emerging economies.

Banks perform a crucial intermediation function that supports financial stability. However, this function also makes banks highly vulnerable to external shocks and global market volatility. Heightened global uncertainty may affect banks' funding conditions, financing activities, liquidity, and risk-taking behaviour, thereby increasing liquidity risk, credit risk, and systemic risk (Albert et al., 2025; Ali et al., 2026; Farooq et al., 2023). As financial markets become increasingly interconnected, understanding how different sources of global uncertainty are transmitted to the banking sector has become essential for strengthening banking resilience and safeguarding financial stability.

Indonesia provides an important context for investigating this issue because Islamic banking has experienced significant growth and has become a key pillar of the national financial sector. Operating within a dual banking system, Islamic banks differ from conventional banks through their adoption of profit-and-loss sharing, risk-sharing principles, and the prohibition of speculative activities and interest (*riba*). These characteristics are widely recognized for enhancing the resilience of Islamic banks during periods of economic and financial turbulence. Nevertheless, Islamic banks remain exposed to external uncertainty arising from changes in global economic policies, geopolitical tensions, and financial market volatility as international financial integration continues to deepen (Akkas & Asutay, 2025; Fatoni, 2022; Zuhroh & Rofik, 2024). Understanding how different sources of global uncertainty affect Islamic bank stability is therefore important for both advancing the Islamic banking literature and informing financial stability policies in Indonesia.

In addition to external uncertainty, domestic macroeconomic conditions also constitute an important determinant of Islamic bank stability. Interest rates, exchange rates, and inflation influence financing costs, customers' repayment capacity, and overall economic activity, potentially amplifying or mitigating the effects of external shocks. Therefore, incorporating global uncertainty together with domestic macroeconomic variables enables a broader understanding of

the factors influencing Islamic bank stability than examining external shocks alone (Athari, 2021; Chen & Lu, 2021). Such an integrated perspective is particularly relevant for Indonesia, where strengthening the resilience of Islamic banks has become increasingly important amid persistent global uncertainty.

Despite the growing body of literature on global uncertainty and banking stability, existing empirical evidence remains inconclusive, particularly in the context of Islamic banking. Several studies suggest that heightened global uncertainty weakens banking conditions by reducing bank performance and market valuation (Albaity et al., 2023; Yasin et al., 2025). In contrast, other studies argue that Islamic banks remain relatively resilient during periods of uncertainty, as reflected in stronger profitability, stable financing growth, and lower default risk (Bilgin et al., 2021a, 2021b; Ozili & Arun, 2022). These contrasting findings indicate that the resilience of Islamic banks under global uncertainty has yet to reach a clear empirical consensus, raising the question of whether different sources of global uncertainty exert heterogeneous effects on Islamic bank stability.

One possible explanation for these inconsistent findings is that previous studies generally conceptualize global uncertainty as a homogeneous external shock. In reality, economic policy uncertainty, geopolitical risk, and financial market uncertainty represent different dimensions of global uncertainty that may influence Islamic bank stability through distinct transmission mechanisms. Moreover, previous studies predominantly focus on conventional banks or examine only a single indicator of global uncertainty, particularly Economic Policy Uncertainty (EPU) (Hui, 2021; Nguyen et al., 2025; Qi et al., 2022). Evidence that simultaneously considers U.S. Economic Policy Uncertainty (EPU), U.S. Geopolitical Risk (GPR), and the CBOE Volatility Index (VIX) in explaining the stability of Islamic Commercial Banks (BUS) remains limited, especially in the Indonesian context (Aisjah et al., 2022; Fianto & Ibrahim, 2025; Sumarto et al., 2025). To fill this research gap, the present study investigates whether different dimensions of global uncertainty exert distinct short-run and long-run effects on Islamic bank stability by adopting a multidimensional perspective of global uncertainty.

By adopting this perspective, the present study adds to the existing literature in several ways. First, it advances the theoretical understanding of Islamic bank stability by demonstrating that global uncertainty should not be viewed as a single homogeneous phenomenon because different dimensions of uncertainty may operate through different transmission mechanisms. Second, it enriches the empirical literature by providing evidence from Indonesia's dual banking system using the Z-score as an integrated measure of Islamic bank stability. Finally, by employing the Vector Error Correction Model (VECM), this study captures the dynamic relationships in both the short run and the long run between global uncertainty and Islamic bank stability. The findings also provide practical implications for Bank Indonesia, the Financial Services Authority (OJK), and Islamic bank managers in designing macroprudential policies, strengthening risk management practices, and enhancing the resilience of Islamic banks against future global uncertainty.

LITERATURE REVIEW

Islamic Bank Stability

Bank stability describes a bank's capacity to perform its intermediation role while maintaining resilience against internal and external shocks, thereby supporting financial system stability (Ferreira, 2023; López-Penabad et al., 2021). In Islamic banking, stability extends beyond

financial performance to include risk management consistent with Sharia principles. In contrast to conventional banks, Islamic banks adopt profit-and-loss sharing arrangements, emphasize risk-sharing, and prohibit interest (riba) and speculative activities. These institutional characteristics strengthen the linkage between financial transactions and the real economy and may enable Islamic banks to respond differently to periods of economic and financial uncertainty (Abasimel, 2023; Bilgin et al., 2021b). However, whether these features consistently enhance Islamic bank stability remains inconclusive, as previous studies report mixed findings.

Among the available indicators of bank stability, the Z-score is commonly recognized as one of the most comprehensive measures because it combines profitability, capital adequacy, and earnings volatility to approximate the likelihood of bank default (Risfandy et al., 2022; A. K. Sharma & Chauhan, 2023). The Z-score is calculated as:

$$Z = \frac{ROA + CAR}{\sigma(ROA)}$$

A higher Z-score indicates greater financial resilience and a lower probability of bank failure, whereas a lower score reflects greater financial vulnerability (Bektas et al., 2022; Mong, 2025). By integrating profitability, capital strength, and earnings volatility, the Z-score offers a more comprehensive measure of bank stability than individual financial ratios (Birindelli et al., 2022; Chand et al., 2021; Dang & Huynh, 2023). Accordingly, Islamic bank stability is measured using the Z-score in this study.

Global Uncertainty as a Multidimensional Concept

Global uncertainty has become an increasingly important determinant of banking stability as financial markets become more integrated. Rather than representing a single source of risk, global uncertainty comprises multiple dimensions originating from different economic and financial environments. Accordingly, this study conceptualises global uncertainty through three complementary dimensions: policy-related uncertainty, geopolitical uncertainty, and financial market uncertainty.

Policy-related uncertainty is measured by the U.S. Economic Policy Uncertainty (EPU) Index, which captures uncertainty arising from changes in fiscal, monetary, and regulatory policies (Qi et al., 2022; Seker, 2023; Subhani et al., 2021). These events disrupt economic activity and increase financial uncertainty, thereby placing additional pressure on banking stability (Biswas et al., 2025; Orden-Cruz et al., 2023; Ozili & Arun, 2022).

Geopolitical uncertainty is represented by the U.S. Geopolitical Risk (GPR) Index, reflecting uncertainty associated with military conflicts, terrorism, diplomatic tensions, and political instability (Han et al., 2026; Ugurlu-Yildirim & Ordu-Akkaya, 2022). Unlike policy-related uncertainty, geopolitical uncertainty primarily influences banking stability by disrupting international trade, reducing business confidence, increasing macroeconomic uncertainty, and amplifying the cross-border transmission of financial shocks (Ginn & Saadaoui, 2025; Kuzina & Steiner, 2025). These conditions may increase credit risk, weaken financing activities, and place additional pressure on banking stability (Adel & Naili, 2024; Pang et al., 2023).

The third dimension is market fear, represented by the CBOE Volatility Index (VIX), which reflects investors' expectations regarding future stock market volatility and is widely recognised as the "fear index" (Farag et al., 2025; A. Sharma & Sharma, 2024). Higher VIX levels indicate

deteriorating investor confidence and tighter financial conditions that may adversely affect banking stability (Adrangi et al., 2021; Bağcı & Bayir, 2025).

Taken together, these indicators capture distinct dimensions of global uncertainty. Examining them simultaneously provides a more comprehensive understanding of Islamic bank stability than relying on a single uncertainty measure and establishes the theoretical foundation for analysing their heterogeneous effects.

Transmission Mechanisms of Global Uncertainty to Islamic Bank Stability

Global uncertainty influences Islamic bank stability through several interconnected transmission mechanisms. Although policy-related uncertainty, geopolitical uncertainty, and financial market uncertainty arise from different sources, they ultimately affect banks by altering financing activities, risk-taking behaviour, liquidity conditions, and the broader macroeconomic environment.

Policy-related uncertainty primarily operates through the expectation and credit channels. Uncertainty regarding future fiscal, monetary, and regulatory policies discourages investment and financing decisions while increasing borrowers' repayment risk. Consequently, banks tend to tighten financing standards and adopt more prudent lending behaviour, reducing financial intermediation and potentially weakening banking stability (Aman et al., 2024; Biswas et al., 2025; Orden-Cruz et al., 2023; Tran et al., 2021).

Geopolitical uncertainty mainly affects banking stability through disruptions to economic activity. Military conflicts, terrorism, and political instability reduce business confidence, interrupt trade, and weaken economic growth, increasing financing risk and exposing banks to greater credit losses (Ginn & Saadaoui, 2025; Kuzina & Steiner, 2025; Phan et al., 2022; Wang et al., 2025).

Market fear, represented by the CBOE Volatility Index (VIX), operates through the market sentiment and liquidity channels. Heightened market volatility increases investor risk aversion, reduces liquidity, and raises uncertainty over asset values, encouraging banks to adopt more cautious financing policies and weakening banking stability (Adrangi et al., 2021; Bağcı & Bayir, 2025; Farag et al., 2025).

Together, these mechanisms suggest that the impact of global uncertainty on Islamic bank stability depends not only on the level of uncertainty but also on its source. Distinguishing policy, geopolitical, and financial market uncertainty therefore provides a more comprehensive understanding of how external shocks are transmitted to Islamic banks.

Why Islamic Banks May Respond Differently from Conventional Banks

Islamic banks are expected to respond differently to global uncertainty because they operate under Sharia principles that emphasize profit-and-loss sharing, risk-sharing, and asset-backed financing while prohibiting interest (riba) and speculative activities (gharar and maysir). These institutional characteristics strengthen the linkage between financial transactions and real economic activities, potentially reducing exposure to excessive leverage and speculative shocks. Consequently, Islamic banks are theoretically expected to be more resilient than conventional banks during periods of heightened uncertainty (Abasimel, 2023; Bilgin et al., 2021b).

Despite these theoretical advantages, empirical evidence remains inconclusive. Some studies report that Islamic banks are relatively more resilient because financing growth remains stable and default risk does not increase significantly during periods of uncertainty (Bilgin et al., 2021a,

2021b). In contrast, other studies find that heightened global uncertainty still weakens Islamic banking performance by reducing profitability, financing quality, and market valuation (Albaity et al., 2023; Yasin et al., 2025). These conflicting findings suggest that the resilience of Islamic banks depends on the nature of external shocks and the channels through which uncertainty is transmitted.

This inconsistency further indicates that different dimensions of global uncertainty may influence Islamic banks in different ways. While policy-related uncertainty mainly affects financing decisions through changes in economic expectations, geopolitical uncertainty disrupts economic activity, and financial market uncertainty operates through investor sentiment and liquidity conditions. Accordingly, analysing these dimensions simultaneously provides a more comprehensive explanation of Islamic bank stability and supports the theoretical rationale for the hypotheses developed in this study.

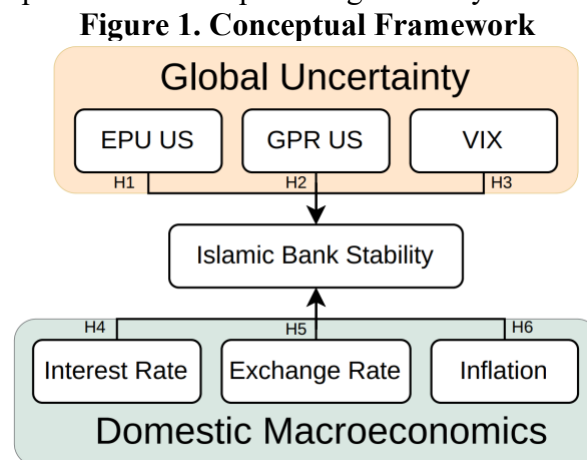
Domestic Macroeconomic Factors

Although this study focuses on global uncertainty, Islamic bank stability is also influenced by domestic macroeconomic conditions. Accordingly, interest rates, exchange rates, and inflation are included as control variables to isolate the effect of global uncertainty on Islamic bank stability.

Interest rates influence financing demand and borrowers' repayment capacity, exchange rates affect economic activity and financing risk through trade and capital flows, while inflation influences purchasing power and financing quality. Together, these macroeconomic factors shape the operating environment of Islamic banks and may either amplify or mitigate the impact of external shocks (Apau et al., 2023; Çiçek & Yıldırım, 2024; Merko & Habili, 2023).

Conceptual Framework and Hypothesis Development

Figure 1 illustrates the conceptual framework of this study. Building on the multidimensional perspective of global uncertainty, the framework proposes that policy-related uncertainty, geopolitical uncertainty, and financial market uncertainty influence Islamic bank stability through different transmission mechanisms. Domestic macroeconomic factors, represented by interest rates, exchange rates, and inflation, are included as control variables to account for the influence of the macroeconomic environment. The conceptual framework of this study is presented in Figure 1, which illustrates the proposed relationships among the study variables.



Source: Prepared by the author (2026)

Economic Policy Uncertainty and Islamic Bank Stability

Greater policy uncertainty discourages financing activities, increases repayment risk, and encourages more conservative financing decisions, potentially weakening Islamic bank stability (Albaity et al., 2023; Yasin et al., 2025). Therefore, the following hypothesis is proposed:

H1: U.S. Economic Policy Uncertainty (EPU) negatively affects the stability of Islamic banks in Indonesia.

Geopolitical Risk and Islamic Bank Stability

Geopolitical shocks disrupt economic activity, weaken business confidence, and increase financing risk, thereby reducing Islamic bank stability (Ginn & Saadaoui, 2025; Kuzina & Steiner, 2025). Accordingly, the following hypothesis is formulated:

H2: U.S. Geopolitical Risk (GPR) negatively affects the stability of Islamic banks in Indonesia.

Market Fear and Islamic Bank Stability

Higher market fear, represented by the CBOE Volatility Index (VIX), reflects tighter financial conditions and greater market uncertainty that may weaken Islamic bank stability (Adrangi et al., 2021; Bağcı & Bayir, 2025). Therefore, the following hypothesis is proposed:

H3: The CBOE Volatility Index (VIX) negatively affects the stability of Islamic banks in Indonesia.

Interest Rates and Islamic Bank Stability

Although Islamic banks operate under Sharia principles, higher benchmark interest rates may reduce financing demand and borrowers' repayment capacity, thereby weakening Islamic bank stability (Apau et al., 2023; Çiçek & Yıldırım, 2024). Therefore, the following hypothesis is proposed:

H4: Interest rates negatively affect the stability of Islamic banks in Indonesia.

Exchange Rates and Islamic Bank Stability

Exchange rate depreciation increases economic uncertainty and financing risk, potentially weakening Islamic bank stability (Apau et al., 2023; Merko & Habili, 2023). Accordingly, the following hypothesis is formulated:

H5: Exchange rates negatively affect the stability of Islamic banks in Indonesia.

Inflation and Islamic Bank Stability

Persistent inflation reduces borrowers' purchasing power and financing quality, thereby increasing financial vulnerability and weakening Islamic bank stability (Çiçek & Yıldırım, 2024; Merko & Habili, 2023). Therefore, higher inflation is expected to reduce the stability of Islamic banks. Accordingly, the final hypothesis is proposed:

H6: Inflation negatively affects the stability of Islamic banks in Indonesia

METHOD

This research adopts a quantitative approach with a time-series design to analyze the effect of global uncertainty on Islamic bank stability in Indonesia. The data used are monthly secondary data for the period 2016–2025. Data on US Economic Policy Uncertainty (EPU) and US Geopolitical Risk (GPR) are obtained from uncertainty.com, while data on global market volatility,

proxied by the CBOE Volatility Index (VIX), are obtained from CBOE. Interest rate, inflation, and exchange rate data are sourced from Bank Indonesia and Investing.com, respectively, whereas data on Return on Assets (ROA) and Capital Adequacy Ratio (CAR) of Islamic Commercial Banks are obtained from the Financial Services Authority (OJK).

The dependent variable in this study is islamic bank stability, measured using the Z-score, which reflects the probability of bank default through a combination of profitability (ROA) and capital adequacy (CAR). A higher Z-score indicates better stability. The independent variables include US EPU, US GPR, and VIX as proxies for global uncertainty. Meanwhile, the control variables consist of interest rates, exchange rates, and inflation, which represent domestic macroeconomic conditions.

To capture the short-run and long-run dynamic relationships among the variables, this study uses the Vector Error Correction Model (VECM) approach (Akbar et al., 2022). The analysis is carried out in several steps, including a stationarity test based on the Augmented Dickey-Fuller (ADF) procedure, selection of the optimal lag length, the Johansen cointegration test, and VECM estimation. Next, a model stability test is conducted to ensure that every characteristic root lies inside the unit circle (roots < 1). The analysis is then continued using the Impulse Response Function (IRF) to examine how banking stability responds to shocks in global uncertainty variables, followed by Variance Decomposition (VD) to evaluate the relative contribution of each variable to fluctuations in banking stability (Wijaya et al., 2024). The proposed research model is specified to analyze the effect of global uncertainty on banking stability as follows:

$$\Delta Z_t = \alpha_0 + \sum_{i=1}^p \alpha_1 \Delta Z_{t-i} + \sum_{i=1}^p \alpha_2 \Delta EPU_{t-i} + \sum_{i=1}^p \alpha_3 \Delta GPR_{t-i} + \sum_{i=1}^p \alpha_4 \Delta VIX_{t-i} + \sum_{i=1}^p \alpha_5 \Delta IR_{t-i} + \sum_{i=1}^p \alpha_6 \Delta EX_{t-i} + \sum_{i=1}^p \alpha_7 \Delta INF_{t-i} + \lambda ECT_{t-1} + \varepsilon_t$$

Δ : Change in variables from the previous period

Z_t : Islamic Bank stability (Z-score)

EPU_t, GPR_t, VIX_t : Global uncertainty variables

IR_t, EX_t, INF_t : Control variables

p : Optimal lag

α_0 : Constant

$\alpha_1 - \alpha_7$: Short-term coefficients

ECT_{t-1} : Error Correction Term (long-term relationship / cointegration)

λ : Adjustment coefficient toward long-term equilibrium

ε_t : Error term

In this model, variables in first differences (Δ) represent short-term effects, while the Error Correction Term (ECT) reflects whether a long-run equilibrium exists among the variables. The ECT coefficient indicates how quickly the system returns to equilibrium following short-run deviations (Syamputri et al., 2021; Wahyudi et al., 2025). Thus, the VECM model allows a more comprehensive analysis of how global uncertainty affects banking stability over both the short-run and long-run horizons simultaneously. With this approach, the present study is expected to offer a broader understanding of how global uncertainty influences the stability of Islamic Commercial Banks in Indonesia.

RESULTS AND DISCUSSION

RESULTS

The data used in this study are monthly time series from 2016 to 2025, reflecting the stability of Islamic Commercial Banks as well as global uncertainty indicators and macroeconomic variables. During this period, there are noticeable fluctuations due to global uncertainty, indicating possible short-term and long-term relationships between variables. These variations provide a basis to analyze how global uncertainty interacts with Islamic banking stability in Indonesia. The first step of the analysis is the stationarity test using the Augmented Dickey-Fuller (ADF) test, as presented in table 1.

Table 1. Stationarity Test (Augmented Dickey-Fuller)

Variabel	Level	First Difference
	P Value	P Value
Epu US	0.0095	0,0000
Geopolitical Risk US	0.0001	0,0000
Volatility Index	0.0003	0,0000
Interest Rate	0.1874	0,0000
Exchange Rate	0.5938	0,0000
Inflation	0.0702	0,0000
Syariah Bank Stability	0.5228	0,0000

Source: Processed data (2026)

Based on the stationarity test results, some variables are already stationary at the level, namely US Economic Policy Uncertainty (EPU), US Geopolitical Risk (GPR), and the Volatility Index (VIX), as indicated by probability values below 0.05. Meanwhile, interest rates, exchange rates, inflation, and Islamic bank stability are not stationary at the level, as their probability values are above 0.05. However, all variables become stationary after the first difference, as shown by probability values of 0.0000. These results indicate a mixed order of integration, $I(0)$ and $I(1)$, which meets the requirement for further analysis using the Vector Error Correction Model (VECM). The next step is to determine the optimal lag to ensure the model can properly capture the dynamics between variables, as shown in table 2.

Table 2. Optimal Lag Test Results

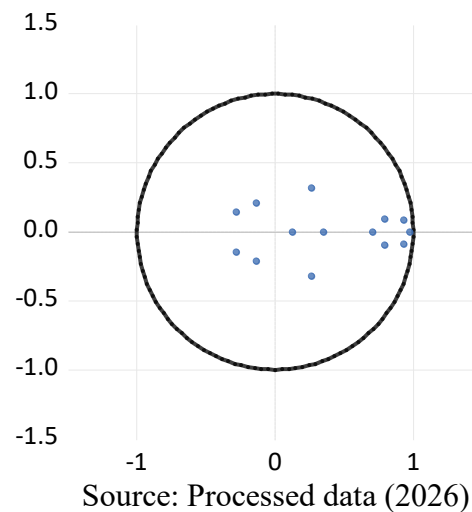
Lag	LogL	LR	FPE	AIC	SC	HQ
0	-2624.9	NA	6.08e+11	46.99892	47.16882	47.06785
1	-1917.9	1313.113	4801279.	35.24783	36.60708*	35.79932*
2	-1865.4	90.91992*	4554840.*	35.18551*	37.73410	36.21955
3	-1833.7	50.87473	6364870.	35.49523	39.23317	37.01183

Source: Processed data (2026)

Based on the optimal lag test results, the Akaike Information Criterion (AIC), Final Prediction Error (FPE), and Likelihood Ratio (LR) indicate the optimal lag at lag 2, as marked by an asterisk (*). Meanwhile, the Schwarz Criterion (SC) and Hannan-Quinn (HQ) suggest lag 1 as

the optimal lag. In this study, lag 2 is selected because AIC and FPE are more sensitive in capturing time series dynamics. Choosing the appropriate lag is important to ensure the model can represent the relationships between variables properly without problems such as autocorrelation or overfitting. Therefore, using lag 2 is expected to produce more accurate estimation results. The next step is to conduct a model stability test to ensure that the model is stable before further analysis.

Figure 2. Stability Test Results
Inverse Roots of AR Characteristic Polynomial



Based on the model stability test shown in figure 2, by the Inverse Roots of AR Characteristic Polynomial graph, all characteristic roots lie inside the unit circle. This indicates that the model satisfies the stability condition, so the estimation results can be considered valid and not explosive. Since the stability requirement is met, the VECM model is appropriate for further analysis. The next step is the Johansen cointegration test to examine the existence of long-term relationships between variables.

Table 3. Johansen Cointegration Test

Hypothesized		Trace	0.05	Prob.**
No. of CE(s)	Eigenvalue	Statistic	Critical Value	Critical Value
None *	0.328315	123.1638	111.78048	0.0077
At most 1	0.193268	76.60185	83.93712	0.1512
At most 2	0.147631	51.47454	60.06141	0.2147
At most 3	0.102729	32.78542	40.17493	0.2265

Source: Processed data (2026)

Based on the Johansen cointegration test results in table 3, under the None hypothesis, the trace statistic value (123.1638) is higher than the 5% critical value (111.78048), and the probability value (0.0077) is below 0.05. This indicates that there is at least one cointegration relationship among the variables in the model. Meanwhile, under the At most 1 hypothesis and beyond, the

trace statistic values are lower than the critical values and the probabilities are above 0.05, indicating that there is no additional cointegration.

These findings indicate that the variables in this study have a significant long-term relationship. Therefore, the Vector Error Correction Model (VECM) is appropriate for analyzing both short-term and long-term dynamics between variables. The next step is to estimate the VECM model to identify the short-term and long-term effects of global uncertainty on the stability of Islamic banking.

Table 5. Long-run and Short-run VECM Estimation Results

Variable	critical t-value	Long Run		Notes	Short Run		Notes
		Normalized Cointegrating Coefficient	t-statistics		Estimated Coefficient	t-statistics	
Epu US	1.9801	-0.1886	3.6081	Sig.	-0.0028	0.7881	Not sig.
GPR US	1.9801	-24.6234	6.2875	Sig.	-0.3569	1.3701	Not sig.
Volatility Index	1.9801	0.7521	1.6348	Not sig.	0.0087	0.2829	Not sig.
Interest Rate	1.9801	3.6222	1.2531	Not sig.	0.1680	0.2265	Not sig.
Exchange Rate	1.9801	2.29E-06	0.0016	Not sig.	0.0001	0.2533	Not sig.
Inflation	1.9801	8.1855	3.5906	Sig.	-0.1271	0.3397	Not sig.

Source: Processed data (2026)

Note: The reported long-run coefficients are normalized cointegrating coefficients estimated by EViews. Therefore, the economic interpretation of the long-run relationships is based on the corresponding long-run equilibrium equation rather than directly on the normalized cointegrating vector. Absolute t-statistics are reported and compared with the critical value at the 5% significance level.

Before interpreting the long-run VECM estimates, it is important to note that the coefficients reported by EViews are normalized cointegrating coefficients rather than conventional regression coefficients. Therefore, the direction of the long-run relationships cannot be interpreted directly from the reported coefficient signs. Instead, the long-run economic relationships are obtained by expressing the dependent variable, Islamic bank stability, on the left-hand side of the equilibrium equation (Johansen, 1995). The normalized cointegrating equation estimated by EViews is:

$$BANKSTABILITY_t - 0.1886EPU_t - 24.6234GPR_t + 0.7521VIX_t + 3.6222IR_t + 2.29 \times 10^{-6}EXR_t + 8.1855INF_t = 0$$

Rearranging the normalized cointegrating equation yields the following long-run equilibrium relationship:

$$BANKSTABILITY_t = 0.1886EPU_t + 24.6234GPR_t - 0.7521VIX_t - 3.6222IR_t - 2.29 \times 10^{-6}EXR_t - 8.1855INF_t$$

Accordingly, the long-run relationships discussed in this study are interpreted based on the long-run equilibrium equation rather than directly on the normalized cointegrating coefficients. Table 5 presents the long-run and short-run VECM estimation results. Based on the long-run equilibrium equation, U.S. Economic Policy Uncertainty (EPU) and U.S. Geopolitical Risk (GPR) have positive and statistically significant effects on Islamic bank stability, as indicated by absolute *t*-statistics of 3.6081 and 6.2875, respectively, both exceeding the critical value of 1.9801. In contrast, inflation has a negative and statistically significant effect on Islamic bank stability, with an absolute *t*-statistic of 3.5906. Meanwhile, the Volatility Index (VIX), interest rate, and exchange rate exhibit negative but statistically insignificant long-run effects because their absolute *t*-statistics are below the critical value.

The short-run estimation shows that none of the explanatory variables significantly affect Islamic bank stability, as all absolute *t*-statistics are below the critical threshold. These findings suggest that the influence of global uncertainty and macroeconomic variables on Islamic bank stability materializes gradually through long-run equilibrium adjustment rather than through immediate short-run responses. The next step is to conduct a causality test to examine the relationship between variables.

Table 6. Granger Causality Test Results

Null Hypothesis:	Obs	F-Statistic	Prob.
Epu_Us Does Not Granger Cause Syariah_Bank_Stability	118	0.54414	0.58185
Syariah Bank Stability Does Not Granger Cause Epu_Us		0.5895	0.5563
Gpr Us Does Not Granger Cause Syariah Bank Stability	118	0.73474	0.48191
Syariah Bank Stability Does Not Granger Cause Gpr Us		1.14073	0.32324
Vix Does Not Granger Cause Syariah Bank Stability	118	0.42651	0.65383
Syariah Bank Stability Does Not Granger Cause Vix		1.1343	0.32528
Interest_Rate Does Not Granger Cause Syariah Bank Stability	118	1.97968	0.14288
Syariah Bank Stability Does Not Granger Cause Interest_Rate		0.9866	0.37603
Exchange_Rate Does Not Granger Cause Syariah Bank Stability	118	0.38091	0.68411
Syariah Bank Stability Does Not Granger Cause Exchange_Rate		2.86243	0.06128
Inflation Does Not Granger Cause Syariah Bank Stability	118	0.34561	0.70854
Syariah Bank Stability Does Not Granger Cause Inflation		0.40832	0.66574

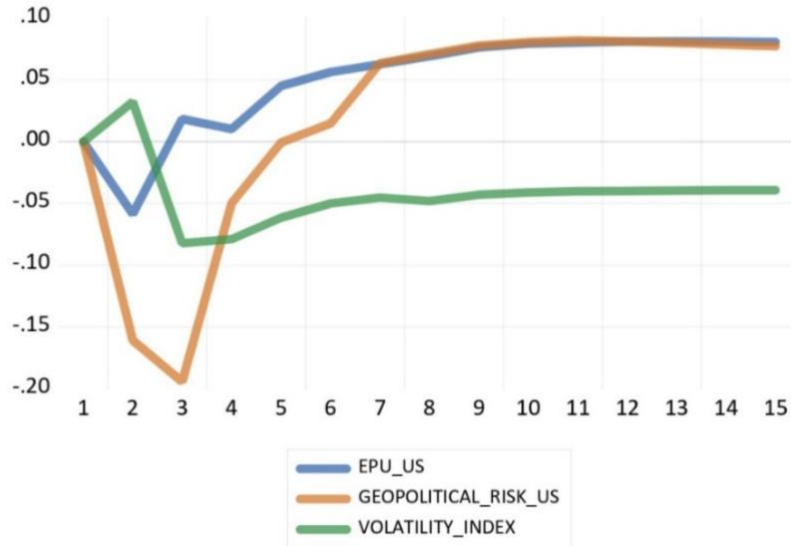
Source: Processed data (2026)

Table 6 presents the results of the Granger causality test between global uncertainty indicators, macroeconomic variables, and Islamic bank stability. The findings indicate that none of the null hypotheses can be rejected at the 5% significance level, as all probability values exceed 0.05. This implies that there is no evidence of either unidirectional or bidirectional Granger causality between U.S. Economic Policy Uncertainty (EPU), U.S. Geopolitical Risk (GPR), the Volatility Index (VIX), interest rate, exchange rate, inflation, and Islamic bank stability. These results suggest that changes in global uncertainty and macroeconomic variables do not directly predict future movements in Islamic bank stability, nor does Islamic bank stability significantly predict subsequent changes in these variables. The next step is to conduct the Impulse Response Function (IRF) analysis to examine how Islamic banking stability responds to shocks from each independent variable.

Figure 3 illustrates the impulse response of Islamic bank stability to a one-standard-deviation shock in U.S. Economic Policy Uncertainty (EPU). The blue line shows that Islamic bank stability initially responds negatively, reaching its lowest level in the second period. Thereafter, the response gradually turns positive, continues to increase until approximately the tenth period, and subsequently converges to a stable positive level. This pattern indicates that the initial adverse effect of an EPU shock gradually weakens over time, with Islamic bank stability eventually reaching a new long-run equilibrium.

Figure 3. Impulse Response Function (IRF) Results for US EPU, US GPR, and VIX

Response of STABILITAS_BANK_SYARIAH to Cholesky One S.D. (d.f. adjusted) Innovations

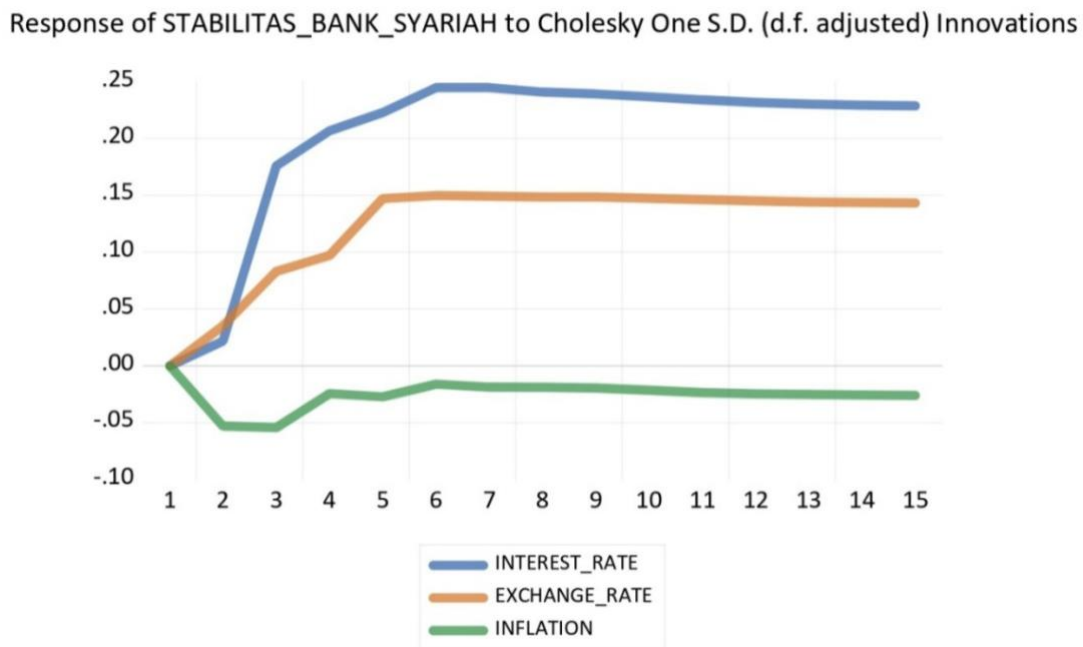


Source: Processed data (2026)

The orange line represents the impulse response of Islamic bank stability to a one-standard-deviation shock in U.S. Geopolitical Risk (GPR). Islamic bank stability initially responds negatively, reaching its lowest level in the third period. The response then recovers rapidly, turns positive around the fifth period, and continues to increase until approximately the eleventh period. Thereafter, it gradually stabilizes and converges to a positive long-run equilibrium. Overall, the impulse response indicates that the adverse effect of a GPR shock is temporary, with Islamic bank stability gradually adjusting and returning to a stable long-run path.

The green line represents the impulse response of Islamic bank stability to a one-standard-deviation shock in the Volatility Index (VIX). Islamic bank stability initially responds positively in the first period but declines sharply in the second and third periods, reaching its lowest level. Thereafter, the response gradually recovers, although it remains negative throughout the subsequent periods. After approximately the fifteenth period, the response stabilizes and converges to a negative long-run equilibrium. Overall, the impulse response indicates that a VIX shock generates a persistent negative response in Islamic bank stability, although the magnitude of the effect gradually diminishes over time.

Figure 4. Impulse Response Function (IRF) Results for Interest Rates, Exchange Rates, and Inflation



Source: Processed data (2026)

The impulse responses of Islamic bank stability to shocks in domestic macroeconomic variables, namely interest rates, exchange rates, and inflation, are presented in Figure 4. The blue line represents the impulse response of Islamic bank stability to a one-standard-deviation shock in the interest rate. Islamic bank stability initially responds positively, increasing sharply during the first few periods and reaching its peak around the sixth period. Thereafter, the response gradually declines but remains positive throughout the subsequent periods. After approximately the fifteenth period, the response stabilizes and converges to a positive long-run equilibrium. Overall, the impulse response indicates that an interest rate shock generates a persistent positive response in Islamic bank stability, although the magnitude of the response gradually moderates over time.

The orange line represents the impulse response of Islamic bank stability to a one-standard-deviation shock in the exchange rate. Islamic bank stability initially responds positively, increasing rapidly during the first few periods and reaching its peak around the sixth period. The response then gradually declines while remaining positive throughout the subsequent periods. After approximately the fifteenth period, the response stabilizes and converges to a positive long-run equilibrium. Overall, the impulse response indicates that an exchange rate shock generates a persistent positive response in Islamic bank stability, although the magnitude of the response gradually moderates over time.

The green line represents the impulse response of Islamic bank stability to a one-standard-deviation shock in inflation. Islamic bank stability initially responds negatively, reaching its lowest level around the third period. The response then gradually recovers but remains below zero throughout the subsequent periods. After approximately the fifteenth period, the response stabilizes and converges to a negative long-run equilibrium. Overall, the impulse response indicates that an

inflation shock generates a persistent negative response in Islamic bank stability, although the magnitude of the response gradually weakens over time.

DISCUSSION

The positive long-run relationship between U.S. Economic Policy Uncertainty (EPU) and Islamic bank stability indicates that Islamic Commercial Banks in Indonesia are relatively resilient to heightened global policy uncertainty. This resilience may stem from the distinctive characteristics of Islamic banking, including profit-and-loss sharing, asset-backed financing, and the prohibition of speculative activities, which promote prudent financing and strengthen the linkage between financial intermediation and the real sector (Albaity et al., 2023; Salisu & Shaik, 2022). As a result, Islamic banks appear better positioned to absorb external policy shocks while maintaining financial stability. This interpretation is further supported by the impulse response analysis, which indicates that Islamic bank stability initially responds negatively to EPU shocks before gradually recovering, crossing into positive territory, and converging toward the long-run equilibrium. This dynamic adjustment suggests that although policy uncertainty generates temporary disruptions, Islamic banks possess sufficient resilience to absorb external shocks and restore stability over time. This evidence supports Albaity et al. (2023), but differs from Desalegn et al. (2023) and Yasin et al. (2025), who reported that policy uncertainty weakens bank stability. Such differences may reflect variations in institutional settings, banking systems, uncertainty measures, and sample periods.

Beyond policy uncertainty, U.S. Geopolitical Risk (GPR) also exhibits a positive and significant long-run relationship with Islamic bank stability. This result suggests that Islamic banks remain resilient during periods of heightened geopolitical tensions, partly because their limited exposure to speculative financial activities and stronger reliance on asset-backed financing reduce vulnerability to external shocks. Moreover, increased geopolitical uncertainty may encourage investors and depositors to prefer Islamic banking institutions that are perceived as more prudent and stable. This interpretation is further supported by the impulse response analysis, which indicates that Islamic bank stability initially responds negatively to geopolitical shocks before gradually stabilizing, crossing into positive territory, and converging toward the long-run equilibrium. This dynamic adjustment suggests that although geopolitical disturbances create temporary pressures on Islamic bank stability, their adverse effects gradually dissipate as the banking system adapts to external shocks. Similar evidence was reported by Albaity et al. (2023) and Fianto et al. (2026). However, Lucchetta (2024) and Vuong et al. (2024) documented a negative relationship, indicating that institutional characteristics and the resilience of Indonesia's Islamic banking sector may shape how geopolitical shocks are transmitted to bank stability.

Unlike policy uncertainty and geopolitical risk, global financial market volatility does not appear to exert a significant long-run influence on Islamic bank stability. Although heightened market volatility generally increases investor risk aversion and financial uncertainty, Indonesian Islamic banks appear relatively insulated because their financing activities are primarily asset-backed and closely linked to the real sector rather than speculative financial markets. Consistent with the long-run VECM estimates, the impulse response analysis reveals only modest and short-lived fluctuations following VIX shocks, with the responses stabilizing relatively quickly around the long-run equilibrium. This pattern suggests that global financial market volatility is not a dominant source of instability for Islamic banks in Indonesia. These findings are broadly consistent

with Billah et al. (2026) and Raza et al., (2023), who highlighted the resilience of Islamic financial institutions during periods of heightened market volatility. In contrast, Al-Romaihi & Kumar (2026) found that market volatility increased banking risk in the GCC region, suggesting that differences in financial market integration and banking structures may explain the insignificant effect observed in Indonesia.

Turning to domestic macroeconomic conditions, interest rates exhibit a negative but statistically insignificant long-run relationship with Islamic bank stability. This finding implies that monetary policy tightening was not a major determinant of Islamic Commercial Bank stability during the observation period. Although benchmark interest rates may indirectly influence financing decisions and deposit mobilisation, Islamic banks are less exposed to direct interest rate risk because their financing contracts are based on Sharia principles rather than interest-bearing instruments (Djelassi & Boukhatem, 2024; Masrizal et al., 2026). The impulse response analysis further confirms this result, showing only a limited and short-lived response of Islamic bank stability to interest rate shocks before gradually returning to equilibrium. This evidence suggests that the transmission of monetary policy to Islamic banks mainly occurs through indirect macroeconomic channels rather than direct interest rate mechanisms. These findings differ from Kazak et al. (2025), highlighting that the influence of interest rates depends on differences in banking structures and monetary policy transmission across countries.

A similar pattern is observed for exchange rates, which also display a negative but insignificant long-run effect on Islamic bank stability. Although exchange rate depreciation may affect trade financing, capital flows, and borrowers' repayment capacity, the relatively limited foreign currency exposure of Indonesian Islamic banks appears to reduce the transmission of exchange rate shocks to overall bank stability (Iqbal et al., 2024; Rahman, 2025). Consistent with the VECM estimates, the impulse response analysis indicates only modest fluctuations following exchange rate shocks, with the responses gradually converging toward long-run equilibrium. This finding suggests that exchange rate movements are not a dominant source of financial instability for Islamic banks in Indonesia. However, Roslen et al. (2025) and Athari et al. (2023) reported stronger adverse effects of exchange rate instability, implying that differences in exchange rate regimes, financial market integration, and foreign currency exposure may explain the contrasting results.

Among the domestic macroeconomic variables, inflation emerges as the only factor exerting a significant negative long-run effect on Islamic bank stability. Persistent inflation reduces borrowers' purchasing power, increases financing risk, and deteriorates financing quality, ultimately weakening banks' financial resilience. This interpretation is reinforced by the impulse response analysis, which reveals a stronger negative response following inflation shocks before gradually converging toward equilibrium, indicating that inflation creates a more persistent adjustment process than the other domestic macroeconomic variables. These findings corroborate Awdeh et al. (2024) and Khan & Khan (2024), who argued that inflation increases financial vulnerability by weakening borrowers' repayment capacity and overall economic conditions. Nevertheless, the results differ from Kazak et al. (2025), who suggested that moderate inflation may improve bank profitability by widening financing margins. Such discrepancies are likely attributable to differences in inflationary environments, banking structures, and macroeconomic conditions across countries.

The Granger causality analysis reveals no causal relationship between global uncertainty indicators, domestic macroeconomic variables, and Islamic bank stability during the observation period. This finding suggests that changes in U.S. Economic Policy Uncertainty, U.S. Geopolitical Risk, the Volatility Index, interest rates, exchange rates, and inflation do not systematically predict subsequent changes in Islamic bank stability in the short run. Instead, Islamic bank stability appears to adjust gradually through the long-run equilibrium mechanism identified by the VECM estimation and reinforced by the impulse response analysis. This evidence indicates that the resilience of Islamic Commercial Banks is driven more by long-term structural adjustment than by short-term dynamic interactions, consistent with the characteristics of Islamic banking, which emphasize prudent financing, asset-backed transactions, and risk-sharing principles (Mawardi et al., 2025; Tarazi & Abedifar, 2022).

Overall, the findings indicate that global uncertainty influences Islamic bank stability through heterogeneous transmission mechanisms rather than a single uniform channel. While U.S. Economic Policy Uncertainty and U.S. Geopolitical Risk strengthen the long-run resilience of Islamic Commercial Banks, financial market volatility represented by the Volatility Index does not exert a significant influence. Likewise, among the domestic macroeconomic variables, inflation emerges as the primary source of vulnerability, whereas interest rates and exchange rates play only a limited role. These findings support the view that different forms of uncertainty affect Islamic banking through distinct economic channels (Albaity et al., 2023; Fianto & Ibrahim, 2025). Accordingly, this study extends the existing literature by adopting a multidimensional uncertainty framework, demonstrating that Islamic bank stability cannot be adequately explained using a single measure of global uncertainty.

From a policy perspective, the findings provide several important implications for regulators and Islamic banking practitioners. For Bank Indonesia and the Financial Services Authority (OJK), maintaining macroeconomic stability, particularly low and stable inflation, should remain a policy priority because inflation represents the most significant domestic source of vulnerability for Islamic Commercial Banks. At the institutional level, Islamic banks should continue strengthening Sharia-compliant risk management, prudent financing policies, and capital resilience to preserve stability during periods of heightened policy and geopolitical uncertainty. In addition, maintaining the fundamental characteristics of Islamic banking, particularly asset-backed financing and profit-and-loss sharing principles, remains essential for enhancing long-term resilience against future external shocks.

This study has several limitations. First, the analysis focuses exclusively on Islamic Commercial Banks in Indonesia, which may limit the generalizability of the findings to countries with different institutional and regulatory environments. Second, global uncertainty is represented only by U.S. Economic Policy Uncertainty, U.S. Geopolitical Risk, and the Volatility Index, whereas other dimensions of uncertainty, such as climate-related risks, global financial stress, or pandemic-induced uncertainty, are not considered. Finally, although the VECM approach effectively captures long-run equilibrium relationships, future research may employ nonlinear or time-varying econometric models to investigate whether the effects of global uncertainty vary across different economic regimes or financial crisis periods.

CONCLUSION

This study demonstrates that different dimensions of global uncertainty exert heterogeneous long-run effects on the stability of Islamic Commercial Banks in Indonesia. U.S. Economic Policy Uncertainty and U.S. Geopolitical Risk strengthen long-run bank stability, whereas the Volatility Index, interest rates, and exchange rates have no significant long-run effects. In contrast, inflation emerges as the primary domestic source of instability. These findings contribute to the Islamic banking literature by adopting a multidimensional uncertainty framework, demonstrating that global uncertainty should not be treated as a homogeneous construct because each dimension influences Islamic bank stability through different transmission mechanisms. The findings imply that regulators should prioritize macroeconomic stability, particularly inflation control, while Islamic banks should strengthen Sharia-compliant risk management and prudent financing practices to enhance resilience against external shocks. This study is limited to aggregate Islamic Commercial Bank data and selected global uncertainty indicators. Future research may incorporate bank-level data, additional uncertainty measures, and nonlinear econometric approaches to provide a more comprehensive understanding of Islamic bank stability.

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