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Monetary Dynamics: Comparative Analysis of the Dual Policies of Malaysia and Indonesia

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KEYWORD

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ABSTRACT

Economic stability is a key indicator of macroeconomic health, directly influenced by the effectiveness of monetary policies implemented by national authorities. This study investigates the monetary dynamics and the impact of dual monetary policies on economic stability in Malaysia and Indonesia. Dual monetary policy involves the simultaneous application of both conventional and sharia-based instruments to achieve macroeconomic objectives such as price stability, economic growth, and inflation control. The study employs Partial Least Squares Structural Equation Modeling (SEM-PLS) with Multi-Group Analysis (MGA) to compare the effectiveness of these policies between the two countries using quarterly data from 2016 to 2024. The results indicate that dual monetary policies significantly influence economic stability in both countries, albeit with different leading instruments. In Indonesia, the Minimum Reserve Requirement (GWM) is the most influential component, while in Malaysia, the Discount Rate holds the most weight. However, no statistically significant differences were found between the two contexts. These findings highlight the strategic importance of integrating conventional and sharia-based instruments to enhance economic resilience in dual financial systems.

1. INTRODUCTION

Monetary policy plays a pivotal role in maintaining macroeconomic stability (Ahiadorme, 2022; B. Danylyshyn & Bohdan, 2022), particularly in developing economies facing structural vulnerabilities (Ahmed et al., 2024; Ajello et al., 2022; Boyarchenko et al., 2022). The effectiveness of such policies is closely linked to a country's ability to control inflation, stabilize exchange rates, and stimulate sustainable growth (Chugunov et al., 2021; Dinh et al., 2025; Kumar, 2023). In the aftermath of global economic disruptions including the COVID-19 pandemic, commodity price

shocks, and financial market volatility many nations have sought more adaptive and inclusive monetary strategies (Dizioli & Wang, 2024). In this context, countries with dual financial systems are increasingly relying on both conventional and Islamic instruments to manage economic complexity.

Indonesia and Malaysia represent two of the most prominent Muslim-majority countries that have institutionalized dual monetary systems (Karuni & Sunaryati, 2025; Muhit et al., 2024), integrating sharia-compliant mechanisms alongside conventional tools. This dual approach not only reflects the religious and ethical preferences of their populations but also introduces diverse channels for monetary transmission. Conventional policy tools such as interest rates, reserve ratios, and open market operations are employed in parallel with Islamic instruments like sukuk, wadiah certificates, and profit-sharing models. Despite their shared objective of economic stability, the coexistence of these instruments introduces unique policy dynamics that are not yet fully understood, particularly in terms of their combined effectiveness (Mojahedi Moakhar et al., 2023; Pribadi et al., 2025).

In monetary economics, the traditional view holds that conventional instruments primarily interest rates and open market operations are sufficient for macroeconomic control. However, this assumption becomes increasingly tenuous in pluralistic financial systems where ethical, religious, and structural preferences lead to the coexistence of Islamic and conventional finance (Ustaoglu & Yildiz, 2023). The dualism of these systems calls for a more nuanced policy framework that can operate across both paradigms. This is not merely a matter of financial inclusion, but a structural reality in countries like Indonesia and Malaysia, where Islamic financial services are not peripheral, but integral to the economy (Abdullah, 2017; Kassim, 2016; Naja et al., 2023).

The rise of Islamic finance is no longer a niche trend, but a significant component of the financial landscape(Alhammadi, 2024; Ustaoglu & Yildiz, 2023). According to the Islamic Financial Services Board (IFSB), global Islamic banking assets exceeded USD 2.2 trillion by 2023, with Southeast Asia particularly Malaysia and Indonesia being among the fastest-growing regions (*Islamic Financial Services Board*, n.d.). Despite this, central banking frameworks have not evolved at the same pace, and empirical research exploring how Islamic and conventional tools interact within a single monetary policy framework remains limited. This gap raises fundamental

questions about the real-world functionality and coherence of dual monetary systems, especially during periods of economic stress.

From a policy perspective, this issue is more than academic. As central banks navigate rising interest rate cycles, capital flow volatility, and inflationary threats, the choice and calibration of instruments both conventional and sharia-based carry significant implications. Without robust empirical evidence, policymakers risk over-relying on one framework at the expense of the other, potentially undermining macroeconomic outcomes. The COVID-19 crisis (Al Waroi, 2024; Nasution et al., 2022; Veza et al., 2021), followed by supply chain shocks and geopolitical uncertainty (Asadollah et al., 2024; Krykavskyy et al., 2023; Yahya & Pamuncak, 2023), has shown that economic resilience depends on the flexibility and inclusiveness of a country's monetary instruments (Akhyar & Rahmi, 2024; D. Danylyshyn et al., 2021).

Therefore, a comparative analysis of how dual monetary policies operate in two structurally similar yet institutionally distinct economies provides critical insight. Understanding which instruments are more influential, whether they operate symmetrically, and how they affect economic stability in tandem is essential for designing modern monetary frameworks. This research not only addresses a clear gap in the literature but responds to a practical need faced by central banks in adapting to dual-system realities. The relevance of studying these dynamics becomes more critical as central banks in both countries face increasing pressure to balance financial stability with social and ethical expectations. Moreover, the growing role of Islamic finance in global markets highlights the need to examine whether Islamic monetary tools can complement or even enhance traditional policy instruments in stabilizing economic fluctuations.

While previous research has explored the individual effects of either Islamic (Hafidh, 2021; Muhit et al., 2024; Naja et al., 2023; Suriani et al., 2021) or conventional monetary policy (Chugunov et al., 2021; Rathnayaka et al., 2024; Ruslan et al., 2023), there remains a lack of comparative, data-driven analysis on how dual monetary instruments perform across different national contexts. Most studies have been limited by narrow timeframes, isolated national scopes, or methodologies that do not allow for simultaneous cross-country analysis. This study addresses that gap by applying Partial Least Squares Structural Equation Modeling (PLS-SEM) with Multi-Group Analysis (MGA), enabling a robust comparison between Indonesia and Malaysia from 2016 to 2024.

The novelty of this study lies in its integration of dual monetary instruments conventional and Islamic within a single analytical framework, applied comparatively across two distinct but structurally similar economies. This approach provides empirical insights into the real-world performance of dual policies, offering a more nuanced understanding of their contribution to economic stability.

The primary objective of this research is to assess the impact of dual monetary policies on macroeconomic stability in Indonesia and Malaysia, and to determine whether significant differences exist in the effectiveness of these policies between the two countries. The findings aim to support policymakers in designing more cohesive, inclusive, and context-sensitive monetary frameworks suitable for dual financial systems.

2. LITERATURE REVIEW

The role of monetary policy in promoting economic stability has long been discussed in macroeconomic literature, particularly through the lenses of monetarist and Keynesian thought. More recently, literature has expanded to include the Islamic monetary perspective, which prohibits riba (interest) and promotes asset-based financial instruments to ensure equity and risk-sharing (Chapra, 2000). These theoretical foundations provide the rationale for the use of both conventional and Islamic instruments in managing macroeconomic conditions.

Empirical studies have examined the effectiveness of these instruments in single-country settings. Winarto and Beik (Winarto & Beik, 2024) analyzed Indonesia's dual monetary system and found that sharia-based tools such as sukuk and SBIS play a complementary role to conventional operations, especially in stabilizing liquidity during volatile periods. Similarly, Bacha (Ismath Bacha, 2008) highlighted Malaysia's success in integrating Islamic monetary operations through structured interbank platforms and proactive issuance of government-backed sukuk, contributing to a more resilient monetary transmission system. Grounded in prior theory and empirical findings, the following hypotheses are proposed:

H1 : Dual monetary policy has a significant positive effect on economic stability in Indonesia.

H2 : Dual monetary policy has a significant positive effect on economic stability in Malaysia.

H3 : There is a significant difference in the impact of dual monetary policy on economic stability between Indonesia and Malaysia.

3. METHODOLOGY

This study employs a quantitative approach using Partial Least Squares Structural Equation Modeling (PLS-SEM) combined with Multi-Group Analysis (MGA) to examine the impact of dual monetary policies on economic stability in Indonesia and Malaysia. The research uses secondary data derived from official sources, including Bank Indonesia, Bank Negara Malaysia, and national statistical agencies, covering quarterly observations from Q1 2016 to Q1 2024. Dual monetary policy is modeled as a latent variable composed of four indicators: interest rates, reserve requirements, conventional open market operations, and sharia-based operations. Economic stability, the dependent latent variable, is primarily measured through inflation rate, following the exclusion of GDP growth due to low factor loading in the measurement model. Inflation is employed as the primary indicator of economic stability because it represents the most direct and operational target of monetary policy in both Indonesia and Malaysia. In both conventional and Islamic monetary frameworks, price stability is a prerequisite for sustainable growth and financial resilience. Previous studies have consistently used inflation as a core proxy for macroeconomic stability, particularly in monetary policy evaluation. The SEM-PLS method is chosen for its capacity to estimate complex relationships among latent constructs and accommodate the non-normal distribution of macroeconomic data. The multi-group analysis allows for the simultaneous comparison of structural paths between Indonesia and Malaysia, identifying both commonalities and distinctions in policy effectiveness across the two monetary systems.

4. RESULTS AND DISCUSSIONS

Result

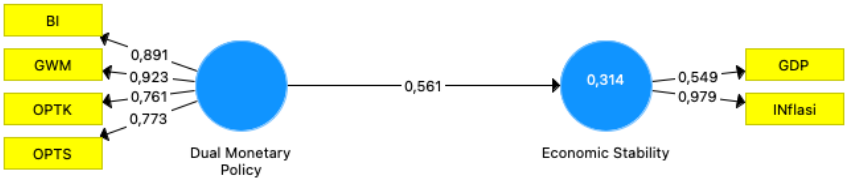

figure 1. Loading Factor Output

Prior to hypothesis testing, an outer model evaluation was conducted to assess the validity and reliability of the measurement constructs in figure 1. Convergent validity was confirmed as all indicators, except GDP growth, showed factor loadings above the 0.7 threshold.

As a result, GDP was excluded from the economic stability construct, and only inflation rate was retained. Discriminant validity was also established through cross-loading analysis, where each indicator loaded more highly on its associated construct than on others in Table 1.

Table 1. Cross Loading

	Dual Monetary Policy	Economic Stability
BI	0,884	0,572
GWM	0,916	0,630
Inflasi	0,583	1,000
OPTK	0,775	0,300
OPTS	0,786	0,307

Source: Output SmartPLS, 2024

Table 1. shows the results of the crossloading test used to evaluate the discriminant validity between constructs. The test results showed that all indicators had a higher loading value on the construct they measured compared to other constructs.

The BI, GWM, OPTK, and OPTS indicators have a higher loading value in the Dual Monetary Policy construct than in the Economic Stability construct, which indicates that these indicators consistently represent a dual monetary policy. Meanwhile, the inflation indicator has the highest loading value in the Economic Stability construct, which indicates that this variable is a strong representation of economic stability.

Thus, the results of this crossloading show that each indicator has good discriminative capabilities and is able to measure its construct precisely. This confirms that the measurement model has met the criteria of discriminant validity.

Reliability test in Table 2. showed strong internal consistency, with composite reliability and Cronbach's alpha values exceeding 0.87 for all latent variables.

Table 2. Output Reliability Test

	Cronbach's Alpha	rho_A	Composite Reliability	AVE
Dual Monetary Policy	0,875	0,949	0,907	0,710
Economic Stability	1,000	1,000	1,000	1,000

Source: Output SmartPLS, 2024

Table 2 presents the results of the reliability and validity testing of the construct using Cronbach's Alpha, rho_A, Composite Reliability, and Average Variance Extracted (AVE) values. The test results showed that the Dual Monetary Policy construct had a Cronbach's Alpha value of

0.875 and a Composite Reliability of 0.907, which is above the minimum limit of 0.70. The AVE value of 0.710 also exceeds the threshold of 0.50, which indicates that this construct has a good level of internal consistency as well as adequate convergent validity.

Meanwhile, the Economic Stability construct shows very high reliability and validity values, with all test indicators reaching maximum values. This shows that the indicators used are able to represent the construct of economic stability very strongly and consistently. Overall, these results confirm that all constructs in the research model have an excellent level of reliability and validity, making them feasible for use in structural relationship testing.

Table 3. Path Coefficient

	Original Sample (O)	Sample Mean (M)	Standard Deviation (STDEV)	T Stat	P Values	Ket
Dual Monetary Policy -> Economic Stability	0,583	0,591	0,087	6,714	0,000	positive & significant

Source: Output SmartPLS, 2024

Table 3. shows the results of testing the structural relationship between the Dual Monetary Policy variable and Economic Stability. The results of the analysis show that dual monetary policy has a positive and significant influence on economic stability. This is shown by the path coefficient value of 0.583 with a T-statistic value of 6.714 and a P-value of 0.000, which is below the significance level of 0.05.

The value of the positive coefficient indicates that the increase in the effectiveness of the dual monetary policy, which includes conventional and sharia monetary instruments, contributes to the improvement of economic stability. Thus, the research hypothesis that dual monetary policy has a positive effect on economic stability is acceptable. These findings indicate that the integration of conventional and sharia monetary instruments in the monetary policy system is able to strengthen macroeconomic resilience and maintain economic stability more optimally.

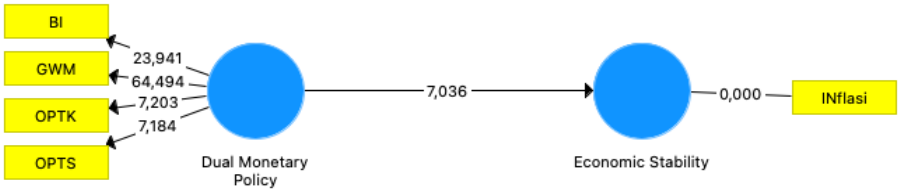

Figure 2. Path Coefficient of Indonesia & Malaysia

The inner model analysis using PLS-SEM table III and Figures 2 shows that dual monetary policy has a statistically significant and positive impact on economic stability in both Indonesia and Malaysia.

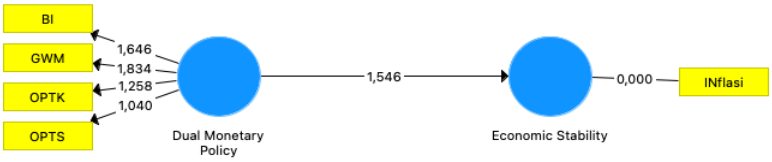

Figure 3. Path Coefficient of Indonesia

The full-sample path coefficient is 0.583 with a t-statistic of 6.714 ($p < 0.001$), indicating a robust structural relationship. When analyzed separately, Indonesia exhibited a path coefficient of 1.546 (Figure 3), while Malaysia showed 1.005 (figure 4). Among the indicators, Indonesia's strongest component was the minimum reserve requirement (GWM, loading 1.834), followed by the BI Rate (1.646), conventional open market operations (1.258), and sharia-based operations (1.040). In Malaysia, the discount rate led with a loading of 1.940, followed by GWM (1.513), OPTK (0.741), and OPTS (0.065).

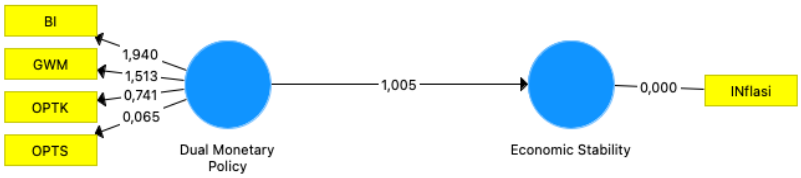

Figure 4. Path Coefficient of Malaysia

Multi-Group Analysis (MGA) results indicate that the structural impact of dual monetary policy on economic stability does not differ significantly between Indonesia and Malaysia. All p-values for group comparison exceed the 0.05 threshold—BI Rate ($p = 0.674$), GWM ($p = 0.458$), OPTK ($p = 0.627$), and OPTS ($p = 0.798$)—demonstrating statistical invariance across the two groups.

Table 4. Output PLS MGA of Indonesia and Malaysia

	Outer Loadings-diff (Indonesia - Malaysia)	p-Value (Indonesia - Malaysia)	p-Value new (Indonesia vs Malaysia)
BI <- Dual Monetary Policy	-0,126	0,674	0,651
GWM <- Dual Monetary Policy	0,139	0,458	0,917
INflasi <- Economic Stability	0,000	0,907	0,185
OPTK <- Dual Monetary Policy	-0,260	0,627	0,746
OPTS <- Dual Monetary Policy	-0,525	0,798	0,405

Source: Output SmartPLS, 2024

Discussion

Dual Monetary Policy and Economic Stability in Indonesia

The findings reveal that dual monetary policy has a significant and positive impact on economic stability in Indonesia, with inflation serving as the key indicator of price stability. The dominance of the minimum reserve requirement (GWM) suggests that Bank Indonesia relies heavily on liquidity-based instruments to manage inflationary pressures within a dual financial system. This approach reflects a cautious monetary stance that prioritizes systemic liquidity control over aggressive interest rate adjustments, which may be less compatible with the operational characteristics of Islamic financial institutions.

Although the BI Rate remains statistically significant, its relative influence is secondary compared to GWM, indicating that interest-based signaling plays a complementary rather than dominant role. The relatively smaller contribution of Islamic open market operations (OPTS) suggests that Islamic monetary instruments in Indonesia function primarily as supportive tools rather than core stabilization mechanisms, reflecting limitations in market depth and transmission capacity. This underscores the effectiveness of dual monetary policy depends less on the formal inclusion of Islamic instruments and more on the alignment between policy instruments, market readiness, and institutional structure within the dual financial system. This pattern aligns with findings from previous research (Hanipah et al., 2023; Hudaya & Firmansyah, 2023), who found that monetary policy instruments have a significant effect on economic growth and stability in Indonesia. These findings strengthen the argument that economic stability resulting from the effectiveness of dual monetary policy not only impacts macro indicators, but also has direct implications for the real sector, as the results of previous research (Yanthiani, 2023) which found that economic instability contributes to the increase in unemployment in Indonesia.

Dual Monetary Policy and Economic Stability in Malaysia

In Malaysia, dual monetary policy also significantly contributes to economic stability, with the discount rate (OPR) emerging as the most dominant instrument. This finding reflects the central role of interest-rate signaling in Malaysia's monetary framework, supported by a well-developed interbank market and a highly integrated financial system. Unlike Indonesia, Malaysia's Islamic financial institutions are more closely integrated into the broader monetary

transmission mechanism, enabling interest-rate adjustments to influence both conventional and Islamic segments of the financial system more effectively.

Despite Malaysia's global reputation in Islamic finance, the relatively weak contribution of Islamic open market operations (OPTS) indicates that Islamic monetary instruments remain largely complementary rather than central to macroeconomic stabilization. This suggests that institutional maturity in Islamic finance does not automatically translate into dominance within monetary policy operations. These findings are partially aligned with Hassan (Hassan et al., 2021) that interest-free (Islamic) monetary management has developed significantly but has yet to surpass conventional tools in delivering price stability and economic outcomes in Muslim-majority countries. Also, aligned with Savon and Yousfi (Savon & Yousfi, 2023), who observe that although Islamic banks formally participate in monetary transmission, interest-rate mechanisms remain the main conduit for influencing macroeconomic trends. Therefore, the result indicating that dual monetary policy positively impacts Malaysia's economic stability, though with conventional dominance.

Differences in the Impact of Dual Monetary Policy on Economic Stability Between Indonesia and Malaysia

The comparative analysis reveals that although Indonesia and Malaysia employ different dominant monetary instruments, liquidity-based controls in Indonesia and interest-rate signaling in Malaysia, the overall effectiveness of dual monetary policy in maintaining economic stability is statistically similar. Indicating that both countries have developed effective frameworks tailored to their respective economic contexts. This finding suggests that the effectiveness of dual monetary systems is driven more by institutional coherence and policy calibration than by the specific dominance of either Islamic or conventional instruments.

These findings are in line with Hanipah and Hudaya (Hanipah et al., 2023), who emphasized that in Indonesia, Islamic monetary instruments are still developing in terms of volume and operational depth, which affects their overall contribution to macroeconomic control. In contrast, Hassan et al. (Hassan et al., 2021)examined the performance of Islamic and conventional monetary frameworks in Muslim-majority countries and concluded that while Islamic systems have evolved, they still coexist with and often rely on conventional mechanisms for broader

effectiveness. Malaysia's system exemplifies this coexistence, where institutional integration of Islamic finance is mature, yet the functional dominance remains with conventional tools.

Thus, the hypothesis that there is a significant difference between Indonesia and Malaysia in the effectiveness of dual monetary policy is not supported. Rather, both countries illustrate that effective policy design lies in the strategic calibration of instruments, regardless of whether Islamic or conventional tools are predominant. The key lies in the adaptability of the framework to local institutional realities, financial infrastructure, and market responsiveness.

5. CONCLUSION

The findings reveal that both Indonesia and Malaysia benefit significantly from their dual monetary systems in achieving economic stability, particularly through inflation control. In Indonesia, the statutory reserve requirement (GWM) emerges as the most dominant instrument, reflecting the central bank's preference for liquidity-based control. Meanwhile, in Malaysia, the Overnight Policy Rate (OPR) plays a more central role, supported by a mature financial infrastructure that facilitates interest-based transmission. Across both contexts, Islamic monetary instruments such as sukuk-based open market operations contribute positively but remain limited in scope and influence.

A key insight from this study is that there is no significant structural difference between Indonesia and Malaysia in terms of the overall effectiveness of their dual monetary policies. This indicates that diverse institutional approaches, whether rooted in interest-based signaling or reserve-based liquidity management can yield similar macroeconomic outcomes when instruments are aligned with national policy frameworks and economic realities.

The study contributes to the growing body of literature on Islamic monetary policy by providing empirical evidence from two major Muslim-majority economies. It emphasizes that the success of dual monetary systems lies not in their formality or structure alone, but in their strategic application and regulatory coherence. For Bank Indonesia, liquidity-based instruments such as reserve requirements remain effective in maintaining price stability, while strengthening Islamic open market operations would enhance the operational role of sharia-based instruments. For Bank Negara Malaysia, interest-rate signaling continues to serve as the primary monetary anchor, although improving the responsiveness of Islamic liquidity instruments would allow them to contribute more effectively to macroeconomic stabilization. Overall, dual monetary

frameworks are most effective when Islamic and conventional instruments are institutionally integrated and supported by adequate market depth.

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