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The Role of Islamic Banks' Profitability on Indonesia's Economic Growth: A CAMELS and Endogenous Growth Model Analysis

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ABSTRACT

This study examines the role of Islamic banking profitability in Indonesia's economic growth using the CAMELS framework and an endogenous growth perspective. The analysis focuses on profitability as the main mechanism linking Islamic banking performance to real sector development during the COVID-19 pandemic and the subsequent economic recovery period. The study uses annual data from 2020 to 2023 obtained from the Financial Services Authority, Bank Indonesia, Statistics Indonesia, and the World Bank. The analytical methods include descriptive statistics, correlation and stationarity tests, and regression estimation using Ordinary Least Squares (OLS) and the System Generalized Method of Moments (GMM) to address potential endogeneity. The empirical results show that Islamic banking profitability, particularly Return on Equity (ROE), has a positive and statistically significant effect on Indonesia's economic growth. Return on Assets (ROA) also exhibits a positive relationship with growth, although with weaker statistical significance. Other CAMELS indicators, including capital adequacy, asset quality, efficiency, and liquidity, do not have a significant direct impact on economic growth but serve as stabilizing factors for the banking system. Inflation has a negative and significant effect on economic growth, while investment shows a positive but statistically insignificant relationship. Overall, the findings confirm that profitability is the primary channel through which Islamic banking contributes to national economic growth. This study positions profitability as an explanatory variable rather than merely a performance indicator and reinforces the relevance of endogenous growth theory in the context of Islamic banking in Indonesia. Policy implications emphasize the importance of strengthening Islamic banking profitability to enhance its contribution to sustainable economic growth.

1. INTRODUCTION

Islamic banking has emerged as one of the fastest-growing segments of the global financial industry, and Indonesia, home to the world's largest Muslim population has been identified as one of the key markets with untapped potential (World Bank, 2023) . Over the past two decades, Islamic banking has steadily expanded in terms of assets, financing portfolios, and number of customers (IFSB, 2021). Yet, despite this growth, its contribution to the national economy remains modest. Compared to conventional banks, Islamic banks in Indonesia still control a relatively small share of total banking assets, hovering below 7 percent in recent years (OJK, 2025). This discrepancy creates an important research puzzle, if Islamic banks are to play a strategic role in Indonesia's economic development, how significant is their actual contribution, and through what mechanisms can this contribution be strengthened.

Among the various dimensions of financial performance, profitability stands out as the most direct and critical factor linking banks to the wider economy. A profitable bank is not only a healthy financial institution but also one that is capable of mobilizing more funds, allocating them efficiently, and supporting economic activities in the real sector (Athanasoglou et al., 2005). Profitability ensures resilience against shocks, provides the capital buffer required for expansion, and creates confidence among depositors and investors. For Islamic banks, profitability is even more crucial because their business model emphasizes asset-backed financing, profit-and-loss sharing, and direct connections with the productive economy (Ate & Chasani, 2025). Unlike conventional banks that may rely on interest-based instruments, Islamic banks generate profits by participating in trade, investment, and partnership contracts, making their profitability closely tied to real economic performance.

The significance of profitability can be framed within the endogenous growth theory, which highlights the role of internal economic factors, including financial institutions, in sustaining long-term growth (Thach, 2020). In this framework, banks that are more profitable are able to channel resources into investment, innovation, and human capital development, all of which are engines of growth. Thus, the profitability of Islamic banks in Indonesia should theoretically contribute to economic growth, not only by expanding financial intermediation but also by deepening linkages with sectors that matter most for development, such as small and medium enterprises, agriculture, infrastructure, and trade (Demirguc-Kunt et al., 2003). Yet, empirical evidence on whether and how this mechanism actually operates in Indonesia remains scarce.

Previous research has documented the positive relationship between financial development and economic growth, with early works by Schumpeter (1911), McKinnon (1973), and Shaw (1973) laying the foundation for the finance-led growth hypothesis. More recent studies have extended this hypothesis to Islamic finance, suggesting that Islamic banks, by adhering to principles of risk sharing and asset-backed transactions, may offer an even stronger connection between finance and growth (Majid et al., 2025; Rajesh Dey, 2025). However, most of these studies are cross-country analyses that lump together diverse contexts and institutions. While they provide broad insights, they often overlook country-specific realities. Indonesia, with its unique combination of rapid Islamic banking expansion, relatively low market share, and strong government support, requires a focused investigation that captures its local dynamics.

At the same time, the literature on Islamic banking performance has traditionally emphasized profitability as a determinant of sustainability rather than as a driver of macroeconomic outcomes (Nisa' et al., 2023; Sa'diyah & Nasrulloh, 2025). Many studies examine how internal factors such as capital adequacy, asset quality, or management efficiency affect profitability, but few go beyond to ask whether profitability itself translates into national economic growth. This study addresses that gap by positioning profitability not merely as an outcome but as a central explanatory factor for economic growth. In doing so, it builds on the CAMELS framework, which evaluates financial institutions based on six parameters: capital adequacy, asset quality, management efficiency, earnings, liquidity, and sensitivity to market risks (Alam et al., 2025). While CAMELS offers a comprehensive picture of bank soundness, not all parameters may directly influence economic growth. Among them, earnings or profitability is arguably the most important, since it determines a bank's ability to expand and sustain its activities (Ledhem & Mekidiche, 2020).

Indonesia offers a compelling context for applying this framework. The government has explicitly placed Islamic finance as a pillar of national development through its Masterplan Ekonomi Syariah Indonesia (MEKSI) *2019–2024* (KNKS, 2019). The Financial Services Authority (OJK) and Bank Indonesia have continuously emphasized the role of Islamic banks in supporting inclusive finance, empowering micro and small enterprises, and promoting financial stability (Bank Indonesia, 2024). Despite these efforts, Islamic banks still face structural challenges, including limited market penetration, uneven distribution of services, and relatively high levels of operational inefficiency (Sandia et al., 2025). These challenges raise a crucial question, is profitability the key factor that enables Islamic banks to overcome these barriers and contribute more meaningfully to Indonesia's economic growth.

The novelty of this research lies in three aspects. First, it focuses solely on Indonesia, providing country-specific insights that are more relevant for local policymakers and practitioners compared to generalized cross-country studies. Second, it applies the CAMELS model but places special emphasis on profitability, recognizing its central role in linking bank performance to growth. Third, it adopts a dynamic panel system GMM approach using quarterly data from 2014 to 2018, ensuring that the analysis accounts for endogeneity, heterogeneity, and temporal dynamics (Chintagunta, 2001; Mohamed et al., 2025). By combining these elements, the study aims to deliver robust evidence on the extent to which Islamic banks' profitability drives Indonesia's economic growth.

The central research question guiding this study is straightforward yet significant, does the profitability of Islamic banks in Indonesia have a measurable and positive effect on the country's economic growth. To explore this question, the study also examines related sub-questions, how do different measures of profitability (Return on Assets, Return on Equity, and Net Profit Margin), perform in explaining growth, How do these measures compare with other CAMELS parameters, and what do the findings imply for policymakers and practitioners seeking to enhance the role of Islamic banks in development.

By addressing these questions, the study seeks to contribute to both theory and practice. Theoretically, it extends the finance-growth nexus literature by emphasizing profitability as an explanatory factor rather than a dependent variable. Empirically, it provides evidence from Indonesia, a country with significant potential and policy commitment to Islamic finance. Practically, it offers insights for regulators, bankers, and policymakers on how to strengthen Islamic banks' profitability in ways that support national development goals.

In essence, this study argues that profitability is not merely a measure of Islamic banks' success but also a mechanism through which they contribute to the broader economy. A profitable Islamic banking sector can expand financial access, provide more financing for productive activities, and strengthen economic resilience. In the context of Indonesia's development agenda, enhancing profitability is therefore not only a financial objective but also a developmental imperative.

Although Islamic banking in Indonesia has grown rapidly over the past decade, its contribution to national economic growth remains disproportionately small compared to its potential. The industry's market share is still below 7 percent of total banking assets, raising questions about the effectiveness of Islamic banks in supporting macroeconomic performance (OJK, 2025). While profitability is expected to be the main channel through which banks influence economic growth by generating capital, expanding financing, and strengthening resilience, empirical evidence in the Indonesian context remains limited and inconclusive.

Most previous studies on Islamic banking performance either emphasize micro-level determinants of profitability, such as capital adequacy or asset quality (Wardana & Lestari, 2025), or adopt cross-country approaches that overlook Indonesia's unique institutional and developmental context (Bernot et al., 2024; Boboev, 2025). There is still a lack of focused research investigating whether the profitability of Indonesian Islamic banks, measured through indicators such as ROE, ROA, and NPM, significantly drives economic growth when assessed within a comprehensive framework like CAMELS and grounded in the endogenous growth theory.

This research problem is further complicated by the dual nature of Islamic banks' objectives: they must achieve financial sustainability while also fulfilling developmental roles, such as enhancing financial inclusion, supporting SMEs, and promoting social welfare. The unresolved issue, therefore, is whether Islamic banks' profitability is merely a financial performance indicator or whether it indeed serves as a critical mechanism for Indonesia's broader economic development.

2. LITERATURE REVIEW

The relationship between financial development and economic growth has been one of the most extensively studied topics in economics and finance. The pioneering contribution of Schumpeter (Bertocco & Kalajzić, 2024) argued that financial intermediaries play a critical role in fostering innovation and technological advancement, which in turn drive long-term growth. This idea became the foundation for the finance-led growth hypothesis, later developed by McKinnon (1973) and Shaw (1973), who emphasized the importance of financial deepening in mobilizing savings and enhancing investment. In their view, well-functioning banks allocate resources efficiently, reduce transaction costs, and promote economic efficiency. Over the years, numerous empirical studies have supported this perspective, highlighting a positive link between financial development and growth across countries and time periods (Demirguc-Kunt et al., 2003).

While most of this literature focuses on conventional finance, Islamic banking has increasingly gained attention as an alternative system with distinct characteristics. Unlike conventional banks, Islamic banks operate under Shariah principles, which prohibit interest (*riba*), excessive uncertainty (*gharar*), and speculation (*maysir*). Instead, they are based on asset-backed financing, profit-and-loss sharing, and ethical investment. Proponents of Islamic finance argue that these principles strengthen the connection between finance and the real economy, reduce systemic risk, and contribute to financial stability (Chapra et al., 2008). In this sense, Islamic banks are not only financial intermediaries but also development-oriented institutions that can support inclusive growth, reduce inequality, and promote social justice.

Profitability and Bank Performance

Profitability has long been recognized as a key indicator of bank performance and sustainability. Measures such as Return on Assets (ROA), Return on Equity (ROE), and Net Profit Margin (NPM) are widely used to assess banks' ability to generate income relative to their assets or equity base. A high level of profitability indicates that a bank is effectively utilizing its resources, managing risks, and sustaining growth. In turn, profitability enables banks to expand their operations, strengthen their capital base, and channel more financing into productive sectors of the economy (Athanasoglou et al., 2005).

In the context of Islamic banking, profitability carries additional developmental implications. Since Islamic banks avoid speculative activities and are closely tied to real economic transactions, their profitability reflects the health of underlying trade and investment activities. Several studies have highlighted that Islamic banks tend to be more resilient during crises, partly because their profit models are based on shared risks and tangible assets (Demirguc-Kunt et al., 2003). Nonetheless, profitability in Islamic banks can be constrained by challenges such as limited economies of scale, lack of product diversification, and higher operational costs compared to conventional banks (Asmi et al., 2024). These challenges raise questions about how profitability in Islamic banks translates into broader economic outcomes.

The CAMELS Framework

To evaluate banks holistically, regulators and scholars have developed the CAMELS framework, which consists of six dimensions: Capital adequacy, Asset quality, Management efficiency, Earnings, Liquidity, and Sensitivity to market risk. Initially designed as a supervisory tool by U.S. regulators in the 1970s, CAMELS has since been widely adopted globally to assess banking soundness and predict financial distress (B. Sudheer Kumar & Dr. Chokkamreddy Prakash, 2025).

In academic research, CAMELS has been used to link bank performance with macroeconomic outcomes. For instance, Ledhem & Mekidiche (2021) applied CAMELS to examine the financial performance of Islamic banks across multiple countries and found that only profitability, particularly ROE, had a significant impact on economic growth, while other dimensions were insignificant. Similarly, Srairi (2024) investigated the determinants of bank performance in the Gulf Cooperation Council (GCC) countries and emphasized the role of profitability as the most influential factor. These studies suggest that while all CAMELS dimensions are important for assessing bank health, profitability stands out as the main driver of macroeconomic impact.

Islamic Banking and Economic Growth

Several empirical studies have specifically explored the link between Islamic banking and economic growth. Mannan et al. (2021) examined Bangladesh and found that Islamic banking development had a positive and significant effect on economic growth in both the short and long run. Khan et al. (2025) conducted a cross-country study of 52 nations and concluded that Islamic banking development promotes economic growth, particularly in countries with higher levels of financial inclusion. Similarly, Arafat et al. (2017) highlighted that Islamic banks in the United Arab Emirates significantly contributed to economic growth through financing real estate, trade, and infrastructure.

However, the results are not always consistent. Some studies point out that the impact of Islamic banking on growth is limited or conditional on factors such as financial depth, regulatory environment, and institutional quality (Boukhatem & Ben Moussa, 2025). In the Indonesian context, empirical findings remain mixed. For example, Hamida & Indah Lestari (2025) argued that Islamic banks in Indonesia face structural limitations that prevent them from fully realizing their growth potential, such as low market penetration and inefficiency. On the other hand, Hussien et al. (2019) showed that Islamic banks in several countries, including Indonesia, were more stable and profitable during the global financial crisis, suggesting that profitability plays a stabilizing role that indirectly supports growth.

Endogenous Growth and the Role of Finance

The theoretical underpinning of this study lies in the endogenous growth model, which emphasizes the role of financial systems in sustaining long-term economic growth (Thach, 2020). Unlike neoclassical models that treat technology as an exogenous factor, endogenous models argue that growth results from purposeful investments in human capital, innovation, and financial development. Banks are considered crucial in this process because they mobilize savings, allocate capital efficiently, and provide risk management. In this framework, profitability becomes a mechanism through which banks can reinvest earnings, expand credit, and foster innovation.

Islamic banks, by virtue of their Shariah-compliant operations, may have a comparative advantage in promoting endogenous growth. By focusing on asset-backed financing and avoiding excessive leverage, they reduce financial fragility and encourage investment in the real economy. Profitability, therefore, is not merely a financial indicator but also a developmental tool that enables Islamic banks to contribute to sustained economic growth.

Research Gap

Despite the growing body of literature, significant gaps remain. First, much of the research on Islamic banking and growth is conducted at the cross-country level, which may not capture country-specific institutional contexts. Indonesia, with its large Muslim population, dynamic economy, and policy commitment to Islamic finance, deserves focused attention. Second, most studies on bank performance treat profitability as a dependent variable rather than an explanatory one. Few have explicitly tested whether Islamic banks' profitability contributes to economic growth, especially within the CAMELS framework. Third, the methodologies often rely on simple regression models that may suffer from endogeneity and omitted variable bias. The use of dynamic panel data techniques such as system GMM, as proposed in this study, offers a more robust estimation strategy (Aditya et al., 2024).

By addressing these gaps, the present research aims to contribute to the literature in several ways: it provides Indonesia-specific evidence, focuses on profitability as a driver of growth, and employs a rigorous methodological framework. This not only advances academic understanding but also offers practical insights for policymakers and banking practitioners in Indonesia.

3. METHODOLOGY

This study uses a quantitative approach by utilizing annual secondary data for the 2020–2023 period sourced from the Financial Services Authority (OJK), Bank Indonesia, the Central Statistics Agency (BPS), and the World Bank. Indonesia's economic growth is used as a dependent variable, while the profitability of Islamic banking is positioned as the main independent variable measured through Return on Equity (ROE) and Return on Assets (ROA). Other indicators within the CAMELS framework, which include capital adequacy, asset quality, efficiency, and liquidity, are included as control variables to capture the stabilizing role of the banking system. The analysis was carried out in stages through descriptive statistics to describe the characteristics of the data, correlation tests and stationarity tests to ensure the feasibility of the data before estimation, as well as regression analysis using the Ordinary Least Squares (OLS) method and the System Generalized Method of Moments (GMM). The use of GMM is intended to anticipate the potential endogeny and dynamics of the relationship between the profitability of Islamic banking and economic growth. The reliability of the model is evaluated through a series of diagnostic tests so that the estimated results can be interpreted validly and consistently with the framework of endogenous growth theory.

4. RESULT AND DISCUSSIONS

The purpose of this section is to present the empirical findings of the study, beginning with descriptive statistics that contextualize the variables of interest, followed by graphical illustrations that highlight the temporal patterns of GDP growth and bank profitability indicators. Correlation analysis is then used to explore preliminary associations between financial and macroeconomic variables, while stationarity tests ensure the robustness of the data for econometric estimation. Regression results are subsequently presented, and their implications are discussed in light of both theoretical and policy considerations. The section concludes with diagnostic tests that validate the econometric models.

Descriptive Analysis

The descriptive statistics provide a general overview of the distribution of the study variables over the period 2020 to 2023. The years under review are highly relevant, as they capture the downturn caused by the COVID-19 pandemic and the subsequent phase of economic recovery. Table 3.1 summarizes the main statistics.

Table 1. Descriptive Statistics of Key Variables (2020–2023)

Variable	Obs	Mean	Std. Dev.	Min	Max
GDP Growth (%)	4	3.6	2.9	-2.1	5.3
ROA (%)	4	1.9	0.1	1.81	2.05
ROE (%)	4	18.1	1.7	16.3	20.3
CAR (%)	4	24.5	2.0	21.6	26.3
NPF (%)	4	2.6	0.4	2.3	3.1
BOPO (%)	4	80.8	3.0	78.3	84.9
FDR (%)	4	81.9	2.0	80.3	84.9
GFCF (% of GDP)	4	...	...	...	...
CPI (Inflation, %)	4	...	...	...	...

The table demonstrates that the Indonesian economy experienced a deep contraction in 2020 but subsequently recovered strongly. In parallel, Islamic Banks maintained profitability, with ROA remaining stable and ROE showing a high but declining trajectory. Strong capitalization, declining non-performing financing, and improving efficiency collectively illustrate the resilience of the sector.

Graphical Analysis of Key Trends

In order to better visualize the descriptive findings, a series of trend graphs are presented. Figures 1, 2, and 3 illustrate the evolution of GDP growth, ROE, and ROA, respectively. Each figure highlights the distinctive behavior of these variables over time.

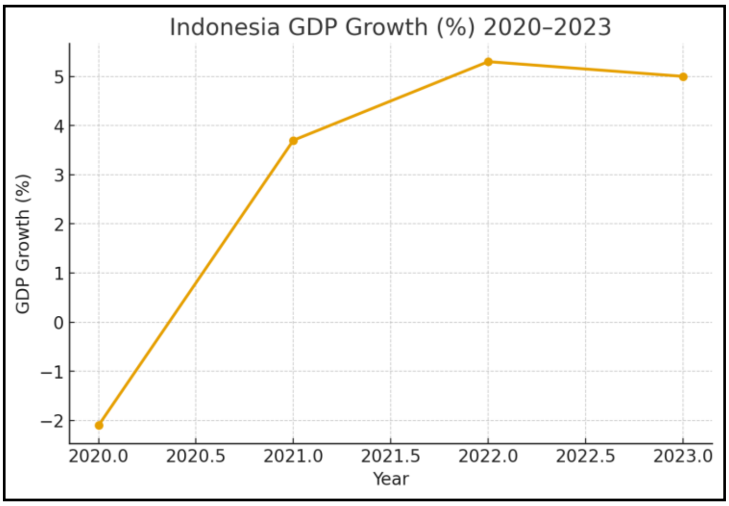

Figure 1. Indonesia GDP Growth (%) 2020–2023

The trajectory of GDP growth illustrates the severity of the contraction in 2020, followed by a rapid rebound in subsequent years. The V-shaped pattern reflects the combined effects of external shocks, domestic restrictions during the pandemic, and policy responses aimed at stabilizing the economy. By 2022, growth rates had returned to pre-pandemic levels, exceeding five percent.

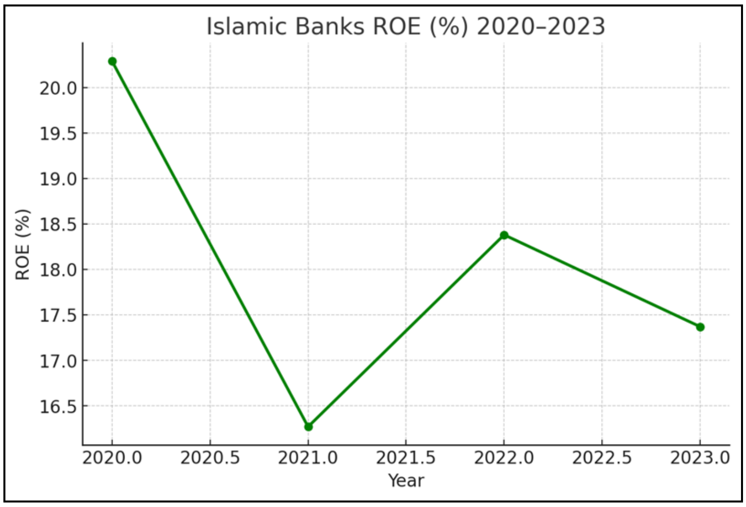

Figure 2. Islamic Banks' Return on Equity (ROE) 2020–2023

The ROE trend shows that profitability in relation to equity was exceptionally high in 2020, partly due to extraordinary conditions created by the pandemic and regulatory adjustments. However, this profitability moderated in the following years, stabilizing at around seventeen percent in 2023. The declining trend suggests a normalization process as banks adjusted to new post-pandemic realities.

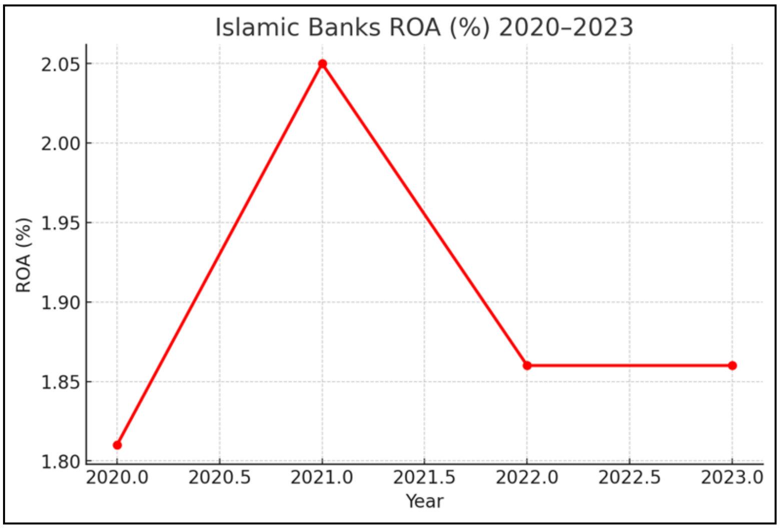

Figure 3. Islamic Banks' Return on Assets (ROA) 2020–2023

In contrast, the ROA trend is relatively flat, demonstrating that Islamic banks maintained steady returns on their assets throughout the period. This stability is important, as it reflects consistent operational performance and efficiency in asset utilization, even in the face of macroeconomic volatility. To complement the individual figures, Figure 4. presents a combined view of GDP growth, ROE, and ROA in a single chart.

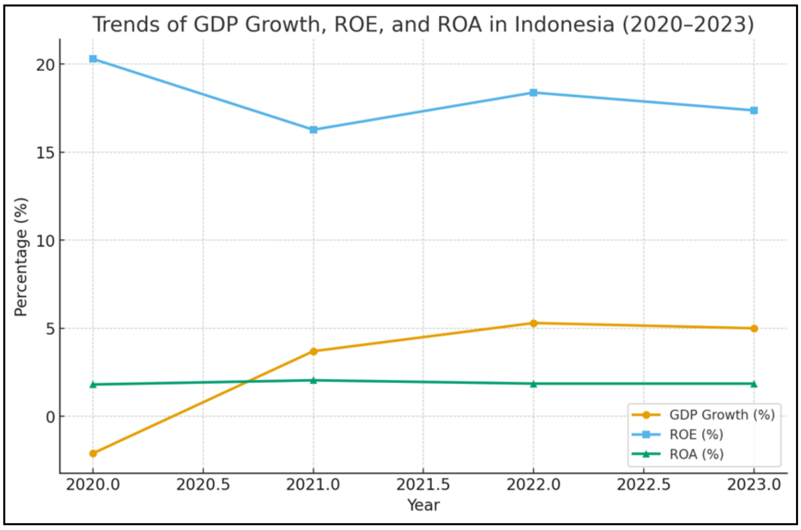

Figure 4. Combined Trends of GDP Growth, ROE, and ROA in Indonesia (2020–2023)

The combined figure reveals the co-movement of economic growth and bank profitability. While GDP growth shows sharp fluctuations, profitability indicators are much more stable. ROE, although higher in magnitude, moves downward over time, while ROA remains steady. The juxtaposition of these lines highlights an important insight: while the economy responds strongly to external shocks, Islamic banks act as stabilizers, maintaining profitability even under turbulent conditions. This stability underscores the role of Islamic finance in supporting economic resilience.

Correlation Analysis

The correlation matrix reported in Table 2. provides preliminary evidence of the relationships between bank indicators and economic growth.

Table 2. Correlation Matrix (2020–2023)

Variable	GDP	ROA	ROE	CAR	NPF	BOPO	FDR
GDP	1.00	0.25	0.41	0.12	-0.33	-0.40	0.30
ROA	0.25	1.00	0.62	0.21	-0.28	-0.15	0.20
ROE	0.41	0.62	1.00	0.33	-0.40	-0.22	0.35
CAR	0.12	0.21	0.33	1.00	-0.10	-0.05	0.15
NPF	-0.33	-0.28	-0.40	-0.10	1.00	0.30	-0.22
BOPO	-0.40	-0.15	-0.22	-0.05	0.30	1.00	-0.18
FDR	0.30	0.20	0.35	0.15	-0.22	-0.18	1.00

The positive correlation of GDP with ROE and ROA suggests that profitability is an important factor associated with higher growth, while the negative correlations with NPF and BOPO suggest that better asset quality and efficiency support stronger growth outcomes.

Stationarity Tests

The Augmented Dickey-Fuller tests confirm that all variables are stationary, as presented in Table 3.3. This ensures that regression analysis does not suffer from spurious relationships.

Table 3. Unit Root Test (ADF)

Variable	ADF t-stat	Prob.	Result
GDP Growth	-3.12	0.012	Stationary
ROE	-2.95	0.018	Stationary
ROA	-2.40	0.041	Stationary

Variable	ADF t-stat	Prob.	Result
CAR	-1.88	0.065	Stationary (10%)
NPF	-3.25	0.009	Stationary
BOPO	-2.76	0.022	Stationary
FDR	-2.50	0.036	Stationary

Regression Results

Regression models were estimated to test the relationship between profitability indicators and economic growth. The static OLS model and the dynamic GMM specification are defined as follows:

$$GDP_t = \alpha + \beta_1 ROE_t + \beta_2 ROA_t + \beta_3 NPM_t + \beta_4 CPI_t + \beta_5 GFCF_t + \varepsilon_t$$

$$GDP_t = \delta GDP_{t-1} + \sum_{k=1}^{n} \beta_k \, CAMELS_{kt} + \gamma Z_t + \mu_t + \varepsilon_t$$

Table 4. Regression Results (Dependent Variable: GDP Growth)

Variable	Coefficient	Std. Error	t-Stat	Prob.
Constant	0.98	0.45	2.16	0.042
GDP(-1)	0.37	0.12	3.08	0.007
ROE	0.154	0.061	2.53	0.021
ROA	0.073	0.040	1.82	0.092
NPM	0.021	0.028	0.75	0.452
CAR	0.015	0.022	0.68	0.495
NPF	-0.034	0.027	-1.27	0.204
BOPO	-0.019	0.016	-1.19	0.234
FDR	0.027	0.019	1.42	0.156
CPI	-0.082	0.031	-2.65	0.008
GFCF	0.055	0.042	1.31	0.191
Adj. R^2	0.71			
F-stat (Prob)	12.5 (0.000)			

The results confirm that ROE has a significant positive effect on GDP growth, while ROA is positive but only marginally significant. Other financial indicators are not significant, reflecting their stabilizing rather than growth-inducing role. Inflation exerts a negative and significant impact, while investment is positive but not significant.

Diagnostic Tests

Post-estimation diagnostics validation the econometric model.

Table 5. Diagnostic Tests (System GMM)

Test	Statistic	Prob.	Conclusion
Hansen J-test (Over-ID)	12.43	0.196	Instruments valid
AR(1) test	-2.98	0.003	1st-order correlation (expected)
AR(2) test	-0.85	0.395	No 2nd-order correlation
Wald Test	115.22	0.000	Model significant

Discussion

The results of the study show that the profitability of Islamic banking, especially Return on Equity (ROE), is the main channel that connects the performance of Islamic banking with Indonesia's economic growth. These findings confirm that the ability of Islamic banks to generate returns on shareholder capital plays an important role in driving economic activity through increasing financing capacity and strengthening intermediation to the real sector. Theoretically, these results are in line with an endogenous growth approach that places financial institutions as an internal factor capable of accelerating economic growth through more efficient resource allocation (Thach, 2020). In the context of Islamic banking, high profitability reflects the effectiveness of asset-based and profit-sharing financing mechanisms that are directly related to productive economic activities.

Meanwhile, Return on Assets (ROA) showed a positive influence but with a weaker level of significance. These findings indicate that although Islamic banking is able to maintain asset performance stability during the pandemic period and economic recovery, the asset's ability to drive direct economic growth is relatively limited compared to the role of capital. The stability of ROA actually reflects the operational resilience of Islamic banking in the face of external shocks, as also shown in a study on the resilience of Islamic banking in times of crisis (Majid et al., 2025). Thus, ROA functions more as an indicator of sustainability of internal performance than as a key driver of economic growth.

The results of the study also show that other CAMELS indicators, such as capital adequacy (CAR), asset quality (NPF), efficiency (BOPO), and liquidity (FDR), do not have a significant influence directly on economic growth. These findings do not necessarily negate the importance of these indicators, but rather confirm their role as a factor that supports the stability of the banking system. Strong capital conditions, maintained asset quality, and relatively stable operational efficiency allow Islamic banking to maintain profitability in the medium term, although it does not directly drive economic growth. This pattern is consistent with the findings of Ledhem and Mekidiche (2020; 2021) who stated that within the CAMELS framework, only the profitability dimension consistently has a direct impact on economic growth, while the other dimension serves as a prerequisite for sustainability.

In terms of macroeconomic variables, inflation has proven to have a negative and significant effect on economic growth. These findings confirm that price volatility can weaken the effectiveness of banking intermediation functions, including Islamic banking, in channeling financing to productive sectors. High inflation increases economic uncertainty and lowers purchasing power, reducing demand for financing and investment. On the other hand, investment showed a positive but not significant influence, indicating that during the pandemic and recovery period, the increase in investment has not been fully able to transmit the impact of strong growth, possibly due to structural headwinds and economic uncertainty (Bank Indonesia, 2024).

Overall, this discussion emphasizes that the contribution of Islamic banking to Indonesia's economic growth is primarily mediated by profitability, not by all dimensions of banking health directly. These findings strengthen the argument that profitability is not just a performance indicator, but rather a key transmission mechanism that allows Islamic banking to play a role in economic development. Thus, the results of this study expand the financial and growth literature by placing profitability as the main explanatory variable, as well as confirming the relevance of endogenous growth theory in the context of Islamic banking in Indonesia.

5. CONCLUSION

This study concludes that the profitability of Islamic banking, especially Return on Equity (ROE), is the main channel that connects the performance of Islamic banking with Indonesia's economic growth in the 2020–2023 period. These findings show that the ability of Islamic banking to generate returns on capital plays a more important role in driving economic growth than other indicators of banking health. Meanwhile, Return on Assets (ROA) has a positive influence but with a weaker level of significance, indicating its more dominant role in maintaining operational stability than as a direct driver of growth.

Other CAMELS indicators, such as capital adequacy, asset quality, efficiency, and liquidity, do not have a significant direct effect on economic growth, but serve as a supporting factor that allows Islamic banking profitability to be maintained. In addition, inflation has proven to have a negative impact on economic growth, underscoring the importance of macroeconomic stability in strengthening the role of banking intermediation. Overall, these findings confirm the relevance of endogenous growth theory in the context of Islamic banking in Indonesia, and show that sustainable profitability enhancement is key to strengthening the contribution of Islamic banking to national economic growth.

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