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ANALYSIS OF THE DETERMINANTS OF MSME FINANCING IN ISLAMIC BANKING

Dwi Wahyuningsih[1], Lavlimatria Esya[2]
[1/2]Universitas Trisakti
dwily.wahyuni@gmail.com

ABSTRACT

Although Micro, Small and Medium Enterprises (MSME) financing provided by Islamic banks in Indonesia has continued to increase in nominal terms, its growth rate has gradually slowed, highlighting the need to examine the macroeconomic factors influencing financing distribution. This study aims to analyze the effects of the Manufacturing Purchasing Managers' Index (PMI), BI-7 Day Reverse Repo Rate (BI7DRR), Bank Indonesia Sharia Deposit Facility (FASBIS), and inflation on MSME financing by Islamic banks in Indonesia. The study is grounded in the Islamic Banking Intermediation Theory and Monetary Policy Theory, which explains that macroeconomic conditions influence the intermediation function of Islamic banks in channeling financing to the real sector. A quantitative approach was employed using secondary data for the 2020–2025 period obtained from the Financial Services Authority (OJK), Bank Indonesia (BI), Statistics Indonesia (BPS), and Standard and Poor's Global (S&P) Global. The data were analyzed using panel data regression, with the Random Effect Model (REM) selected as the most appropriate model based on the Chow, Hausman , and Lagrange Multiplier tests. The results indicate that the Manufacturing PMI has a positive and significant effect on MSME financing, while the BI-7 Day Reverse Repo Rate (BI7DRR) has a negative and significant effect. FASBIS has a negative but insignificant effect, whereas inflation has a negative and significant effect on MSME financing in Indonesian Islamic banks. These findings imply that stronger manufacturing activity encourages MSME financing, while tighter monetary policy and higher inflation tend to reduce financing distribution. Meanwhile, FASBIS has not been proven to significantly influence MSME financing.

Keywords: *MSME Financing, Manufacturing PMI, BI7DRR, FASBIS*

INTRODUCTION

Islamic banking is a financial institution that conducts its business activities based on Islamic sharia principles, namely by avoiding the practices of *usury* , *gharar* (uncertainty), and *maisir* (speculation). In its operations, Islamic banks use various contracts in accordance with Islamic law such as *mudharabah* , *musyarakah* , *murabahah* , *ijarah* , and *salam* to channel funds to the public. The concept of *profit and loss sharing* and fairness between the bank and customers places the relationship not only as a creditor and debtor as in conventional banking, but more of a partnership in economic activities. According to Antonio (2020), Islamic banks are intermediary institutions that collect funds from the public and redistribute them in the form of financing based on sharia principles to support halal and productive economic activities.



Figure 1. Sharia Bank Financing
Source: OJK (Financial Services Authority)

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The development of Islamic bank financing from December 2019 to June 2025 shows an increasing trend in total financing each year, although the growth rate fluctuates. In December 2019, total financing was recorded at IDR 355,182 billion, with a growth of 10.93%. This then increased to IDR 383,944 billion in 2020 and IDR 409,878 billion in 2021, but growth slowed to 8.10% and 6.75%, respectively. In 2022, financing saw a significant surge to IDR 491,489 billion, with the highest growth of 19.91%, reflecting the recovery in economic activity. The upward trend continued in 2023, with total financing reaching IDR 568,436 billion and a growth of 15.66%, before rising again in 2024 to IDR 624,560 billion, with a growth of 9.87%. As of June 2025 (*year to date*), total financing had reached IDR 646,511 billion, but growth slowed to 3.51%. Overall, the data shows that Islamic bank financing continues to increase nominally year after year, but the growth rate tends to fluctuate and has begun to slow in the most recent period.

Islamic banking serves not only as a financial intermediary institution but also as an economic development instrument that stimulates the real sector through profit-sharing financing and productive business financing, particularly in the MSME sector. Financing is one of the primary functions of Islamic banking in carrying out its financial intermediation role for the public. In practice, financing development is influenced not only by internal banking factors but also by macroeconomic conditions. Research by Husaeni (2020) shows that macroeconomic variables such as inflation, benchmark interest rates, and exchange rates influence Islamic bank financing in Indonesia. Ascarya (2021) also found that macroeconomic conditions such as economic growth and monetary stability play a role in determining the dynamics of Islamic banking financing.

Micro, Small, and Medium Enterprises (MSMEs) remain the backbone of the Indonesian economy amidst the acceleration of digital transformation. Despite facing post-pandemic volatility, this sector has proven capable of adapting through the integration of a more inclusive digital ecosystem. According to Setiawan & Arifin (2024), the resilience of MSMEs currently depends heavily on stable access to liquidity supported by accommodative monetary policy. Islamic banking in Indonesia has transformed into a primary provider of financial solutions for the real sector through more transparent schemes. The mandate to channel a minimum of 20% of financing to the MSME sector has become a key driver of Islamic asset growth. Rahayu (2025) emphasized that Islamic banks have a comparative advantage in mitigating real sector risks through fairer profit-sharing agreements compared to conventional banking.

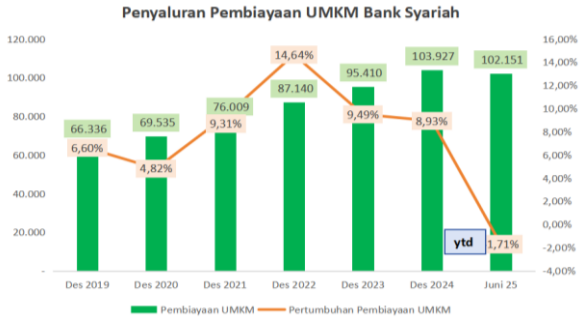


Figure 2. Distribution of Islamic Bank MSME Financing

Source: OJK (Financial Services Authority)

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The graph of MSME financing disbursement by Islamic banks from December 2019 to June 2025 shows an upward trend in nominal financing, although the growth rate fluctuates. In December 2019, MSME financing was recorded at IDR 66,336 billion, with a growth of 6.60%, then increased to IDR 69,535 billion in 2020 with a growth of 4.82%. Furthermore, in 2021 and 2022, financing continued to increase to IDR 76,009 billion and IDR 87,140 billion, with growth of 9.31% and 14.64%, respectively, which was the highest growth during that period. In 2023 and 2024, financing again increased to IDR 95,410 billion and IDR 103,927 billion, but growth slowed to 9.49% and 8.93%. As of June 2025 (*year to date*), MSME financing was recorded at IDR 102,151 billion with a growth of 1.71%, indicating a slowdown in growth in the most recent period.

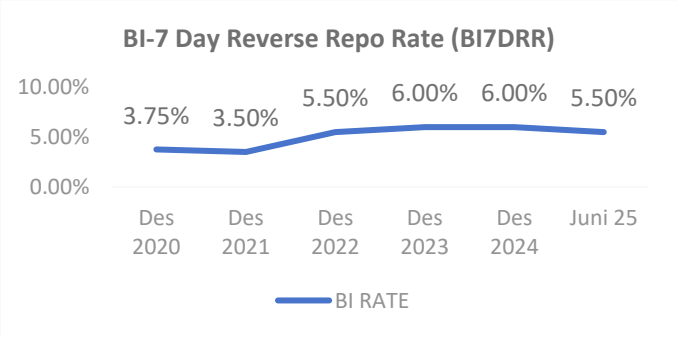


Figure 3. Development of BI-7 Day Reverse Repo Rate (BI7DRR) 2020-2025
Data source: Bank Indonesia (2025)

Based on the data in Figure 2 and Figure 3, a contrasting negative correlation is seen between monetary policy and the performance of Islamic banking intermediation, where the surge in *the BI-7 Day Reverse Repo Rate* (BI7DRR) from a low of 3.50% in 2021 to 6.00% in 2023-2024 is directly proportional to the deceleration in the growth rate of MSME financing which slowed from a peak of 14.64% in 2022 to only 8.93% in 2024. Although nominally, total financing continued to grow to Rp 103,927 billion, the downward trend in percentage growth in the last two years indicates that monetary tightening has increased the cost *of funds* and financing risks, so that Islamic banking tends to be more selective in channeling capital to the MSME sector amidst these economic pressures. Based on Mulyani's study (2025), there is a significant correlation between the increase in the benchmark interest rate and the tightening of criteria for disbursing working capital financing in Islamic banks.

Research by Sari *et al. (2021) shows that the Capital Adequacy Ratio (CAR), BI7DRR, and inflation* simultaneously influence MSME lending. Partially, the BI7DRR is proven to have a significant influence on lending, reflecting that changes in the benchmark interest rate influence banking lending policies. Research by Husaeni (2020) also shows that macroeconomic variables such as the BI7DRR, inflation, and the exchange rate influence Islamic bank financing in Indonesia. Setiawan and Kurniasih (2021) found that the BI7DRR plays a role in determining the dynamics of Islamic bank financing growth because the benchmark interest rate policy can influence financing demand and banking sector stability.

Agency theory states that the relationship between managers and shareholders in banks can be influenced by macroeconomic factors such as *the Purchasing Managers' Index*

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(PMI). When the PMI increases, indicating a positive economic outlook, managers can adjust investment and credit decisions to optimize returns for shareholders, thereby improving the bank's operational performance (Jensen & Meckling, 1976). Business cycle theory states that bank performance often fluctuates in line with the economic cycle (Burns & Mitchell, 1946). During periods of economic growth, when the PMI increases, businesses and banks tend to increase their lending and business activities. Conversely, when the PMI decreases, banks face higher risks due to a decrease in borrower repayment capacity (Meyer & Habanabakize, 2019).

The Purchasing Managers' Index (PMI) is one of the most important economic indicators consistently monitored by economists and financial analysts. This index provides a comprehensive overview of the condition of a country's manufacturing sector. The Manufacturing PMI is calculated based on a monthly survey sent to purchasing managers at various manufacturing companies regarding production, new orders, shipments, employment, and inventories. The five indicators used to measure the PMI are: 30% new orders, 25% production, 20% employment, 15% supplier shipments, and 10% inventories (Joseph *et al.* , 2011). The PMI is used as a forecasting tool for important economic variables, including changes in GDP and growth rates (Afshar *et al.* , 1997). The Manufacturing PMI ranges from 0 to 100, with a reading above 50 indicating expansion and a reading below 50 indicating contraction. According to Saputra (2025), the PMI serves as a *leading indicator* that helps Islamic banks predict financing demand from the manufacturing MSME sector.

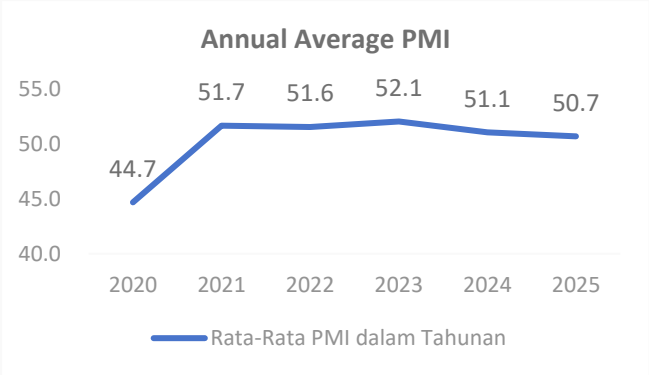


Figure 4. Monthly Average of Manufacturing Purchasing Managers' Index (PMI)
Data Source: S&P Global

Based on annual trend data, the manufacturing sector demonstrates significant resilience with an average PMI consistently in the expansion zone (above 50.0) since the sharp recovery in 2021 to 2024, after previously contracting to 44.7 during the 2020 pandemic. Although it reached its peak performance in 2023 with a figure of 52.1, there was a slight normalization to 51.1 in 2024, indicating a slowdown in growth amid global economic dynamics, but still within the category of healthy and stable business conditions. Hartanto & Sari (2024) emphasize that the integration of PMI data in the Islamic banking credit assessment system can reduce the risk of information uncertainty.

Research by Citra and Suman (2022) shows that the Bank Indonesia Sharia Deposit Facility (FASBIS) has a negative and significant impact on Islamic bank financing in Indonesia. FASBIS is a short-term funding instrument provided by Bank Indonesia for Islamic banks experiencing excess liquidity. The greater the funds placed in FASBIS, the less

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funds can be channeled as financing to the public. Research by Nikmah and Hidayati (2022) found that FASBIS has a positive but insignificant effect on *murabahah financing* , both in the short and long term. These differences in results indicate that the influence of FASBIS on Islamic bank financing still requires further study, particularly on MSME financing in Islamic banking in Indonesia.

An increasingly used indicator of real sector activity in economic analysis is the Purchasing Managers' Index (PMI). Research by Do and Dao (2024) found that the PMI is linked to banking performance because changes in industrial activity can affect credit demand and bank operational efficiency. An increase in the PMI is often accompanied by increased bank lending to the industrial sector, as companies require additional working capital to meet increased production demand.

Inflation also puts pressure on Islamic banks in terms of collecting funds from the public, because the decline in the value of money affects the level of public *savings* , which affects Islamic Bank financing (Saekhu, 2015). Real income of the community is caused by rising prices in the economy as a whole, reduced income resulting in a decline in customers' ability to save in banks (Sitanggang & Munthe, 2019). Research by Soegiharso and Gitaharie (2015) shows that inflation at a certain level (below the *threshold value*) is necessary to encourage economic growth.

Based on the background and perspectives above, this study aims to analyze the influence of the Manufacturing *Purchasing Managers' Index* (PMI), *the BI-7 Day Reverse Repo Rate* (BI7DRR), the Bank Indonesia Sharia Deposit Facility (FASBIS), and Inflation on MSME Financing in Islamic Banking. *The state of the art* of this research lies in combining the Manufacturing PMI variable as an indicator of real sector activity with Islamic monetary policy instruments (BI7DRR and FASBIS) and inflation in analyzing the determinants of MSME financing, which is still rarely done in previous studies, especially in the post-pandemic period of 2020-2025. This research is expected to contribute to the development of literature on the determinants of MSME financing in Islamic banking and serve as a reference for further research that examines the relationship of macroeconomic variables to MSME financing in Islamic Banking.

METHODS

This study uses a quantitative approach with a panel data regression analysis method, namely a combination of *time series* and *cross-section data* (Wooldridge, 2020). The study population is all Sharia Commercial Banks (BUS) and Sharia Business Units (UUS) in Indonesia registered with the Financial Services Authority (OJK). A sample of 18 Sharia banks (12 BUS and 6 UUS) was selected through a *purposive sampling technique* based on the availability of complete data for the 2020-2025 period. Secondary data was obtained from the OJK, Bank Indonesia, BPS, and S&P Global. The dependent variable is MSME Financing, while the independent variables include Manufacturing PMI, BI7DRR, FASBIS, and Inflation. The selection of the best model is carried out using the Chow Test, Hausman Test, and *Lagrange Multiplier Test* to determine between *the Common Effect Model* (CEM), *Fixed Effect Model* (FEM), or *Random Effect Model* (REM).

The regression equation model used is a semilog model: $\ln Y = \alpha + \beta_1 X_1 + \beta_2 X_2 + \beta_3 \ln X_3 + \beta_4 X_4 + \varepsilon$. Prior to the analysis, classical assumption tests were performed including multicollinearity tests (VIF < 10) and heteroscedasticity tests. Hypothesis testing was

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carried out through partial tests (t-test) to test the influence of each variable, simultaneous tests (F-test) to test the influence together, and the coefficient of determination (R^2) to measure the model's ability to explain variations in the dependent variable, with a significance level of α = 5% (Ghozali, 2018; Gujarati & Porter, 2022).

RESULTS AND DISCUSSION

First, the research results contain the objective conditions of the research. This section contains research data that can be presented in several forms, for example: tables or graphs. Tables or graphs are only related to the research results. The caption of the table or graph is written above it, with Cambria typeface, font size 11, spacing 1.15 with the provisions of line spacing after and before 0. If there are subheadings in the results or in other sections, write the first, second and so on letters in bold. No other numbers, letters, or bullets are given. This section is written in Cambria type, font size 11, spacing 1.15 with line spacing after and before 0. Foreign languages, regional languages, and nonstandard terms are printed in italics, except for proper names.

Descriptive Statistics

Descriptive statistics provide an overview of the characteristics of the research data through the mean, median, minimum, maximum, standard deviation, skewness, and kurtosis values of 108 observations (18 Islamic banks, 2020-2025). The results are presented in Table 1 below.

Table 1. Descriptive Statistics

Variabel	N	Mean	Median	Minimum	Maksimum	Std. Deviasi	Skewness	Kurtosis
PMI Manufaktur (X1)	108	51,7167	51,2500	50,9000	53,5000	0,8975	1,1435	2,8226
BI7DRR (X2)	108	4,9167	5,1250	3,5000	6,0000	1,0116	-0,2766	1,4189
lnFASBIS (X3)	108	10,2133	10,0850	9,8100	10,7600	0,3766	0,4425	1,4872
Inflasi (X4)	108	2,6933	2,2400	1,5700	5,5100	1,3578	1,3060	3,3001
lnPembiayaan UMKM (Y)	108	3,3125	2,5950	0,1200	13,6000	2,5941	1,9924	7,4226

Source: Processed data

The Manufacturing PMI averaged 51.7167 (above 50), indicating the manufacturing sector was in an expansionary phase with low variation (std. deviation 0.8975). A minimum value of 50.9 and a maximum of 53.5 indicated stability in the manufacturing sector during the study period. The BI7DRR averaged 4.9167% with a range of 3.50%-6.00%, reflecting the dynamics of Bank Indonesia's monetary policy in responding to economic conditions. lnFASBIS averaged 10.2133 with small variation (std. deviation 0.3766). Inflation averaged 2.6933% with a range of 1.57%-5.51%, with the maximum value occurring in 2022 due to post-pandemic economic recovery and global supply chain disruptions. lnMSME financing has the highest variation (std. deviation 2.5941) with a range of 0.12-13.60, reflecting

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differences in intermediation capacity between Islamic banks.

Selection of Regression Estimation Model

Estimation model selection is carried out through three stages of testing to determine the best model among the Common Effects Model (CEM), the Fixed Effects Model (FEM), and the Random Effects Model (REM). According to Gujarati and Porter (2021), panel data regression has three estimation approaches, requiring a series of tests to determine the most appropriate model to ensure consistent, efficient, and unbiased estimation results.

Chow Test

The Chow test is used to select between CEM and FEM. According to Gujarati and Porter (2021), the Chow test is conducted by testing the significance of differences in characteristics between cross-sectional units by comparing probability values. If the probability value is <0.05, the fixed effects model is more appropriate. The test results are presented in Table 2.

Table 2. Chow Test Results

Effects Test	Statistics	df	Prob.
Cross-section F	50,6248	17.86 -	0.0000
Cross-section Chi-square	259,0436	17	0.0000

Source: Processed data

The probability value of Cross-section F (0.0000) and Cross-section Chi-square (0.0000) < 0.05, so H0 is rejected. These results indicate that there are significant differences in characteristics between cross-section units, so the Fixed Effect Model (FEM) is more appropriate to use than the Common Effect Model (CEM).

Hausman test

The Hausman test is used to select between FEM and REM. According to Gujarati and Porter (2021), the Hausman test is conducted to evaluate whether the difference between the Fixed Effect and Random Effect estimates is significant. If the difference is insignificant (p-value > 0.05), then the Random Effect Model (REM) is more appropriate. The test results are presented in Table 3.

Table 3. Hausman Test Results

Test Summary	Chi-Sq. Statistic	Chi-Sq. df	Prob.
Random cross-section	0.0000	4	1,0000

Source: Processed data

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The probability value is 1.0000 > 0.05, so H0 is accepted. This result indicates that the individual effects are not correlated with the independent variable, so the Random Effects Model (REM) is more appropriate than the FEM.

Lagrange Multiplier Test

The Lagrange Multiplier test is used to select between CEM and REM. According to Breusch and Pagan (1980), this test was developed to test for the presence of random effects in panel data regression models. If the probability value is <0.05, the Random Effects Model (REM) is more appropriate than the Common Effects Model (CEM). The test results are presented in Table 4.

Table 4. Lagrange Multiplier Test Results

Hypothesis Test	Statistics	Prob.
Breusch-Pagan Cross-section	214,2910	0.0000

Source: Data processed 2026

The probability value is 0.0000 < 0.05, so H0 is rejected. These results confirm that the Random Effect Model (REM) is more appropriate than the CEM. Based on the three tests the Chow Test, the Hausman Test, and the Lagrange Multiplier Test—the Random Effects Model (REM) was selected as the best estimation model for this study. This model is able to accommodate random differences in characteristics between banks without ignoring the influence of independent variables on MSME financing.

Classical Assumption Test

Multicollinearity Test

A multicollinearity test was conducted to determine whether there was a strong relationship or correlation between the independent variables in the regression model. According to Gujarati and Porter (2021), a regression model is considered free of multicollinearity if the correlation coefficient between the independent variables is below 0.85. The test results are presented in Table 5.

Table 5. Multicollinearity Test Results

	X1	X2	X3	X4
X1	1	0.4473	0.6634	-0.4093
X2	0.4472	1	0.8253	0.4417
X3	0.6634	0.8253	1	0.1838

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	X1	X2	X3	X4
X4	-0.4093	0.4417	0.1838	1

Source: Data processed 2026

All correlation coefficients between independent variables were below 0.85, indicating that the regression model did not experience multicollinearity. The highest correlation occurred between BI7DRR and FASBIS (0.8253), which is still below the critical limit. The lowest correlation was between FASBIS and inflation (0.1838). Thus, each independent variable provides different information in explaining variations in MSME financing.

Heteroscedasticity Test

A heteroscedasticity test was conducted to determine whether the residual variance in the regression model is constant. According to Gujarati and Porter (2021), a regression model is considered free of heteroscedasticity if the residuals are randomly distributed and do not form a specific pattern. The test results, using a residual graph, show that the residual values fluctuate around the zero line without forming a systematic pattern such as tapering, widening, or wavy. The residual distribution over the 108 observations is relatively stable, thus the regression model meets the homoscedasticity assumption and is suitable for further analysis.

Panel Data Regression Analysis

Panel data regression analysis was used to identify and measure the influence of independent variables on MSME financing. This method was chosen because the data characteristics consist of two dimensions: an individual dimension (*cross-section*) covering 18 Islamic banks and a time dimension (*time series*) during the period 2020–2025 (Baltagi, 2021; Gujarati & Porter, 2021). Based on the results of the Chow Test, Hausman Test, and Lagrange Multiplier Test, the Random Effect Model (REM) was selected as the best estimation model. The estimation results were analyzed through partial tests (t-test), simultaneous tests (F-test), and coefficient of determination (*Adjusted R-Square*).

t-test (Partial Test)

The t-test is used to test the significance of the regression coefficient of each independent variable individually on the dependent variable. According to Ghozali (2021), a variable is considered to have a significant effect if the probability value is <0.05. The test results are presented in Table 6.

Table 6. Partial Test Results (t-Test)

Variables	Coefficient	t-Statistic	Prob.	Information
Manufacturing PMI (X1)	0.6501	4,0188	0.0001	Significant

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Variables	Coefficient	t-Statistic	Prob.	Information
BI7DRR (X2)	-1.2413	-8,9095	0.0000	Significant
FASBIS (X3)	-0.1977	-0.8396	0.4031	Not Significant
Inflation (X4)	-0.5572	-5.5259	0.0000	Significant

Source: Processed data

Manufacturing PMI has a positive and significant effect (coefficient 0.6501; prob. 0.0001), so H1 is accepted. BI7DRR has a negative and significant effect (coefficient -1.2413; prob. 0.0000), so H2 is accepted. FASBIS has no significant effect (prob. 0.4031), so H3 is rejected. Inflation has a negative and significant effect (coefficient -0.5572; prob. 0.0000), so H4 is accepted.

F Test (Simultaneous Test)

The F-test was conducted to determine whether all independent variables simultaneously influence the dependent variable. According to Ghozali (2021), if the probability value is <0.05, then all independent variables simultaneously have a significant effect. The test results are presented in Table 7.

Table 7. F Test Results

Information	Mark
F-statistic	25,1791
Prob(F-statistic)	0.0000
Significance Level (α)	0.05
Decision	H_0 Rejected, H_a Accepted
Conclusion	Significant Influence

Source: Processed data

The probability value is 0.0000 < 0.05, indicating that all independent variables together have a significant effect on MSME financing. Although FASBIS is not partially significant, its presence, along with other variables, still contributes to explaining variations in MSME financing.

Coefficient of Determination

The coefficient of determination (Adjusted R-Square) is used to measure the extent to which an independent variable explains variation in the dependent variable. According

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to Ghozali (2021), the Adjusted R-Square value provides a more accurate estimate than the R-Square because it adjusts for the number of independent variables and observations. The test results are presented in Table 8.

Table 8. Results of the Determination Coefficient

Information	Mark
Adjusted R-Squared	0.5747

Source: Processed data

Adjusted R-Squared value of 0.5747 (57.47%) indicates that the regression model is able to explain 57.47% of the variation in MSME financing, while the remaining 42.53% is influenced by other factors outside the research model. This result is in line with the F-test which shows a simultaneous significant model, so *the Random Effect model* is suitable for explaining the influence of independent variables on MSME financing.

The Influence of Manufacturing PMI on MSME Financing

The results of the study indicate that the Manufacturing PMI has a positive and significant effect on MSME financing in Islamic banking (coefficient 0.6501; prob. 0.0001). This finding indicates that every increase in the Manufacturing PMI will be followed by an increase in MSME financing distribution, so the first hypothesis (H1) is declared accepted. These results are in line with the Islamic Banking Intermediation Theory (Ascarya, 2023), which states that the main function of Islamic banks is to collect and channel funds to the productive sector. Increased economic activity through an increase in the Manufacturing PMI increases the need for working capital, investment, and production in the real sector, thus increasing the demand for MSME financing. Ismail (2022) emphasized that Islamic financing is closely linked to the real sector, so changes in industrial activity affect the dynamics of financing distribution. Karim (2021) also explained that the success of MSME financing is influenced by macroeconomic conditions and business sector prospects.

These results are supported by empirical data showing an average PMI of 51.7167 (expansion zone) with values ranging from 50.90 to 53.50, indicating stable and growing manufacturing activity. The PMI, as a leading indicator (Joseph et al., 2011; Afshar et al., 1997), helps Islamic banks predict financing demand (Saputra, 2025). Research by Do & Dao (2024) found that the PMI influences banking performance through changes in industrial activity and credit demand, while Dewi & Kurniawan (2024) emphasized the relevance of the PMI in mapping the potential for MSME financing distribution. Thus, the Manufacturing PMI has proven to be an important indicator in supporting the growth of MSME financing in Islamic banking.

The Impact of BI7DRR on MSME Financing

The BI7DRR has a negative and significant effect on MSME financing (coefficient -1.2413; probability 0.0000), meaning that an increase in the BI7DRR reduces MSME financing, thus accepting the second hypothesis (H2). This result is supported by the Islamic Banking Intermediation Theory (Ascarya, 2023) and Karim (2021), which explains that

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although Islamic banks are not interest-based, changes in the benchmark interest rate influence people's behavior in choosing savings and financing instruments. An increase in the BI7DRR increases the cost of funds and makes banks more selective in channeling financing. Islamic monetary policy (Ascarya, 2022) emphasizes the importance of monetary stability for real sector financing, where monetary tightening through an increase in the BI7DRR reduces financing demand and increases banking prudence.

Empirical data shows an average BI7DRR of 4.9167%, with a peak of 6.00% during monetary tightening (2021-2022), which coincided with a slowdown in MSME financing growth. Research by Sari et al. (2021) found that BI7DRR significantly influenced MSME credit distribution, Husaeni (2020) explained that BI7DRR influences Islamic bank financing through changes in liquidity, and Setiawan & Kurniasih (2021) emphasized that BI7DRR plays a role in the dynamics of Islamic bank financing growth. Thus, BI7DRR is proven to be an important macroeconomic factor influencing the development of MSME financing in Islamic banking.

The Influence of FASBIS on MSME Financing

FASBIS has no significant effect on MSME financing (coefficient -0.1977; prob. 0.4031), so the third hypothesis (H3) is rejected. The Islamic Banking Intermediation Theory (Ascarya, 2023) explains that FASBIS is a *standing facility instrument* for short-term liquidity management, not a direct determinant of financing. Bank Indonesia (2023) emphasizes that FASBIS functions as a means of liquidity stabilization, not an instrument to encourage financing distribution. Funds placed in FASBIS are *idle funds* that have not been distributed, so changes in their value do not automatically affect MSME financing. Financing distribution decisions are more influenced by internal bank factors such as Third Party Funds (TPF), risk management, financing quality, and business strategy (Ascarya, 2023).

Empirical data shows an average FASBIS of 10.2133 with small variations (std. deviation 0.3766), but changes in the value are not accompanied by significant changes in MSME financing. This finding is consistent with Nikmah & Hidayati (2022) who stated that FASBIS does not significantly influence murabahah financing, both short-term and long-term, because FASBIS functions more as a liquidity management instrument. Thus, FASBIS plays a greater role in maintaining the liquidity stability of Islamic banking than in determining the amount of financing to the MSME sector.

The Impact of Inflation on MSME Financing

Inflation has a negative and significant effect on MSME financing (coefficient -0.5572; probability 0.0000), meaning that increased inflation reduces MSME financing, thus accepting the fourth hypothesis (H4). The Islamic Banking Intermediation Theory (Ascarya, 2023) states that high inflation reduces economic stability and real sector activity, thus hampering the intermediation function. Karim (2021) explains that inflation is a general price increase that reduces people's purchasing power, increases production costs, and reduces the ability of businesses to expand their activities. Handayani (2023) adds that price stability is important for the growth of Islamic financial institution financing because high inflation reduces economic activity and increases business uncertainty.

Empirical data shows an average inflation rate of 2.6933%, with a peak of 5.51% (2022) due to post-pandemic economic recovery and global supply chain disruptions, which

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have depressed business activity and demand for financing. Research by Sari *et al.* (2021) found that inflation significantly impacts MSME credit distribution, while Husaeni (2020) explained that inflation is a macroeconomic variable that impacts Islamic bank financing. Thus, inflation has been shown to be a factor inhibiting the increase in MSME financing, while controlled inflation creates conducive economic conditions for the growth of productive financing.

CONCLUSION

Based on the results of the analysis regarding the influence of the Manufacturing *Purchasing Managers' Index* (PMI), *BI-7 Day Reverse Repo Rate* (BI7DRR), Bank Indonesia Sharia Deposit Facility (FASBIS), and inflation on MSME financing in Islamic banking in Indonesia during the 2020–2025 period, the following conclusions were obtained.

1. *Purchasing Managers' Index* (PMI) has a positive and significant effect on MSME financing in Islamic banking in Indonesia. Therefore, the first hypothesis (H1) is accepted. These results indicate that increased manufacturing sector activity, reflected in the PMI increase, can drive increased financing disbursement to the MSME sector. This condition indicates that real sector expansion provides better business prospects, enabling Islamic banking to more optimally carry out its intermediary function through productive financing.
2. *The BI-7 Day Reverse Repo Rate* (BI7DRR) has a negative and significant effect on MSME financing in Islamic banking in Indonesia. Therefore, the second hypothesis (H2) is accepted. This finding indicates that an increase in the BI7DRR tends to reduce MSME financing disbursement, while a decrease in the BI7DRR can encourage increased financing. This demonstrates that monetary policy still influences Islamic banking intermediation activities even though its operational mechanism does not directly utilize interest rates.
3. The Bank Indonesia Sharia Deposit Facility (FASBIS) has no significant effect on MSME financing in Islamic banking in Indonesia. Therefore, the third hypothesis (H3) is not proven or rejected. The results of this study indicate that changes in the placement of funds in the FASBIS instrument have not been able to influence the amount of MSME financing disbursed by Islamic banking. This finding indicates that FASBIS plays a more important role as a liquidity management instrument than as a factor that directly determines the distribution of financing to the MSME sector.

Inflation has a negative and significant effect on MSME financing through Islamic banking in Indonesia. Therefore, the fourth hypothesis (H4) is accepted. These results indicate that increasing inflation tends to hinder the distribution of MSME financing by creating pressure on economic activity and the real sector. Conversely, a more controlled inflation rate can support the creation of more conducive economic conditions, thus increasing the distribution of MSME financing by Islamic banking.

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