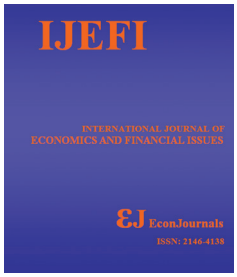

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Dynamics of Growth and Stability in the Islamic Financial Services Industry on ECA, GCC, MENA, SSA, and EAP

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ABSTRACT

The Islamic Financial Services Industry is experiencing significant growth despite the global economic challenges, such as inflation, geopolitical tensions, and rising global debt. The stability of Islamic finance is becoming increasingly crucial in ensuring the resilience of the global financial system. However, there is still a research gap in empirically evaluating the role of Islamic financial instruments such as Sukuk (Islamic Bonds), Takaful, and Islamic Fund, on the growth and stability of IFSI. Therefore, this study aims to analyse the effect of these three instruments on IFSI growth and evaluate the variation of their impact across regions. Using panel data regression method for the period 2017-2023, this study focuses on five main regions, namely Europe and Central Asia (ECA), Gulf Cooperation Council (GCC), Middle East and North Africa (MENA), Sub-Saharan Africa (SSA), and East Asia and the Pacific (EAP). The results showed that Sukuk, Takaful, and Islamic Fund contributed positively and significantly to the growth of IFSI. Sukuk (Islamic Bonds) acts as a stable source of long-term financing, Takaful enhances industry resilience through sharia-based risk mitigation, and Islamic Fund encourages sustainable investments that contribute to the expansion of Islamic financial markets. Regionally, the GCC and Southeast Asia regions show greater influence than other regions, driven by more mature regulations and more developed financial infrastructure. The findings provide important implications for regulators, investors, and financial institutions in designing policies and developing innovative Islamic finance products to enhance the sustainable growth of IFSI. In addition, this study provides a theoretical contribution by integrating the concepts of Capital Market Equilibrium Theory and Islamic Portfolio Theory in Islamic finance analysis. Thus, a deep understanding of the dynamics of Islamic financial instruments is essential in strengthening the Islamic financial ecosystem in the modern era.

Keywords: Islamic Financial Services Industry, Islamic Bonds, Takaful, Islamic Fund, Islamic Financial Stability
JEL Classifications: G15, G21, G22, G23, O16, P43

1. INTRODUCTION

The year 2023 presents challenges to the global financial landscape, characterised by sustained inflation, geopolitical tensions, rising global debt, and vulnerabilities in the commercial real estate sector. Despite these headwinds, the Islamic financial services industry (IFSI) has shown continued growth and overall resilience based on prudent financial health indicators (IFSB, 2023). Sustained financial stability largely depends on the industry's capacity to absorb economic shocks. Therefore, prudent policies and preparedness in the face of potential adverse scenarios are key factors in maintaining the stability and resilience of the Islamic financial services industry (IFSB, 2018).

According to the IFSI Stability Report 2023 published by the Islamic Financial Services Board (IFSB), total global IFSI assets reached approximately USD 3.25 trillion in 2022, up from USD 3.06 trillion in 2021 (IFSB, 2023). This growth is mainly driven by the Islamic banking sector, which accounts for 69.3% of total IFSI assets in 2022, with assets reaching USD 2.25 trillion. In

addition, Islamic capital markets, including instruments such as Sukuk, contributed 29.8% to IFSI's total assets. The Takaful sector, despite having a smaller share, shows an annual growth of 16.1% by 2022, reflecting the increasing demand for Islamic insurance products (IFSB, 2022).

Recent statistics show that Sukuk issuance reached a record high of USD 174.6 billion in 2022, with GCC countries leading the market, followed by Southeast Asia (IFSB, 2022). Similarly, the Takaful sector recorded a compound annual growth rate (CAGR) of 8.4% during 2017-2022, dominated by markets in the Middle East, South Asia, and Sub-Saharan Africa. The Islamic investment fund industry is also experiencing significant expansion, with assets under management (AUM) exceeding USD 200 billion by 2023, mainly in Malaysia, Saudi Arabia, and Indonesia (IFSB, 2023).

The IFSI Stability Report highlights two main foci. First, it analyses IFSI's resilience and growth in the context of the global macroeconomic environment in 2023. Second, an assessment of emerging issues and their potential impact on the IFSI, with an emphasis on two main aspects: crypto and digital assets, and financial risks associated with climate change. The assessment of the resilience of the Islamic financial services industry (IFSI) in 2023 should be contextualised within the broader global dynamics, characterised by complex macroeconomic challenges. Therefore, a deep understanding of this relationship is crucial for policymakers and market participants in maintaining financial stability and fostering IFSI growth amidst the changing global landscape (IFSB, 2023).

From a policy perspective, various regions have adopted regulatory measures to foster IFSI growth. Regionally, countries in the Gulf Cooperation Council (GCC) and Southeast Asia, particularly Malaysia and Indonesia, continue to lead in the development of Islamic finance. Policy initiatives and supportive regulatory frameworks in these regions have played an important role in fuelling the growth of IFSI. In addition, countries in South Asia and Sub-Saharan Africa are beginning to show increasing interest in Islamic financial services, with several countries adopting regulatory frameworks to facilitate the growth of the sector. In the East Asia and Pacific (EAP) region, countries such as Malaysia and Indonesia have implemented comprehensive Islamic governance frameworks to support the development of Islamic finance. In Europe and Central Asia (ECA), interest in Islamic finance is increasing, especially in the UK and Turkey which have introduced Sukuk-friendly regulations (IFSB, 2021).

While the Islamic finance industry remains resilient to global challenges, continued vigilance and effective risk management and supervision remain crucial. The lack of uniform regulatory standards across jurisdictions, liquidity constraints and the need for greater product diversification are some of the key obstacles that need to be addressed to ensure the stability and sustainability of the industry (IFSB, 2023). Previous studies have examined the growth of Islamic finance, but few have systematically explored the impact of key IFSI components Sukuk, Takaful, and Islamic investment funds on the stability and expansion of the industry. This study aims to fill that gap by analysing how these financial instruments contribute to the development of IFSI.

The theoretical foundation of this study is based on the Theory of Capital Market Equilibrium (Sharpe, 1964) and Islamic Portfolio Theory (Markowitz, 1952), which provide insights into risk-return dynamics and asset allocation in Islamic finance. Given the rapid evolution of the IFSI, understanding the interrelationships between its main components is crucial for policymakers, investors, and financial institutions.

This study aims to analyse the effect of Sukuk, Takaful and Islamic investment funds on IFSI growth, evaluate regional variations in the impact of financial instruments and provide policy recommendations to enhance Islamic financial stability. This study contributes both practically and theoretically by presenting empirical evidence on the development of IFSI as well as offering insights for regulators, financial institutions, and investors in strengthening the global Islamic finance ecosystem.

2. LITERATURE REVIEW

2.1. Islamic Bonds

Islamic bonds or Sukuk are sharia-based financial instruments that serve as an alternative to conventional bonds. Sukuk is defined as a certificate of ownership of income-generating assets with sharia principles, without elements of usury, gharar, and maysir (Rabbani et al., 2025). In the context of the Islamic Financial Services Industry (IFSI), Sukuk plays an important role in providing a long-term source of funding for the public and private sectors. As an instrument issued based on asset backed transactions, Sukuk provides stability and resilience to global economic turmoil.

This research refers to the Capital Market Equilibrium Theory by (Sharpe, 1964) which states that financial assets should be priced according to their systematic risk. In the perspective of Islamic finance, this principle is aligned with a fair distribution of risk in accordance with sharia. Several previous studies have discussed the impact of Sukuk on the Islamic finance industry. For example, a study by (Rahman and Kassim, 2020) found that Sukuk issuance contributed significantly to economic growth in countries with a growing Islamic finance industry. In addition, a study by (Ahmed et al., 2021) showed that Sukuk has lower volatility than conventional bonds, thus providing stability to the financial system.

2.2. Takaful (Islamic Insurance)

Takaful is a form of Islamic insurance that operates on the principle of risk sharing and collective responsibility (BenSaid, 2025). Unlike conventional insurance which is based on premiums and company profits, Takaful uses the concept of tabarru' (grant) which ensures that participants' funds are used to cover claims submitted by members who have suffered losses. As part of IFSI, Takaful plays a role in expanding Islamic financial inclusion by providing Shariah-based risk protection. Takaful has a significant role in enhancing the stability of the Islamic finance industry by reducing uncertainty and mitigating financial risks collectively.

Expected Utility Theory by (Von Neumann and Morgenstern, 1944) explains how individuals make decisions under conditions of uncertainty. In the context of Islamic finance, this theory is

applied in the operational mechanism of Takaful to ensure fairness and balance in sharing risks. A study by (Ali and Hassan, 2019) found that the Takaful industry has faster growth than conventional insurance in countries with significant Muslim populations. In addition, research by (Ismail et al., 2021) shows that supportive regulatory policies, such as those implemented in Malaysia and Saudi Arabia, have an important role in encouraging the development of the Takaful sector.

2.3. Islamic Fund

Islamic Fund is an investment fund managed in accordance with sharia principles (Wahyudi and Leny, 2024). In IFSI, Islamic funds play a crucial role in increasing the allocation of capital to productive sectors that comply with sharia principles. With the growing demand for ethical investments, Islamic funds are becoming an important instrument in attracting global investors who seek socially and religiously responsible investment alternatives.

Modern Portfolio Theory (Markowitz, 1952) is the foundation of investment fund management, which emphasises the importance of diversification to reduce risk. In the context of Islamic finance, this theory is adapted to sharia principles to ensure a balance between risk and compliance with sharia rules.

Research by (Abdullah et al., 2020) found that the performance of Islamic mutual funds has better resilience during crisis periods compared to conventional mutual funds. In addition, a study by (Mansour et al., 2021) shows that the global demand for Islamic funds has increased significantly in the last decade, especially in the GCC region and Southeast Asia.

3. RESEARCH METHODS

3.1. Statistical Analysis

Statistical analysis is a systematic process that includes collecting, organising, interpreting, and presenting quantitative data using statistical techniques to identify patterns, trends, and relationships in the data (Gao et al., 2023). In the context of this study, statistical analyses are used to evaluate the relationship between Energy Security Index, Primary Energy Consumption, and Renewable Energy Share. This research aims to provide deeper empirical insights into the interaction between economic and environmental factors in Indonesia, as well as policy implications that can be taken to achieve inclusive sustainable development.

3.2. Classical Assumptions

The classical assumption test is a series of tests conducted to ensure that the regression model used meets the basic assumptions to obtain an unbiased, consistent, and efficient estimate of the model parameters by going through tests of normality, multicollinearity, heteroscedasticity, and autocorrelation (Khan et al., 2023).

3.3. Model Selection

In panel data analysis, the three main models often used for estimation are the Common Effect Model, Fixed Effect Model, and Random Effect Model. To determine the most appropriate model, a series of tests such as the chow test, hausman test, and Breusch-pagan lagrange multiplier test are required (Gujarati, 2006).

3.4. Panel Data Regression Model

According to (Baltagi, 2005) panel data is generated from observations of a number of individuals monitored over several different time spans. One of the regression models available for panel data is a model that maintains a constant slope but has varying intercept values. In a one-way component model, variation is due to either cross-sectional or time-related units, while in a two-way model, variation is affected by both cross-sectional and time-related units. Panel data regression analysis aims to estimate and predict differences in characteristics between individuals or between times and find the mean value of the data set (both sample and population) by observing the relationship between the variable under study, the dependent variable, and the variable used to explain it, the independent variable. Then mathematically the regression model of this study is arranged as follows:

$$Y = \beta 0 + \beta 1\ X1 + \beta 2\ X2 + \beta 3\ X3 + \varepsilon \quad (1)$$

Description:
Y: Islamic Financial Services Industry
β0: Intercept
β1, β2: Regression Coefficient
X1: Sukuk
X2: Takaful
X3: Islamic Fund
ε: Error Term

3.5. Statistical Test t (Partial Test)

In research, the significance of the effect of the independent variable on the dependent variable is seen through the t statistical test (Widarjono, 2018). In its use, if t-count> t-table or significance is <(α) 5%, this indicates that there is a partially significant effect between the independent variable and the dependent variable (Gujarati, 2006).

The hypothesis in this test is:

- H_0: βi < 0 There is no significant effect between the independent variable and the dependent variable partially
- H_a: βi > 0 There is a significant influence between the independent variables on the dependent variable partially.

The test criteria are as follows:

1. If t-statistic > t-table then H_0 is rejected. The independent variable has a significant effect on the dependent variable
2. If t-statistic < t-table then H_0 is accepted. The independent variable does not have a significant effect on the dependent variable.

3.6. F Statistical Test

The F-statistic test is used to show how the independent variables interact with each other and have an impact on the dependent variable (Wooldridge, 2013). If the F-count exceeds the F-table in the test, then simultaneously the independent variables have a considerable influence on the dependent variable, or the data is consistent with the research hypothesis.

- H_0: βi < 0 There is no significant influence between the independent variables on the dependent variable together
- H_a: βi > 0 There is a significant influence between the independent variables on the dependent variable together.

The test criteria are as follows:

1. If F-statistic > F-table then H_0 is rejected. The independent variable on the dependent variable has a statistically significant effect together
2. If F-statistic < F-table then H_0 is accepted. The independent variable on the dependent variable does not have a statistically significant effect together.

3.7. F Test Coefficient of Determination (R^2)

According to Widarjono (2018), the coefficient of determination (R^2) is used to measure the proportion of the contribution of the independent variable in explaining the dependent variable. An R^2 value close to one indicates that the regression model has a good ability to explain data variability, while an R^2 value close to zero indicates limited ability. However, R^2 has the disadvantage that it tends to increase with the addition of independent variables, even though these variables do not necessarily increase the predictive power of the model. Therefore, adjusted R^2 is used which corrects for the addition of irrelevant independent variables, so that the adjusted R^2 value will not exceed R^2 and may decrease or become negative if the addition of independent variables does not improve the quality of the model or if the model shows a low level of fit.

4. RESULTS

4.1. Descriptive Statistical Analysis

Descriptive Statistical Analysis functions in descriptions that include the mean and median of a set of sorted data (Table 1). In addition, this analysis includes data distribution such as maximum value, minimum value, and standard deviation value as an indicator of data distribution in the study (Jin et al., 2023).

The analysis results show that the average value of Islamic Bonds is 22.00840, with a minimum value of 0.800000 and a maximum of 57.80000. This indicates that there is considerable variability in the issuance of Islamic Bonds, reflecting different policy strategies and market demand in different regions. Takaful has an average of 5.166857, with a minimum value of 0.010000 and a maximum of 16.70000. Islamic Fund has an average of 21.83600, with a minimum value of 0.100000 and a maximum of 62.90000. A relatively stable distribution is indicated by the median value of 22.70000, which is quite close to the mean value. Islamic Financial Services Industry (IFSI) as the dependent variable has an average of 545.1843, with a minimum value of 17.20000 and a maximum of 1847.420. The median value of 546.2000 which is almost identical to the mean indicates a relatively symmetrical distribution of the data and reflects significant differences in the level of development of the Islamic financial industry in different regions.

Table 1: Statistical analysis

Statistical classifications	X1	X2	X3	Y
Mean	22.00840	5.166857	21.83600	545.1843
Median	24.40000	4.100000	22.70000	546.2000
Maximum	57.80000	16.70000	62.90000	1847.420
Minimum	0.800000	0.010000	0.100000	17.20000

Source: Research results Year 2025

4.2. Classical Assumptions

Based on the normality test using the Skewness Kurtosis method, the probability of 0.109867 > 0.05 is obtained (Table 2). Then the skewness value of 1.227236 and the kurtosis value of 2.233970 indicate that the data follows a normal distribution pattern.

Based on the results of the multicollinearity test, it was found that there were no variables with a relationship that exceeded the correlation value of 0.8 (Table 3). Therefore, it can be concluded that there is no significant multicollinearity between the independent variables used in this study. This means that the variables do not show a strong linear relationship or lack of significant interrelationships among others, so there is no significant interdependence.

4.3. Model Selection

The Chow Test results found that the statistical Chi-square value (19.784606) > Chi-square table (9.48773) at degrees of freedom = 4.27 with a probability level of 0.0006 <0.05 means rejecting H_0 so that the Fixed Effect model should be used (Table 4).

The Hausman Test results found that the Chi-square statistic value is 19.702974 > Chi-square table 7.81473 at degrees of freedom = 3 with a significant level of 0.0002 <0.05, so H_0 is rejected (Table 5). Therefore, the Fixed Effect model is the preferred choice.

4.4. Panel Data Regression Result

The regression calculation results (Table 6) show a confidence level of 0.5% which is then transformed into a mathematical form:

Y = 21.0233980658 + 4.31252396477*X1 + 77.6640973131*X2 + 8.78073984908*X3

Table 2: Normality test

Distribution parameters	Statistic	Probability
Skewness	1.227236	0.109867
Skewness 3/5	2.148261	0.015847
Kurtosis	2.233970	0.012743
Normality	2.153749	0.340659

Source: Research results year 2025

Table 3: Multicollinearity test

Correlation coefficient variable	X1	X2	X3
X1	1.000000	0.778036	0.645613
X2	0.778036	1.000000	0.280790
X3	0.645613	0.280790	1.000000

Source: Research results year 2025

Table 4: Chow test

Test summary	Chi-square statistic	Chi-square degrees of freedom	Probability	Conclusion
Fix effect model	19,784606	4,27	0.0006	H_0 rejected

Source: research results year 2025

4.5. Statistical Test t (Partial Test)

The coefficient of Islamic Bonds (X1) of 4.312524 indicates that each 1 unit increase in the value of Islamic Bonds will increase the Islamic Financial Services Industry (Y) by 4.312524 assuming other variables remain constant. The t-statistic value is 2.299741 at the 5% significance level, and the probability value (0.0215) is smaller than 0.05. Therefore, it can be concluded that Islamic Bonds have a positive and significant effect on the Islamic Financial Services Industry partially.

The Takaful coefficient (X2) of 77.66410 indicates that each 1 unit increase in the value of Takaful will increase the Islamic Financial Services Industry (Y) by 77.66410 assuming other variables remain constant. The t-statistic value is 4.939123 at the 5% significance level, and the probability value (0.0000) is smaller than 0.05. Therefore, it can be concluded that Takaful has a positive and significant effect on the Islamic Financial Services Industry partially.

The coefficient of Islamic Fund (X3) of 8.780740 indicates that every 1 unit increase in the value of Islamic Fund will increase the Islamic Financial Services Industry (Y) by 8.780740 assuming other variables remain constant. The t-statistic value is 2.168299 at the 5% significance level, and the probability value (0.0379) is smaller than 0.05. Therefore, it can be concluded that the Islamic Fund has a positive and significant influence on the Islamic Financial Services Industry partially.

4.6. F Statistical Test

The F test is a statistical test conducted to determine how much influence the independent variables together have on the dependent variable. In the Ordinary Least Square estimation results, the probability value is 0.0000 and significant at the 5% level. So it can be concluded that Sharia Bonds (X1), Takaful (X2), and Islamic Fund (X3) together or simultaneously have a significant effect on the Islamic Financial Services Industry (Y).

Table 5: Hausman test

Test summary	Chi-square statistic	Chi-square degrees of freedom	Probability	Conclusion
Random effect model	19,702974	3	0.0002	H_0 rejected

Source: Research results year 2025

4.7. Result of the Coefficient of Determinations (R^2)

The coefficient of determination is used to measure how much variation in the dependent variable can be explained by variations in the independent variables. In this study, the coefficient of determination was carried out to determine how much the percentage of Sharia Bond (X1), Takaful (X2), and Islamic Fund (X3) variables together or simultaneously had a significant effect on the Islamic Financial Services Industry (Y). Based on the results of the analysis, the value of the coefficient of determination (R^2) is 0.756876. This means that the influence of the variation of the independent variable on the variation of the dependent variable is 75.68% while the remaining 24.32% is explained by variables outside the model.

5. DISCUSSION

5.1. Significance of Islamic Bonds in the Islamic Financial Services Industry (IFSI)

The Islamic bond market is experiencing a significant expansion that reflects the increasing confidence of global investors in Islamic financial instruments. This growth is driven by the increasing need for sharia-based funding, both in the public and private sectors (Smaoui and Khawaja, 2017). Along with the increasing role of the Islamic Financial Services Industry (IFSI) in the global financial system, Islamic bonds are becoming the main option for countries and companies that want to raise funds without violating sharia principles.

Figure 1 shows that total global Sukuk issuance is increasing gradually, from USD 125 billion in 2017 to USD 174.6 billion in 2022. This increase reflects a compound annual growth rate (CAGR) of 6.9%, suggesting that Islamic bonds are not only growing as an alternative to conventional bonds but also contributing to the stability of the Islamic finance industry. This increase in demand is driven by a variety of factors, including the economic growth of Muslim-majority countries, government policies that support Islamic finance, as well as the trend of sustainable investment gaining global attention (IFSB, 2022).

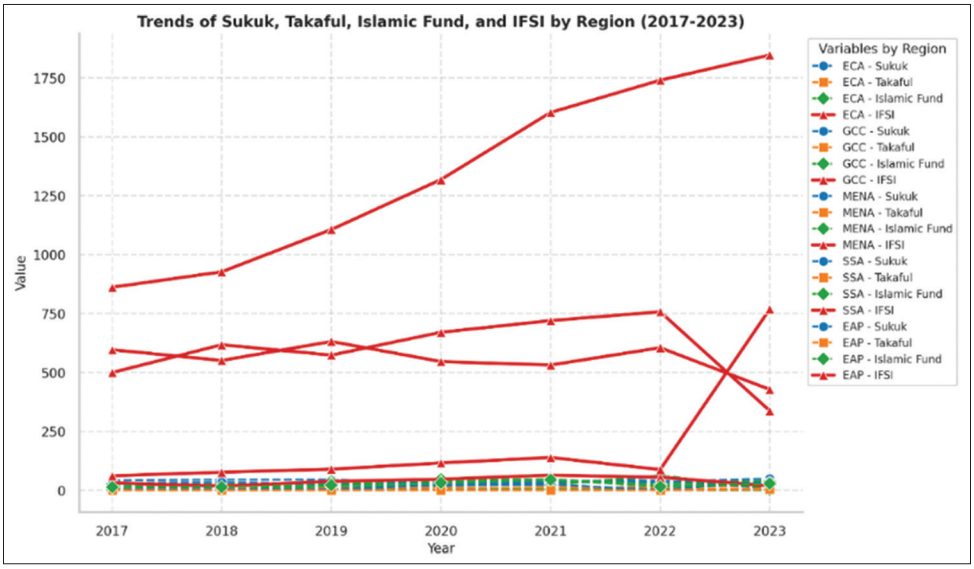
In the Gulf Cooperation Council (GCC) region, Islamic bonds have become the dominant investment instrument, accounting for around 40% of total Islamic finance assets. Saudi Arabia and the United Arab Emirates are the two countries with the highest Islamic bond issuance in the region, supported by progressive

Table 6: OLS calculation results panel data regression equation selected model FEM

Variable	Coefficient	Standard error	t-Statistic	Probability
C	21.02340	80.02094	0.262724	0.7945
X1	4.312524	1.875222	2.299741	0.0215
X2	77.66410	15.72427	4.939123	0.0000
X3	8.780740	4.049598	2.168299	0.0379
R-squared	0.756876	Mean dependent variance		545.1843
Adjusted R-squared	0.733348	Standard deviation dependent variance		504.1141
S.E. of regression	260.3164	Akaike info criterion		14.06888
Sum squared resid	2100704.	Schwarz criterion		14.24664
Log likelihood	-242.2055	Hannan-Quinn criter.		14.13024
F-statistic	32.16895	Durbin-Watson stat		1.361776
Prob (F-statistic)	0.000000			

Source: Research results year 2025

Figure 1: Trends of Sukuk, Takaful, Islamic Fund, and IFSI by Region (2017-2023)



government policies and high institutional investor demand. Southeast Asia, led by Malaysia and Indonesia, has an Islamic bond contribution of around 35% to total Islamic finance assets, with regulatory support and growing financial innovation (Nagano, 2017). Meanwhile, the Middle East and North Africa (MENA) region is experiencing more moderate growth in the Islamic bond market, with countries such as Egypt and Morocco beginning to enter this market. In Europe and Central Asia (ECA), interest in Sukuk has started to increase, particularly in Turkey and the UK which have introduced a more favourable regulatory framework for Islamic finance. As for Sub-Saharan Africa (SSA) and South Asia (SA), the development of the Islamic bond market is still in its infancy, although Nigeria and Pakistan have shown increasing adoption of Islamic bonds as a means of financing national development.

Islamic bonds play a strategic role in enhancing the resilience of the Islamic financial system as well as expanding the scope of the IFSI. As a long-term financing instrument, Islamic bonds not only provide an alternative to conventional bonds but also provide stable investment opportunities for investors who wish to avoid usury practices (Godlewski et al., 2013). In addition, Sukuk issuance allows countries and corporations to obtain funds with a more transparent and asset-based mechanism, which directly enhances the integrity of the Islamic financial system. The main advantage of Islamic bonds over conventional bonds lies in their real asset-based transaction structure, which reduces the potential for excessive speculation. This contributes to the stability of the financial system, especially in the face of global economic volatility. With the increase in Sukuk issuance, IFSI can strengthen interconnectivity among Islamic financial institutions, improve liquidity, and expand the global investor base seeking Shariah-compliant investment instruments.

Capital Market Equilibrium Theory (Sharpe, 1964) explains that the price of a financial asset is determined by the level of systematic risk inherent in the asset. In the context of Islamic finance, this theory can be adapted to explain how Islamic bonds are priced in the market based on their fundamental characteristics of being real asset-based. Unlike conventional bonds that depend on interest rates, Islamic bonds reflect the intrinsic value of the underlying project or asset, making them more stable and free from speculation-based volatility.

Islamic Portfolio Theory (Markowitz, 1952) emphasizes the importance of diversification in managing investment risk. In Islamic finance, Islamic bonds play a role as a diversification instrument that reduces risk in an Islamic investment portfolio. By investing in bonds, investors can earn stable returns without violating sharia principles, thus creating a more optimal portfolio from a risk management perspective. In the Islamic financial system, financial intermediation is carried out without the element of usury, which makes Islamic bonds one of the main instruments in channeling funds from investors to the real sector. Through Islamic bonds, capital can be allocated more efficiently to support infrastructure projects and economic development in accordance with Islamic values.

Panel data regression analysis shows that Islamic bond issuance has a positive and significant impact on IFSI growth (Smaoui and Nechi, 2017). The t-test results in this study show that the coefficient of the Islamic bond variable is positive with a significance level below 5%, which indicates that an increase in Islamic bond issuance is directly correlated with IFSI expansion. In addition, the high coefficient of determination (R^2) value indicates that the variability in IFSI growth can be substantially explained by the Islamic bond factor.

Based on the findings of this study, a number of policy implications can be applied to optimize the role of Islamic bonds in the Islamic Financial Services Industry (IFSI). First, Islamic finance authorities need to strengthen the legal framework and governance in the issuance of Islamic bonds to increase transparency and strengthen investor confidence. Second, countries with emerging Islamic financial sectors need to encourage the strengthening of secondary markets as an effort to increase the liquidity of Islamic

bonds. Third, supportive fiscal policies, including the provision of tax incentives, can be a strategic instrument in accelerating the growth and expansion of the Islamic bond market at the global level (Zin et al., 2018).

5.2. Significance of Takaful in the Islamic Financial Services Industry (IFSI)

The development of the Takaful industry shows significant growth driven by increased demand for Islamic financial products and government policy support in various countries. Based on data, the total assets of the global Takaful industry have exceeded USD 60 billion by 2023, with an average annual growth rate (CAGR) of 8.4% since 2017. The Gulf Cooperation Council (GCC) region remains a major hub for the industry, accounting for nearly 50% of the total premium contribution, while Southeast Asia, particularly Malaysia and Indonesia, is also showing rapid growth due to progressive regulation and adaptive product innovation (Al-Amri and Hossain, 2015). In the MENA (Middle East and North Africa) region, countries such as Egypt and Morocco have started adopting Takaful regulations to increase Islamic financial inclusion. In addition, the increasing penetration of Takaful in Sub-Saharan Africa (SSA) and Europe and Central Asia (ECA) regions indicates a great potential for the expansion of the industry in emerging markets.

The integration of Takaful with other Islamic financial sectors, such as Islamic banking, Islamic capital markets and Islamic investments, has also been a major factor supporting IFSI's growth. Many Islamic banks now offer Takaful products as part of their service portfolio, while Sukuk issuances are increasingly using Takaful-based structures to enhance risk protection for investors. In addition, investment funds managed by Takaful companies must adhere to strict Shariah compliance standards, ensuring that capital allocation is done in an ethical and productive manner. In this context, Takaful serves not only as a financial protection instrument, but also as a mechanism for strengthening the Islamic financial system as a whole (Kader et al., 2010).

From an economic stability perspective, Takaful plays an important role in enhancing the resilience of the Islamic financial system to external shocks. The collective participation-based model applied in the industry ensures that risks are managed in a more distributed manner, thereby reducing the potential instability that results from the concentration of risks in one particular entity. A study by (Al-Amri and Hossain, 2015) shows that Takaful institutions tend to have a higher level of solvency than conventional insurance companies to deal with global economic uncertainty. This is due to more prudent fund management principles and the use of more sustainable business models.

The regression analysis in this study shows a significant positive relationship between the growth of the Takaful industry and the development of IFSI. From the perspective of Islamic finance theory, the role of Takaful in supporting financial system stability can be explained through several approaches. Based on Expected Utility Theory (Von Neumann and Morgenstern, 1944) individuals and institutions use Takaful as a risk mitigation instrument to optimize welfare under conditions of uncertainty. Meanwhile, within the framework of Islamic Risk and Insurance Theory, the concept of risk sharing in Takaful is seen as a fairer sharia-based solution compared to the risk transfer model used in conventional insurance. Takaful's operational model based on tabarru' and mudharabah also ensures that the relationship between participants and operators remains based on the principles of transparency and fairness.

In the Islamic financial intermediation system, Takaful acts as an instrument that links the financial sector with the real sector, thus ensuring that the distribution of funds in the Islamic financial ecosystem remains focused on productive investments. With the increasing adoption of Takaful in various countries, the industry is projected to continue contributing to the expansion and stability of the Islamic Financial Services Industry (IFSI) in the long run (Khan and Bhatti, 2008). Therefore, strategic steps are needed from regulators and stakeholders to strengthen the legal and regulatory infrastructure related to Takaful, expand market accessibility through product digitalization, and encourage closer integration between Takaful and other Islamic financial sectors to create a more inclusive and sustainable financial system.

5.3. Significance of Islamic Fund in the Islamic Financial Services Industry (IFSI)

Islamic funds have evolved into financial instruments that have a significant impact on the Islamic Financial Services Industry (IFSI). With the increasing global demand for Shariah-compliant investments, Islamic funds play a role in increasing financial inclusion, broadening the investor base, and supporting the stability of the Islamic financial system (Nisar and Farooq, 2020). The Islamic Financial Services Board reports that total assets under management (AUM) in Islamic funds have increased from USD 75 billion in 2017 to USD 130 billion by 2023, with a compound annual growth rate (CAGR) of 8.2%. This growth is driven by increasing investor awareness of the importance of Shariah-compliant investments, as well as stronger regulatory support from various countries.

The distribution of Islamic funds shows that the Gulf Cooperation Council (GCC) region remains the dominant market with more than 40% of the total global Islamic fund AUM, driven by supportive government policies and high demand from institutional investors (Nagano, 2017). Southeast Asia, particularly Malaysia and Indonesia, has also seen a rapid increase with a 35% contribution to total Islamic finance assets due to innovations in Islamic finance regulations and products. Meanwhile, the Middle East and North Africa (MENA), Europe and Central Asia (ECA), and Sub-Saharan Africa (SSA) regions show more moderate growth, with countries such as Turkey, Nigeria, and Pakistan starting to increase the adoption of Islamic funds as an alternative to sharia-based investments.

Islamic funds play an important role in maintaining the stability of the Islamic financial system by providing a more stable investment alternative to conventional instruments. Unlike interest-based investments that are vulnerable to fluctuations in global interest rates, Islamic funds are based on real assets that have lower volatility and more stable returns in the long run. In

addition, Islamic Fund helps increase the liquidity of Islamic financial markets by connecting surplus funds with sectors that need Islamic financing (Indriani and Dewi, 2021). The panel data regression results in this study show that Islamic Fund has a positive and significant impact on IFSI growth, with the coefficient of determination (R^2) indicating that this variable explains most of the variability in IFSI expansion.

Islamic Fund also serves as a risk diversification instrument in Islamic investment portfolios. Based on Modern Portfolio Theory (Markowitz, 1952), portfolio diversification can reduce risk without sacrificing returns. In the context of Islamic finance, Islamic funds provide broader investment options for investors while adhering to Shariah principles. These instruments allow investors to access various halal sectors that have different levels of risk, thus creating balance in the investment portfolio.

In Islamic financial intermediation theory, Islamic funds act as intermediaries that channel funds from investors to various Islamic economic sectors, such as infrastructure, halal manufacturing, and Islamic property (Harahap and Soemitra, 2022). Islamic funds also improve the efficiency of Islamic capital markets by providing funds to companies in need of capital through Islamic equities and Sukuk. As such, Islamic funds strengthen interconnectivity within the IFSI ecosystem and promote real sector growth in accordance with Islamic economic principles.

Islamic Fund has better resilience to global economic shocks compared to conventional financial instruments. A study by (Al-Khazali et al., 2014) shows that during the economic crisis, Islamic funds tend to experience lower volatility than conventional mutual funds. This is due to the nature of Islamic funds that are based on real assets and avoid instruments based on speculation and excessive leverage. In the regression analysis, Islamic funds are shown to have a positive correlation with macroeconomic stability in the Islamic financial system.

Strengthening the Islamic Fund in IFSI requires a comprehensive policy approach to improve its competitiveness and effectiveness in supporting the Islamic financial system. Regulation and governance of Islamic Funds should be strengthened to enhance transparency, accountability and global investor confidence. Governments and Islamic finance authorities need to develop progressive policies by introducing clearer standards for Shariah-compliant investment practices. In addition, the development of a secondary market for Islamic funds is an important aspect in enhancing investment liquidity and flexibility. A robust secondary market will allow investors to exit and enter into investments more easily, thus creating healthier and more sustainable market dynamics. From a fiscal perspective, providing tax incentives and fiscal policies that support Islamic funds can increase their attractiveness among institutional and retail investors. Such incentives can be in the form of tax deductions on investment gains or subsidies for Islamic Fund managers who are committed to sustainable Islamic investments (Saptono and Khozen, 2022).

Diversification of Islamic Fund products should also be a top priority in its development strategy. Innovative products such as Islamic index funds and Shariah-based exchange-traded funds (ETFs) can broaden the investor base and increase the attractiveness of Islamic funds as competitive global investment instruments (Hassan and Mollah, 2018). In addition, integration with financial technology (Fintech) will be a key factor in increasing the accessibility of Islamic funds for retail investors. Utilizing digital technology in the management of Islamic funds can speed up the investment process, increase transparency, and open up opportunities for new investors who previously had limited access to Islamic financial instruments.

6. CONCLUSION

This study highlights the crucial role of Sukuk (Islamic bonds), Takaful, and Islamic funds in promoting the growth and stability of the Islamic Financial Services Industry (IFSI). The analysis shows that these three Islamic financial instruments have a positive and significant influence on the development of IFSI globally, with stronger variations in impact in the GCC and Southeast Asia. Sukuk (Islamic Bonds) are proven to be a stable long-term financing instrument, Takaful enhances industry resilience through Shariah-based risk mitigation mechanisms, and Islamic Funds contribute to financial inclusion and growth of Islamic principle-based investments.

From a policy perspective, the results of this study provide recommendations for regulators and stakeholders in developing more comprehensive policies to strengthen Islamic finance infrastructure. The practical implications include the need to increase transparency in the issuance of Sukuk (Islamic Bonds), strengthening regulations for the Takaful industry, and diversifying Islamic Fund products to increase the attractiveness of global investors.

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