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Research Article

The Influence of Monetary Policy on Foreign Capital Inflows: A Case Study on Sharia Banks Listed on the Indonesian Stock Exchange

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ABSTRACT

This study aims to analyze the influence of monetary policy on capital flows in Indonesian Sharia banking. Monetary policy plays a crucial role in determining investment attractiveness through exchange rates and inflation, which can influence investor decisions in allocating capital. This research uses a quantitative approach with multiple linear regression analysis to examine the effects of exchange rates and inflation on capital inflows. The data analyzed covers 36 months from January 2022 to December 2024. The results show that exchange rates have a significant partial influence on capital flows in Sharia banking, while inflation does not have a significant partial effect. These findings indicate that investors consider exchange rate stability to be the primary factor when allocating capital in the Sharia banking sector, highlighting the importance of macroeconomic stability for creating a conducive investment climate.

Keywords: Exchange Rate; Inflation; Capital Inflows; Sharia Banking; Monetary Policy

1. INTRODUCTION

The Indonesian financial system has experienced significant dynamics over the past decade, primarily influenced by the monetary policy interventions of Bank Indonesia as the national monetary authority (Hadi, 2024). These policies have affected domestic and international capital flows, particularly in controlling inflation and managing exchange rates. Effective monetary policy is essential for maintaining macroeconomic stability, as it influences the cost of borrowing, investment returns, and overall financial market confidence. Higher interest rates can attract foreign capital by offering better returns. They may also increase the cost of business financing, while lower rates can boost economic growth but risk fueling inflation. On the other hand stable exchange rates reduce uncertainty for investors, supporting long-term investment decisions and promoting financial stability (Pasaribu, 2018).

According to Capital Flow Theory, the movement of capital across borders is driven by differences in investment returns, economic stability, and country-specific risks (Zhao et al., 2020). Capital can enter a country either as direct investment in physical assets or through financial market investments (Rasyidin, Rizkina, & Saleh, 2023), depending on the investor's strategic goals. When a country is perceived to have strong economic prospects, political stability, and attractive returns, it becomes a prime destination for capital inflows. This reflects the significant expansion of the Islamic finance sector and is highlighted by the increasing presence of Sharia-compliant banks on the Indonesian Stock Exchange. This includes institutions like Bank Aladin Syariah Tbk, Bank Syariah Indonesia Tbk, Bank BTPN Syariah Tbk, and other Sharia financial entities (Atikah & Sayudin, 2024).

This rapid growth in the Sharia financial sector has been supported by a solid regulatory framework, starting with the issuance of Law No. 7 of 1992, which legalized profit-sharing financial systems in Indonesia. Sharia financial institutions, including 10 Sharia Commercial Banks (BUS), 23 Sharia Business Units (UUS), and 149 Shariah Community Finance Banks, now operate within this framework, reflecting the increasing diversity and complexity of the financial landscape (Puteh et al., 2018). As a critical component of the national financial system, Sharia banking is vital in supporting sustainable economic development by facilitating financial intermediation based on profit-sharing principles, which differ significantly from conventional interest-based models (Puteh et al., 2018).

Capital Flow Theory also highlights the importance of macroeconomic stability in attracting capital inflows. Countries with stable macroeconomic conditions, including low Inflation and predictable exchange rates, are often preferred by

investors due to lower investment risks (Githaiga & Kilong'i, 2023). High Inflation can erode purchasing power and reduce the real value of investment returns, thus decreasing investor interest. Cost-push inflation arises when the cost of production inputs, including raw materials, labor, or energy, increases sharply. This increase forces businesses to raise the prices of their goods and services to maintain profitability (Nikiforos et al., 2024). Consumers experience a decline in purchasing power. Companies also face higher operating costs, which can lower profit margins and reduce potential returns for investors.

Demand-pull inflation occurs when the demand for goods and services surpasses the available supply. This creates upward pressure on prices as businesses attempt to balance the excess demand (Adhikari et al., 2025). This can create inflationary pressures that diminish real investment returns, making the economic environment less attractive to foreign investors. The Monetarist Theory emphasizes that Inflation is primarily a result of excessive money supply growth in an economy (Halim et al., 2025). This theory suggests that when the money supply expands faster than the economy's capacity to produce goods and services, it leads to higher prices, erodes the purchasing power of money, and reduces the real returns on investments.

Changes in Inflation and exchange rates often trigger reactions in financial markets, impacting capital flows (Silaban, 2022). In the context of Sharia banking, this dynamic becomes particularly interesting given the unique characteristics of the Sharia system, which avoids interest and uncertainty. Although Sharia financial instruments are not directly linked to interest rates, fluctuations in exchange rates and Inflation can still influence investor interest in Sharia-compliant stocks traded in the capital market (Meilaniwati & Tannia, 2021). This is because exchange rate volatility can affect the profitability of cross-border investments. At the same time, inflation can erode the real returns on equity, making these instruments less attractive to domestic and international investors. In addition, macroeconomic instability can increase perceived investment risk, potentially reducing the demand for Sharia-compliant financial products (Soemitra, 2017).

Exchange rate theory emphasizes the critical role of exchange rates in determining a country's export competitiveness and attractiveness as an investment destination (Baidawi et al., 2024). The Purchasing Power Parity (PPP) theory states that exchange rates should shift to account for price level variations between countries (Noval & Nadia, 2020). This adjustment ensures that the purchasing power of goods remains relatively stable across international markets. For example, when a country has a higher inflation rate than its trading partners, its currency is likely to depreciate. This adjustment helps balance the price level differences and sustain export competitiveness.

The Interest Rate Parity (IRP) theory argues that differences in interest rates between countries determine exchange rates. These variations influence investment returns and drive capital flows (Trinanda & Sairin, 2024). Suppose one country offers higher interest rates than another. Investors may shift their capital to the higher-yield market, leading to exchange rate adjustments as demand for the higher-interest currency increases (Rizki, 2021). As a rapidly growing sector in Indonesia, Sharia banking has faced various domestic and global economic challenges. Exchange rate volatility, inflationary pressures, the COVID-19 pandemic, and economic recovery processes have all impacted investor decisions when allocating capital to Sharia banking stocks According to the Inflation Theory, high Inflation can erode purchasing power and reduce the real value of investment returns thereby reducing investor interest (Inayah, 2023).

The rising interest in ethical investment aligned with Sharia principles presents a unique opportunity for Sharia banking to attract more capital flows. Investors today consider potential financial returns and their investments' social impact and moral values (Kusumawardhani et al., 2022). The attractiveness of Sharia financial instruments still depends heavily on macroeconomic stability including inflation rates and the exchange rate of the Indonesian rupiah. Capital movements into these stocks reflect not only the internal performance of companies but also market responses to national monetary policy dynamics.

Despite the increasing research on monetary policy and capital flows, there is still a limited number of studies that specifically address how macroeconomic variables such as interest rates and inflation influence foreign investment decisions in the context of the Islamic banking sector. The existing literature focuses more on the conventional banking system and the stability of the financial system in general. According to Setiawan et al. (2024) examined the effect of interest rate hikes on commercial bank profits but did not explore how these interest rate changes affect investor behavior in the Islamic financial sector. Meanwhile, according to Astuti et al. (2025), it highlights the role of central banks in controlling inflation and maintaining financial system stability without examining the specific response of the Islamic sector to inflation dynamics and monetary policy.

From 2014 to 2024 Indonesia has undergone various phases of monetary policy to address Inflation and exchange rate pressures. These policies have presented challenges and opportunities for the financial sector including Sharia banking. As a rapidly expanding component of the national financial system Sharia banking has directly felt the impact of every monetary policy shift (Noval & Nadia, 2020). Research on this topic is crucial for linking macroeconomic dynamics with market responses to Sharia financial sector financial instruments.

Building on the background provided, this study seeks to investigate the impact of monetary policy on foreign capital flows in Sharia banks listed on the Indonesian Stock Exchange. The findings of this study are expected to enhance understanding of how monetary policy instruments such as interest rate adjustments, inflation rates, and exchange rate

movements influence foreign investors' decisions when investing in Sharia banking stocks. This research aims to offer practical insights for regulators and market participants on strategies to improve the stability and attractiveness of investments in the Sharia banking sector in Indonesia.

2. RESEARCH METHOD

This study uses a quantitative research method that combines descriptive and analytical approaches. This type of research relies on numerical data and statistical analysis to test hypotheses and explore the relationships between different variables (Mohajan, 2020). In this context, the study seeks to quantitatively evaluate the impact of macroeconomic factors, particularly inflation and exchange rates, on capital inflows into Sharia banks in Indonesia. This approach is suitable for identifying significant statistical relationships and making general conclusions based on the collected data.

The research population comprises all Sharia banks operating in Indonesia, reflecting the growing significance of the Islamic finance sector in the national economy. This population was selected based on its relevance to the study's objectives. Sharia banks play a critical role in providing financial services by Islamic principles, emphasizing risk-sharing, asset-backed transactions, and interest-free financing. These banks also serve as a vital component of the broader financial system, contributing to financial inclusion and economic stability.

Sample Selection

The sample for this study was chosen using purposive sampling, a non-probability method in which the researcher intentionally selects participants based on predefined criteria. In this study, the criteria for selecting Sharia banks are included.

The sample for this study was chosen using purposive sampling, a non-probability method in which the researcher intentionally selects participants based on predefined criteria. According to Iskandar et al. (2023), purposive sampling is a technique in which the researcher deliberately chooses participants who meet certain characteristics or criteria relevant to the research objectives. In this study the criteria for selecting Sharia banks included:

1. Transparency of Information

The selected banks must provide comprehensive and transparent financial disclosures, including quarterly and annual reports, to ensure the accuracy and reliability of the data used in the analysis.

2. Consistence in Financial Reporting

The banks must have consistently published financial statements over the 36 months from January 2022 to December 2024. This criterion ensures that the data reflects long-term trends and are not influenced by temporary fluctuations or accounting irregularities.

3. Responsiveness to Monetary Policy Changes

The banks must demonstrate sensitivity to changes in monetary policy reflecting their integration into the broader financial system and their exposure to macroeconomic factors such as inflation and exchange rates.

This study was conducted using data from Sharia banks listed on the Indonesia Stock Exchange (IDX). The research covers the period from January 2022 to December 2024 reflecting both short-term and medium-term economic conditions.

Data Collection

The data used in this study consists of secondary data gathered from a range of reliable sources. According to Sulung & Muspawi (2024), secondary data refers to data that have been previously collected and published by other parties, such as institutions, agencies, or previous researchers, and are reused for different research objectives. This type of data is considered efficient for large-scale analysis, especially when data collection is constrained by time or access.

The data used in this study consists of secondary data gathered from a range of reliable sources.

1. Financial Statements and Annual Reports

These detailed financial disclosures from Sharia banks provide insights into their financial performance, capital structure, and overall financial health.

2. Stock Market Data

Information on the stock performance of Sharia banks, including share price movements, market capitalization, and trading volumes, obtained from the Indonesia Stock Exchange (IDX) and financial data providers.

3. Economic Indicators

Key macroeconomic variables, such as inflation and exchange rates, are sourced from Bank Indonesia (BI) and official statistical agencies. These indicators are critical for assessing the broader economic context in which Sharia banks operate.

Primary data were not used in this study as the research design focuses on observable macroeconomic indicators and publicly available financial disclosures. As noted by Sulung & Muspawi (2024), primary data typically involve first-hand information collected directly by researchers through methods such as interviews, surveys, or observations.

The use of secondary data is advantageous in this context as it allows for the analysis of a larger and more comprehensive dataset, reduces the potential for bias, and increases the reliability of the findings. Thorough data validation was conducted to ensure accuracy and consistency across various sources.

Data analysis

This study employs multiple linear regression for data analysis, a statistical method to explore the relationship between two or more independent variables and a single dependent variable (Alita et al., 2021). The independent variables include inflation rates and exchange rates while the dependent variable is capital inflow measured through the stock price movements of Sharia banks. Multiple linear regression is well-suited for this type of analysis as it enables the simultaneous evaluation of multiple factors offering a more comprehensive view of the factors influencing capital inflow (Igan & Tan, 2017). This method captures the collective impact of various macroeconomic variables on capital inflows which is essential for identifying the relative importance of each factor in shaping investment decisions.

Before performing the regression analysis, a series of classical assumption tests were conducted to ensure the validity and reliability of the model. These included the normality test, which evaluates whether the residuals follow a normal distribution, the heteroscedasticity test, which checks for consistent variance in the residuals across different levels of the independent variables, and the multicollinearity test, which assesses the degree of correlation between independent variables. High levels of multicollinearity can cause issues in regression analysis by increasing the standard errors of the coefficients, reducing the precision of the estimates, and making it difficult to isolate the individual effects of each variable.

Data processing and statistical analysis for this study were carried out using SPSS statistical software, which provides a comprehensive suite of statistical techniques, including regression analysis, hypothesis testing, and diagnostic tests, making it a suitable choice for this study (Fitria & Sudarmadi, 2019). The software's advanced features, including its ability to handle large datasets and perform complex statistical calculations, ensured the accuracy and reliability of the results. This approach provides robust insights into the relative impact of inflation and exchange rates on capital inflows, supporting the study's objective of identifying key macroeconomic factors influencing investment behavior in the Sharia banking sector.

3. RESULTS AND DISCUSSION

3.1 Classical Assumption Tests

3.1.1 Normality Test

The One-Sample Kolmogorov-Smirnov (KS) test assesses whether the residuals from the regression model follow a normal distribution. This test measures the extent to which the distribution of residuals, which are the differences between predicted and actual values, deviates from the expected normal distribution. In this study, the analysis focuses on the unstandardized residuals generated from the multiple linear regression model. The results of this normality test serve as the basis for determining whether the model meets the classical regression assumptions, ensuring the validity and accuracy of the regression analysis.

Table 1. Normality Test Results

One-Sample Kolmogorov-Smirnov Test			
			Unstandardized Residual
N			35
Normal Parameters[a,b]	Mean		.0000000
	Std. Deviation		11551.84847490
Most Extreme Differences	Absolute		.126
	Positive		.126
	Negative		-.043
Test Statistic			.126
Asymp. Sig. (2-tailed)[c]			.171
Monte Carlo Sig. (2-tailed)[d]	Sig.		.165
	99% Confidence Interval	Lower Bound	.155
		Upper Bound	.174

The normality test results using the One-Sample Kolmogorov-Smirnov (KS) Test on the unstandardized residuals show that the Asymp. Sig. (2-tailed) value is 0.171, which is above the significance level of 0.05. This indicates that the residuals are normally distributed, meeting the normality assumption necessary for multiple linear regression analysis.

3.1.2 Heteroscedasticity Test

The heteroscedasticity test is conducted to assess whether the variance of the residuals remains consistent across all levels of the independent variables in the regression model. If the residuals exhibit non-constant variance, a condition known as heteroscedasticity, it can undermine the reliability of the regression results, leading to inefficient estimates and potentially biased statistical inferences. Identifying and addressing heteroscedasticity is essential to ensure the accuracy and validity of the regression model.

Table 2. Heteroscedasticity Test Results

Coefficients[a]					
	Unstandardized Coefficients		Standardized Coefficients		
Model	B	Std. Error	Beta	t	Sig.
1(Constant)	18315.534	31953.306		.573	.571
Inflation	-539.478	901.050	-.108	-.599	.554
Exchange Rate	-.470	2.036	-.042	-.231	.819

a. Dependent Variable: Abs_RES

The test results show that the value for the Inflation variable is 0.554, while the Exchange Rate variable has a significant value of 0.819. Both values exceed the 0.05 threshold, indicating that the regression model does not exhibit heteroscedasticity. This suggests the model meets one of the key classical assumptions required for valid multiple linear regression analysis.

3.1.3 Multicollinearity Test

The multicollinearity test evaluates the extent of correlation among the independent variables in a regression model. High multicollinearity can create instability in the regression coefficients, potentially resulting in inaccurate or misleading interpretations of the model's findings. This test typically examines the Tolerance and Variance Inflation Factor (VIF) values. A tolerance value greater than 0.10 and a VIF value less than 10 indicate the model is free from multicollinearity, suggesting that the independent variables are not excessively correlated.

Table 3. Multicollinearity Test Results

Coefficients[a]							
	Unstandardized Coefficients		Standardized Coefficients	t	Sig.	Collinearity Statistics	
Model	B	Std. Error	Beta			Tolerance	VIF
1(Constant)	163913.335	55595.817		2.948	.006		
Inflation	-1763.709	1567.744	-.182	-1.125	.269	.947	1.056
Exchange Rate	-10.204	3.542	-.465	-2.881	.007	.947	1.056

Based on the tolerance values for both independent variables, 0.947 and the VIF values 1.056, which are within the normal tolerance range, It can be concluded that the independent variables in this regression model do not exhibit multicollinearity.

3.2 Multiple Linear Regression Analysis

Multiple linear regression analysis evaluates the simultaneous and partial effects of independent variables, such as capital inflow and inflation, on the dependent variable, which in this case is the exchange rate.

Table 4. Multiple Linear Regression Analysis Results

Coefficients[a]					
		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
Model		B	Std. Error	Beta		
1	(Constant)	163913.335	55595.817		2.948	.006
	Inflation	-1763.709	1567.744	-.182	-1.125	.269
	Exchange Rate	-10.204	3.542	-.465	-2.881	.007

Regression Coefficient Interpretation:

1. The constant (intercept) value of 163,913.335 indicates that if both the inflation and exchange rate variables are assumed to be zero, the capital inflow will be at 163,913.335 units. This represents the baseline estimate of capital inflow without any influence from inflation and exchange rates.
2. The regression coefficient for the inflation variable is -1,763.709, meaning that for every 1% increase in inflation, the capital inflow decreases by 1,763.709 units, assuming the exchange rate remains constant. The negative direction of this coefficient reflects the tendency for higher inflation to reduce foreign investment attractiveness, as it indicates economic instability.
3. The regression coefficient for the exchange rate variable is -10.204, indicating that for every one-point increase in the exchange rate, the capital inflow decreases by 10.204 units, assuming inflation remains constant. This suggests that currency depreciation can make foreign investors more cautious in investing their capital, due to the increased exchange rate risk affecting their returns.

3.3 Hypothesis test

3.3.1 t-Test

The t-test assesses the individual impact of each independent variable's impact on the dependent variable in the analysis.

Table 5. t-Test Results

Coefficients[a]						
		Unstandardized Coefficients		Standardized Coefficients		
Model		B	Std. Error	Beta	t	Sig.
1	(Constant)	163913.335	55595.817		2.948	.006
	Inflation	-1763.709	1567.744	-.182	-1.125	.269
	Exchange Rate	-10.204	3.542	-.465	-2.881	.007

a. Dependent Variable: Capital flows

The coefficient output shows that the significance value for the inflation variable is 0.269 which is above the 0.05 threshold. This indicates that inflation does not have a statistically significant partial effect on capital inflow. The exchange rate variable has a significant value of 0.007 below 0.05, indicating a significant partial effect on capital inflow. This result suggests that exchange rates have a more direct and immediate impact on investment flows.

3.3.2 F-Test

The F-test is used to assess whether the independent variables, when considered together, have a significant overall impact on the dependent variable in the regression model.

Table 6. F-Test Results

ANOVA[a]						
Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	1208933611.833	2	604466805.917	4.263	.023[b]
	Residual	4537136908.357	32	141785528.386		
	Total	5746070520.190	34			

The ANOVA table reveals that the F-test significance value is 0.023, lower than the 0.05 threshold. When considered together, this indicates that the inflation and exchange rate variables have a statistically significant simultaneous effect on capital inflow. This finding suggests that the combined influence of these two macroeconomic factors plays a critical role in determining capital movements within the Sharia banking sector.

3.3.3 Coefficient of Determination (R^2) Test

The Coefficient of Determination (R^2) test measures how much of the variation in the dependent variable can be explained by the independent variables included in the regression model. This statistic provides insight into the overall explanatory power of the model, indicating the extent to which the independent variables collectively influence the dependent variable.

Table 7. Coefficient of Determination (R^2) Test Results

Model Summary				
Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.459[a]	.210	.161	11,907.37286

The Model Summary output reports an R Square value of 0.210, which means that the inflation and exchange rate variables can collectively explain 21% of the variation in capital inflow.

DISCUSSION

The Relationship of Inflation to Capital Inflows

This indicates that inflation does not have a statistically significant partial effect on capital inflow in Sharia banking. This lack of significance suggests that other factors, such as exchange rate stability, interest rates, or overall market conditions, may be more influential in shaping investor decisions in this context. This lack of significance may be due to other more dominant factors influencing investor decisions, including exchange rate stability, global market conditions, risk sentiment, fiscal policy, and benchmark interest rates, which were not included in this research model. Investors may prioritize these macroeconomic variables when determining their capital allocation, especially in the context of short-term investments in Sharia capital markets.

From an economic perspective, high inflation can reduce investor interest in capital investment, as it signals price instability and weakens purchasing power (Rizki, 2021). When inflation rises, the overall cost of goods and services increases, reducing the purchasing power of consumers and businesses. This can disrupt business performance, squeeze profit margins, and reduce investor interest in equity-based or bond assets. The real value of investment returns can also be eroded when inflation rates exceed the rate of returns, pushing investors to seek investment instruments that offer better protection against inflation (Inayah, 2023).

Additionally, inflation is often associated with increased market volatility and economic uncertainty. When the prices of goods and services fluctuate sharply, it becomes difficult for investors to predict the future value of their assets. This uncertainty can worsen risk sentiment, making investors more cautious when allocating capital. In such scenarios, many investors may prefer safer assets that provide more stable returns, such as precious metals or other tangible assets, which can preserve their investment value against inflationary pressures.

High inflation can also impact monetary policy. Central banks typically respond to rising inflation by increasing interest rates to control price pressures. However, this approach can raise borrowing costs, potentially slowing economic growth and reducing investment incentives. This challenge can be even more complex in Sharia banking, which avoids interest-based financial instruments, as there is no mechanism to adjust returns in line with inflation through interest rates.

This indicates that inflation does not have a statistically significant partial effect on capital inflow in Sharia banking. This lack of significance suggests that other factors, such as exchange rate stability, interest rates, or overall market conditions, may be more influential in shaping investor decisions in this context. The insignificance of inflation may be due to the presence of more dominant factors influencing investor behavior, including exchange rate stability, global market sentiment, fiscal policy, and benchmark interest rates which were not incorporated into this research model. Investors may prioritize these macroeconomic indicators when determining capital allocation, particularly in the context of short-term investments in Sharia capital markets.

From an economic standpoint, high inflation can reduce investor interest in capital investment, as it indicates price instability and weakens purchasing power (Rizki, 2021). When inflation rises, the general cost of goods and services increases, reducing the purchasing power of both consumers and businesses. This may disrupt business performance, compress profit margins, and lessen investor interest in equity-based or bond assets. The real value of investment returns can also diminish when inflation rates outpace returns prompting investors to seek instruments that offer greater protection against inflation (Inayah, 2023).

Inflation is often associated with increased market volatility and economic uncertainty. As the prices of goods and services fluctuate unpredictably it becomes difficult for investors to estimate the future value of their investments. This heightened uncertainty worsens risk sentiment, making investors more cautious in allocating capital. Investors tend to favor safe-haven assets that deliver more predictable returns such as gold or other tangible commodities which help preserve investment value against inflationary pressures.

High inflation also influences monetary policy decisions. Central banks typically respond to surging inflation by raising interest rates to contain price levels. This can raise borrowing costs, potentially slowing economic growth and reducing investment appetite. In the context of Sharia banking the challenge becomes more complex due to the prohibition of interest-based financial mechanisms. Without conventional interest tools to offset inflation, Islamic financial institutions may face limitations in adjusting their returns to remain attractive under inflationary conditions.

Relationship of Inflation to Capital InflowsThe findings of this study are in line with Jannah & Retnowati (2020), who found that inflation has a positive and significant effect on foreign direct investment (FDI) in Indonesia. This suggests that in certain contexts moderate inflation may reflect economic growth potential thus attracting capital inflows.

The results of this study differ from those of Hidayat et al. (2023), who demonstsrated that inflation has a significant influence on investment decision-making particularly when combined with factors like financial distress and currency exchange volatility. Their findings suggest that inflation can be a key driver in shaping investor preferences and can significantly affect firm valuation through its impact on investment flows. The divergence in findings may be due to

differences in research scope, sectoral focus, or the inclusion of moderating variables such as financial health which were not considered in the present study.

The Relationship Between Exchange Rate to Capital Inflow

This study finds that the exchange rate has a statistically significant partial effect on capital inflow in Sharia banking. This result indicates that exchange rate movements are a key determinant in explaining the pattern of foreign capital entering the domestic Sharia financial market. Investors engaged in portfolio investment are often sensitive to currency fluctuations, as these directly impact the final returns after repatriation.

From an economic perspective the attractiveness of a stable or appreciating currency lies in its ability to preserve and potentially increase the value of foreign investment returns. A strong and stable local currency provides a favorable conversion margin when profits are brought back to the investor's home country which is especially relevant for short-term investors seeking predictable gains (Kusumawardhani et al., 2022). If an investor allocates funds to a country with an appreciating currency, they not only earn from asset performance but also benefit from currency appreciation (Mourine & Septina, 2023).

A volatile or depreciating currency introduces considerable risk. Exchange rate depreciation reduces the real value of returns when converted, potentially leading to capital losses. This risk is amplified in emerging markets where political instability or macroeconomic shocks can trigger rapid currency fluctuations. Such volatility creates uncertainty and may deter foreign investment, particularly when reliable risk-hedging instruments are limited.

Exchange rate dynamics also impact on broader economic competitiveness. A stronger currency tends to reduce export competitiveness by making goods more expensive on the international market, potentially slowing economic growth. A weaker currency improves export competitiveness but can drive imported inflation, raise operational costs and erode profit margins across sectors.

For Sharia banking institutions exchange rate stability is especially critical. Due to their emphasis on long-term, asset-backed contracts and avoidance of interest-based financial instruments, Islamic banks have fewer tools to hedge against currency risk. Unlike conventional banks that utilize derivatives and forward contracts, Sharia banks rely on real economic transactions that are more exposed to fluctuations. This makes them more vulnerable to volatility and highlights the importance of macroeconomic stability in attracting capital into Islamic financial markets.

The results of this study are consistent with Sinurat et al. (2025), who found that the exchange rate had a positive and significant effect on foreign direct investment (FDI) in Indonesia from 2015 to 2024. This finding underscores the role of currency stability as a key attractor of foreign capital. This finding differs from Putri et al. (2021), who found that the exchange rate had a negative and significant effect on FDI. The depreciation of the rupiah created uncertainty and reduced the value of foreign capital, discouraging long-term investment. The difference in results may arise from differing time periods, data types (FDI vs. portfolio), or sectoral focus, indicating that exchange rate sensitivity may vary across investment types and institutional frameworks.

4. CONCLUSION

The findings of this study indicate that monetary policy represented by inflation and exchange rate influences capital inflow in Sharia banking. Not all effects are statistically significant on a partial basis. Inflation does not significantly impact capital inflow which may suggest that investors in the Sharia capital marketplace greater emphasis on exchange rate stability as the primary consideration. The exchange rate has a significant negative impact, meaning that a weakening exchange rate tends to reduce investment interest. Simultaneously inflation and the exchange rate significantly affect capital inflow.

Sharia banks should strengthen their risk management strategies by improving corporate governance and financial transparency as well as developing competitive Sharia-compliant products to enhance investment attractiveness. The government and monetary authorities must maintain macroeconomic stability to create a favorable investment climate.

RECOMMENDATIONS

Based on the research findings it is recommended that monetary authorities such as Bank Indonesia maintain exchange rate stability through consistent macroeconomic policies as exchange rate fluctuations significantly affect capital inflows into Sharia banking. Sharia financial institutions should enhance their risk management capabilities and improve financial transparency, while also offering competitive, Sharia-compliant investment products to attract more foreign investors. The government is advised to ensure overall macroeconomic stability by maintaining inflation within manageable levels and aligning fiscal and monetary policy objectives. For future researchers it is suggested to expand the model by including other macroeconomic variables such as interest rates, political risk, or global capital market indicators,

and to conduct comparative studies between Sharia and conventional banking sectors for a more comprehensive understanding of investor behavior.

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