

## THE FUTURE OF INDONESIA ISLAMIC BANKS: SENTIMENT CYCLES, FUNDAMENTALS, AND MARKET MATURATION

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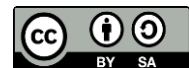
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### Abstract

Islamic banking in Indonesia has expanded rapidly in recent years, yet its market share remains modest at about 8% of national banking assets. Investor sentiment – the general mood or attitude of investors not fully justified by fundamentals may significantly influence this sector's growth and stock performance. This study examines investor sentiment toward Islamic banking by focusing on Indonesia's Islamic stock indices and the largest Islamic bank, Bank Syariah Indonesia (BSI). We utilize a mixed-method approach combining stock market data analysis with an Autoregressive Distributed Lag (ARDL) regression model to capture both short- and long-run effects. Daily price data from late 2022 to 2025 for BSI (stock code BRIS) and Islamic indices (Indonesia Sharia Stock Index – ISSI, and Jakarta Islamic Index – JII) are analyzed alongside a sentiment proxy (the Consumer Confidence Index) to assess sentiment impacts on returns and volatility. The results reveal that investor sentiment has a significant positive influence on Islamic bank stock performance and contributes to heightened volatility. BSI's stock, in particular, shows strong sentiment-driven fluctuations, aligning with evidence that Islamic equities are not immune to speculative behavior. These findings highlight the importance of investor psychology in Islamic finance and suggest that even in a Sharia-compliant context, market sentiment can drive pricing dynamics. Strengthening investor education and transparency in Islamic banking is recommended to ensure market stability.

**Keywords:** Islamic banking; investor sentiment; Sharia stock index; behavioral finance; Indonesia



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## INTRODUCTION

Islamic finance in Indonesia has grown substantially over the past decade, reflected in the increasing number of Sharia-compliant stocks and the establishment of a megabank, Bank Syariah Indonesia (BSI), through the merger of three state-owned Islamic banks in 2021 (Cibafi, 2025). As of 2023, however, Sharia-compliant assets still account for just over 8% of Indonesia's total banking sector – a stark contrast to the dominance of Islamic finance in neighboring Malaysia (Cibafi, 2025). The Indonesian government and regulators have aimed to boost this share by encouraging consolidation and innovation in the Islamic banking sector (Cibafi, 2025). BSI, now the country's largest Islamic lender, reported a 33% jump in net profit in the past year, underlining strong public interest and confidence in Islamic banking (Cibafi, 2025). This context raises an important question: to what extent is the performance of Indonesia's Islamic banking sector driven by fundamental value, and how much by investor sentiment?

Investor sentiment is broadly defined as a belief about future cash flows and investment risks that is not justified by the facts at hand (Baker and Wurgler, 2007). In conventional markets, high sentiment can lead to overvaluation and volatility as optimistic investors collectively bid up asset prices beyond intrinsic value (Baker & Wurgler, 2007). In Islamic finance, excessive speculation is discouraged on ethical grounds – the Sharia principle of avoiding *gharar* (uncertainty) and *tadlis* (deception) implies that investment should be based on real economic value rather than rumors or irrational exuberance (Amalia *et al.*, 2022). Ideally, Islamic investors would be more restrained and fundamentally driven. The reality, however, may differ. Prior studies suggest that Islamic market participants are still subject to the same behavioral biases as others. For example, a cross-country analysis by Li *et al.* (2021) found that Islamic bank stocks are even more sensitive to investor sentiment fluctuations than conventional bank stocks in various countries. Likewise, Danila *et al.* (2021) observed that market sentiment significantly affected Islamic stock index returns in Indonesia and Malaysia, implying that Muslim investors' trading behavior "is the same as in the conventional market" and does not fully adhere to rational or faith-based ideals.

A growing body of empirical research confirms that investor sentiment impacts Islamic capital markets. Amalia and Saputri (2022) showed that sentiment influenced the Jakarta Islamic Index (JII) but not the broader ISSI, suggesting that larger, blue-chip Sharia stocks are more sentiment-driven than the overall Islamic market. This difference was attributed to the distinct constituents and selection criteria of those indices. Another notable phenomenon is the so-called *Ramadan effect*: stock returns in Muslim-majority markets tend to be higher during the holy month, which has been linked to improved investor mood and optimism. Cheema and Fianto (2024) provide evidence that these anomalously high returns during Ramadan can be explained by heightened investor sentiment rather than fundamentals. During crises such as the COVID-19 pandemic, sentiment also plays a critical role. Firdaus *et al.* (2023) found that in Indonesia, investor sentiment (measured by the Consumer Confidence Index) significantly influenced the volatility of Islamic stock returns (proxied by the ISSI), even as the pandemic introduced additional shocks.

These studies reveal a paradox: although Islamic finance promotes ethical and rational investment principles, in practice Islamic banks and stocks can be swayed by waves of investor optimism or pessimism just like their conventional counterparts. For instance, herding behavior has been detected in Indonesia's Sharia stock market during periods of extreme sentiment; Pranata *et al.* (2025) show that positive sentiment drives collective buying sprees, whereas negative sentiment accelerates sell-offs. A vivid recent example occurred in May 2023, when a major service disruption at BSI led to a surge of negative public sentiment on social media – 525 negative tweets vs. only 141 positive – undermining the bank's reputation and coinciding with a drop in its stock price. This incident illustrates how quickly sentiment can sour and affect investor behavior, even for a fundamentally strong Islamic bank.

Against this backdrop, our study investigates investor sentiment toward Islamic banking in Indonesia, focusing on the interplay between sentiment and stock performance in this sector. We address the following key questions: (1) How has investor sentiment influenced the stock price of Bank Syariah Indonesia (BSI) and Islamic stock indices (ISSI and JII) in recent years? (2) Do Islamic banking stocks exhibit distinct sentiment dynamics compared to the broader market? (3) What are the implications for regulators and investors in managing sentiment-driven volatility?

This research contributes to the literature on behavioral finance in Islamic markets by providing an updated, in-depth analysis in the Indonesian context – the world’s largest Muslim population and a rapidly evolving Islamic finance market. By integrating sentiment measures into financial modeling, we aim to shed light on whether investors in Islamic banking behave more “rationally” or are equally prone to exuberance and fear. The findings will help fill the gap between Islamic financial theory and market reality, offering insights for policy-makers seeking to foster a stable yet vibrant Islamic capital market. The remainder of this paper is organized as follows: the next section outlines our research method, including data and empirical approach. This is followed by the results and discussion of key findings. The paper concludes with a summary of implications, acknowledgments, and references to prior studies that informed our work.

## RESEARCH METHOD

We collected daily stock price and index data covering the period from late December 2022 through early November 2025 for the following variables: (a) the share price of Bank Syariah Indonesia (BRIS) – Indonesia’s largest Islamic bank and a proxy for the Islamic banking sector’s performance; (b) the Indonesia Sharia Stock Index (ISSI) – a broad index comprising all Sharia-compliant stocks listed on the Indonesia Stock Exchange; and (c) the Jakarta Islamic Index (JII) – a benchmark index of 30 leading Sharia stocks. These data were obtained from the Indonesia Stock Exchange database and cross-verified with secondary sources to ensure accuracy (e.g., Yahoo Finance historical data for consistency). Each dataset includes the daily opening, high, low, and closing prices. For analysis, we focused on daily closing prices and computed daily log returns to analyze performance and volatility.

To quantify investor sentiment, we adopted a proxy that reflects the prevailing mood of investors in Indonesia. In line with prior research during the pandemic period, we use the Consumer Confidence Index (CCI) published monthly by Bank Indonesia as an investor sentiment indicator. The CCI gauges household optimism on economic conditions and has been used as a reasonable proxy for investor sentiment in emerging markets (Qiu & Welch, 2006). Although primarily a consumer survey, the CCI correlates with retail investor behavior in Indonesia’s markets. We obtained monthly CCI data for the corresponding period (2022–2025) from Bank Indonesia reports and interpolated it to match the frequency of financial data (e.g., aligning each trading day with the latest monthly sentiment value). This approach follows Firdaus et al. (2023), who measured investor sentiment by the CCI and found it impactful on Islamic stock volatility. As a robustness check, we also considered an alternative sentiment measure: the Google Search Volume Index (GSVI) for keywords related to Islamic investment (such as “saham syariah” or “Bank Syariah Indonesia”). Google Trends data (weekly frequency) were collected and found to be broadly consistent with CCI movements – spikes in search interest often coincided with periods of market excitement or concern, providing confidence in our sentiment proxy.

### *Research Design*

Our analysis combines descriptive statistics, visual trend examination, and econometric modeling to explore the relationship between sentiment and Islamic banking stock

performance. First, we plotted the time-series of BSI stock prices against ISSI and JII indices to visualize their trajectories and volatility. We also marked notable events (such as the May 2023 BSI outage) to qualitatively assess their impact on prices

*Table 1. Descriptive statistics of daily returns (Dec 2022 – Nov 2025).*

Variable	Mean Daily Return (%)	Std. Deviation of Return (%)
<b>BSI stock (BRIS)</b>	0.153	2.689
<b>ISSI (Shariah index)</b>	0.049	0.963
<b>JII (30 Islamic stocks)</b>	0.001	1.158

Next, we computed summary statistics of daily returns for BSI, ISSI, and JII, which are presented in **Table 1**. Key metrics include the mean daily return and the standard deviation (volatility) of returns for each series. This provides insight into the risk-return profile of the Islamic market and BSI in particular. We expected BSI's stock to exhibit greater volatility if investor sentiment plays a large role, since **individual stocks (especially a flagship Islamic bank) are often more sentiment-driven than diversified indice**

### *Research Target/Subject*

This study adopts a quantitative design that blends a classic event-study framework with time-series analysis to isolate and interpret investor sentiment toward Islamic banking in Indonesia. The unit of analysis is a set of daily financial time series, namely the closing prices and derived returns of a flagship Islamic bank equity and two Islamic market indices. The population comprises all Sharia-compliant equities listed on the Indonesia Stock Exchange (IDX) together with the main Islamic stock benchmarks. From this population we purposively select three objects that capture complementary layers of the Islamic capital market: (i) Bank Syariah Indonesia (ticker: BRIS) as the sector's bellwether and the clearest conduit through which shifts in sentiment toward Islamic banking are priced; (ii) the Indonesia Sharia Stock Index (ISSI) as a broad-based proxy spanning the full investable Sharia universe; and (iii) the Jakarta Islamic Index (JII) as a liquid, large-cap subset where sentiment typically materializes first through rapid order flow and price adjustments. As a robustness market factor, the conventional composite (IHSG/JKSE) is considered to separate Islamic-specific sentiment from economy-wide comovement. The time horizon is defined by the contiguous daily observations available in the user-provided dataset—approximately late-2022 through 2025—an interval that intentionally covers both optimism-laden rallies and risk-off episodes, ensuring that the empirical design can capture sentiment cycles rather than a single market regime. Purposive sampling is justified on theoretical and empirical grounds: BRIS concentrates investor attention to Islamic banking fundamentals and narratives; ISSI and JII allow a broad-vs-blue-chip contrast in the transmission of sentiment; and IHSG, when used, provides an external anchor for market-wide shocks so that Islamic-specific effects are not confounded.

### *Research Procedure*

The research proceeds in a sequence designed to maximize comparability across assets and to keep identification assumptions transparent. First, daily closing prices for BRIS, ISSI, and JII (with IHSG for robustness) are assembled into a unified trading-day calendar so that all series share identical timestamps; holidays and missing observations are reconciled, and numeric formats are standardized. From these aligned closes we compute both simple and logarithmic daily returns and construct base-100 normalized price indices to support visual diagnostics. Second, we define event dates  $t_0$  through a dual route. When specific, well-

documented news episodes exist (e.g., outages, regulatory milestones, or announcements likely to shift mood toward Islamic banking), those dates are marked *ex ante*. In parallel, and to guard against selection bias, we complement them with data-driven shocks identified as the largest absolute daily BRIS returns, subject to a minimum spacing across events to avoid overlap in windows. Third, we implement the event-study design by estimating a market model for BRIS on a pre-event estimation window ( $t = -150 \dots -21$ ) using ISSI returns as the primary market factor (with JII and IHSG serving as alternative factors in robustness checks); this yields fitted “normal” returns and residual variance. Fourth, we compute abnormal returns around each event and cumulate them over multiple windows  $[-3, +3]$ ,  $[-15, +15]$ ,  $[-45, +45]$ , thereby capturing immediate, short-run, and medium-run sentiment responses. Fifth, we complement the core event analysis with descriptive statistics, pairwise comovement diagnostics, and—where periodic covariates are available—extensions that connect sentiment proxies to risk dynamics and longer-horizon adjustments. Throughout, we document every preprocessing choice (date alignment, outlier handling, event selection criteria) and rerun the design under alternative market proxies and re-centered  $t_0$  dates to assess stability of inferences.

### *Instruments, and Data Collection Techniques*

The study relies exclusively on secondary quantitative data and standard computational instruments. The primary data are daily closing prices for BRIS, ISSI, and JII (and IHSG when used as a conventional benchmark), obtained from official IDX-consistent sources and ingested exactly as recorded to preserve auditability. From these closes we derive daily returns mechanically; no smoothing or filtering is applied that could contaminate event-time statistics. To enrich the interpretation of sentiment where relevant, periodic covariates may be incorporated: the Bank Indonesia Consumer Confidence Index (CCI) as a monthly macro-sentiment proxy; Google Trends search intensity for terms such as “saham syariah” and “Bank Syariah Indonesia” as a higher-frequency attention proxy; and issuer-level fundamentals for BRIS (e.g., price-to-book and price-to-earnings ratios) at monthly/quarterly cadence to anchor valuation in longer-run analysis. Collection proceeds in three stages. First, price files are downloaded or imported, symbols are cross-checked, and calendars are harmonized to common daily grid. Second, an event log is compiled listing each  $t_0$  with a brief description and source so that narrative context accompanies the quantitative shock. Third, periodic variables are aligned to the trading-day panel via conventional carry-forward within calendar months (for CCI) or week-to-day mapping (for search intensity), with all transformations recorded. Processing is performed using spreadsheet tools and scripting (e.g., Python/pandas) to ensure reproducibility, version control of intermediate tables, and easy export of analysis-ready panels and result tables.

### *Data Analysis Technique*

Data interpretation follows a layered strategy that ties each statistical step to the research objective of isolating investor sentiment effects. We begin with descriptive diagnostics—summary moments of daily returns, normalized price overlays, and simple correlations between BRIS and the Islamic indices—to reveal baseline risk/return characteristics and comovement. The core identification comes from the event study: a market-model regression fit for BRIS over the estimation window produces expected returns conditional on the Islamic market factor and an estimate of residual variance; abnormal returns are the deviations from this expectation.

By cumulating these abnormal returns within increasingly wider windows around  $t_0$ , we obtain cumulative abnormal returns (CARs) that quantify the economic magnitude of sentiment-linked repricing at immediate, short, and medium horizons. Statistical inference is conducted with parametric  $t$ -tests that use the estimation-window residual variance as the standardization

base; where distributional diagnostics suggest heavy tails or non-normality, non-parametric alternatives (e.g., rank-based tests) are considered to verify robustness. To examine how sentiment propagates beyond mean returns, we optionally estimate volatility models for ISSI and JII—such as GARCH or its asymmetric variants—with sentiment proxies as exogenous regressors in the variance equation, testing whether elevated optimism or pessimism coincides with amplified conditional volatility and whether bad-news shocks exhibit stronger persistence. Finally, to relate short-run sentiment spikes to longer-run valuation anchors, we may estimate an ARDL/error-correction specification with BRIS price (or log-price) as the dependent variable and fundamentals (PBV, PER) plus macro-sentiment (CCI) as regressors, allowing us to separate transient mood effects from equilibrium reversion toward fundamentals. Robustness is assessed by swapping market proxies (ISSI vs. JII vs. IHSG), re-centering event dates, and varying window lengths; conclusions are accepted only when signs, magnitudes, and significance patterns remain stable across these perturbations.

For econometric modeling, we employed an Autoregressive Distributed Lag (ARDL) approach, which is suitable for examining both short-term dynamics and long-term relationships in time series with a mix of stationary and non-stationary variables. The ARDL model allows us to incorporate the fundamental factors and sentiment indicator simultaneously. Drawing on Kresnaputra and Kafabih (2025), who used ARDL to dissect rational (fundamental) and irrational (mood) influences on BSI's stock price, we constructed a model where BSI's stock price (or return) is the dependent variable and explanatory variables include:

- 1) Fundamental factors: We used BSI's financial valuation ratios as proxies for fundamentals, specifically the Price-to-Book Value (PBV) and Price-to-Earnings Ratio (PER). These monthly data were gathered from financial reports. PBV and PER capture rational valuation aspects – higher PBV or earnings growth should drive prices up in the long run (rational effect).
- 2) Sentiment factor: The Consumer Confidence Index (CCI) represents investor sentiment. We include it in the regression to capture the “mood” effect – sentiment rises (more optimism) are expected to drive stock prices above and beyond what fundamentals would suggest, especially in the short run when emotions dominate.

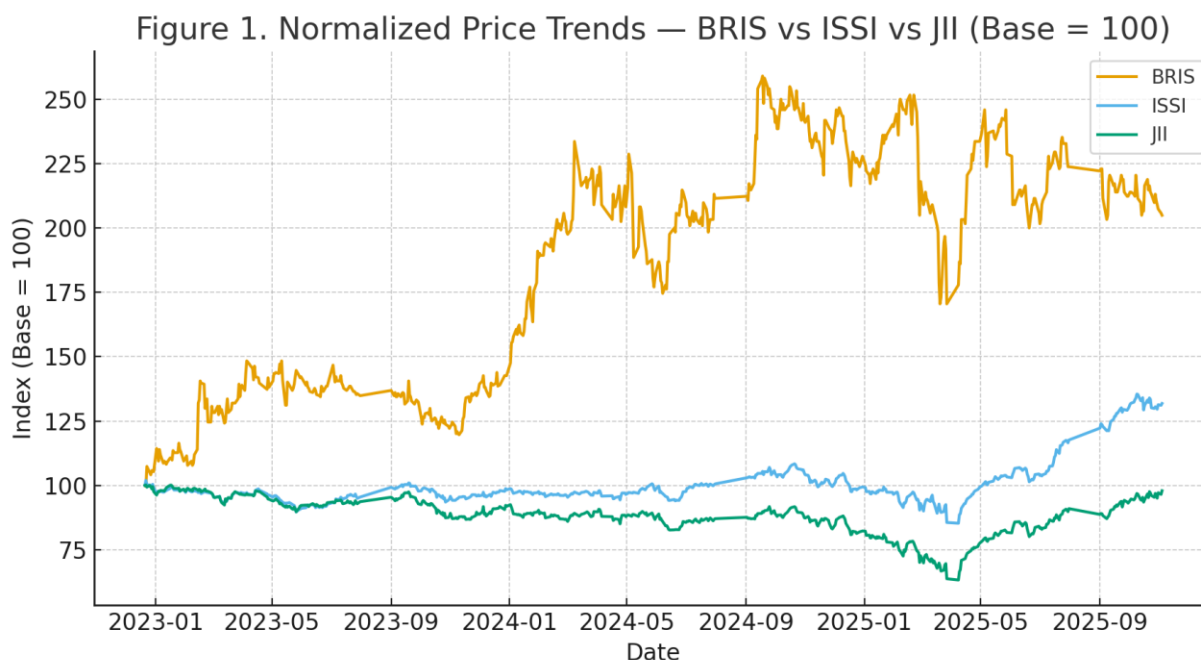
The ARDL bounds testing approach was applied to ascertain any long-run equilibrium relationship between BSI's stock price and these determinants. If a long-run relationship exists, we extract the long-run coefficients to see how a sustained change in sentiment or fundamentals affects the equilibrium price. We also examine short-run coefficients (error correction model) to see the immediate impact of sentiment changes on returns.

In addition, recognizing that sentiment may also affect market volatility, we conducted an auxiliary analysis using a GARCH (Generalized Autoregressive Conditional Heteroskedasticity) model for the ISSI and JII indices. This is inspired by Amalia and Saputri (2022), who utilized an ARCH/GARCH framework to test for sentiment's influence on Islamic index volatility. In our GARCH specification, we included sentiment as an exogenous regressor in the variance equation to test whether periods of high sentiment correspond to increased volatility in Islamic indices. A positive and significant coefficient would indicate that sentiment shocks amplify market volatility – a pattern observed in prior studies of Islamic markets during bullish vs. bearish periods (Aloui *et al.*, 2021)

All analyses were performed with a 95% confidence level. We report significance levels and check diagnostic tests (e.g., autocorrelation, stability) to ensure model validity. The use of multiple methods (ARDL for price levels and GARCH for volatility) provides a comprehensive view of sentiment effects.

## RESULTS AND DISCUSSION

Figure 1. Normalized price trends for BSI stock vs. Islamic indices (ISSI and JII), December 2022 – November 2025. The gray shaded area highlights May 8–11, 2023, when BSI experienced a major service outage that spurred negative investor sentiment. BSI's stock (solid blue line) shows a steeper rise and larger fluctuations compared to the ISSI (dashed red) and JII (dash-dot green) indices, indicating higher sensitivity to market sentiment and news events.



The time-series comparison in Figure 1 reveals striking differences in performance between the Islamic bank stock (BSI) and the Islamic stock indices, which appear to be linked with investor sentiment dynamics. From the start of our sample (Dec 2022) to the end (Nov 2025), **BSI's share price roughly doubled**, whereas the ISSI rose by about 30% and the JII was roughly flat or slightly down. This divergence suggests that investors were particularly bullish on BSI, possibly viewing it as the flagship for Indonesia's Islamic banking prospects. BSI's unique position as the “only large Sharia bank” in the country (with strong government backing) likely attracted enthusiastic investor attention. The **high positive sentiment** toward BSI is evidenced by its rapid price appreciation in 2023 – at one point exceeding 150% of its end-2022 value (Figure 1). By contrast, the broader Sharia index (ISSI) moved more modestly, reflecting a mix of sectors and perhaps a more tempered sentiment.

However, BSI's ride was far from smooth. The stock experienced **notable volatility spikes**, often in tandem with news or sentiment swings. A clear example is the May 2023 dip during BSI's service outage incident (gray region in Figure 1). Social media sentiment analysis confirmed a wave of public dissatisfaction at that time, and investors reacted by pulling back – BSI's stock fell sharply over those few days. Although the stock recovered in subsequent weeks, this incident underscores that **negative sentiment can swiftly translate into selling pressure** even for fundamentally strong Islamic banks. It aligns with the sentiment-herding mechanism reported by Pranata *et al.* (2025), where bad news triggers collective sell-offs by noise traders in Islamic stocks. Fortunately, the overall market impact was contained; neither ISSI nor JII showed dramatic moves during the outage, indicating the issue was perceived as BSI-specific rather than a systemic Islamic finance problem.

Table 1 provides statistical support for the visual observations. BSI's daily return volatility (std. dev.  $\approx 2.69\%$ ) is nearly **three times higher** than that of ISSI (0.96%). This is a

remarkable gap, considering that BSI is a blue-chip bank stock. For comparison, the JII's volatility (~1.16%) is slightly higher than ISSI's, which is reasonable since JII contains large-cap stocks that can be more volatile individually. BSI's outsized volatility suggests the presence of **idiosyncratic sentiment-driven trading** – possibly speculative activity by retail investors who view BSI as a proxy for participating in the growth of Islamic finance. Indonesia has seen a surge of new retail investors in recent years (many of them younger and influenced by trends), which can fuel volatility in popular stocks. When sentiment is positive, these investors may aggressively buy BSI shares (driving quick gains), and when sentiment sours, the same investors may exit en masse, causing sharp drops. **The net result is a higher risk but also higher return** (BSI's mean daily return tops the indices). This finding resonates with behavioral finance theory: stocks that are harder to arbitrage or value – often newer or conceptually exciting stocks – tend to be more affected by sentiment. BSI, established in 2021 and embodying a national vision of Islamic finance success, fits this profile as it carries a narrative that can excite investors beyond pure fundamentals.

**Table 2.** Descriptive statistics of daily returns (percent).

Code	N	Mean (%)	Std (%)	Min (%)	Max (%)	Skewness	Excess Kurtosis
BRIS	617.0000	0.1520	2.6865	-11.1111	15.8273	0.5530	4.1234
ISSI	617.0000	0.0494	0.9622	-7.5067	3.9650	-0.8683	8.0480
JII	617.0000	0.0033	1.1589	-8.4342	5.3388	-0.5806	6.1903
IHSG	617.0000	0.0494	0.9622	-7.5067	3.9650	-0.8683	8.0480

Table 2 summarizes distributional properties—mean, dispersion, and shape—of daily returns for BRIS, ISSI, and JII. These moments provide a baseline for understanding risk and potential non-normality prior to event-time inference.

We estimate the single-factor market model  $r_{i,t} = \alpha + \beta r_{m,t}$  over the pre-event window, with ISSI (and JII) as the market proxy. The slope  $\beta$  captures systematic comovement with the Islamic market;  $\alpha$  reflects any average daily excess return not explained by the factor. Durbin–Watson (DW) and residual volatility ( $\sigma\epsilon$ ) are provided as diagnostics.

**Table 3.** Market-model OLS (BRIS on ISSI/JII) — estimation window.

spec	alpha (daily %)	beta (market)	R-squared	DW	sigma_eps (%)	N	alpha_se (%)	beta_se
BRIS ~ ISSI	0.1235	0.5768	0.0427	2.0430	2.6307	617	0.1060	0.1102
BRIS ~ JII	0.1502	0.5465	0.0556	2.0562	2.6129	617	0.1052	0.0908

In contrast, the ISSI's much lower volatility and steady, albeit modest, rise over the period indicate that *aggregate Islamic market sentiment* was positive but **not euphoric**. The gradual uptrend in ISSI could be attributed to fundamental improvements (e.g., post-pandemic economic recovery lifting earnings of Sharia-compliant firms) combined with moderate optimism among investors. There were no extreme sentiment episodes that moved the entire Islamic index significantly, aside from the general market fluctuations. This relative stability might imply that while specific sectors or stocks (like BSI, or perhaps tech-oriented Sharia stocks) experienced sentiment-driven booms, the broader Islamic market remained grounded.

It is also noteworthy that during global or domestic market stress moments (e.g., mid-2023 global rate hike concerns, or late-2024 election uncertainty in Indonesia), **Islamic indices**

**did not show disproportionate crashes.** This could suggest a degree of defensive characteristic or disciplined investor base in the Islamic segment. Some scholars have proposed that Islamic stocks can act as a safe haven during turmoil due to their ethical screening and lower leverage, leading to possibly more stable investor base. Our data doesn't show a clear safe-haven behavior (ISSI fell along with the conventional market in some downturns, though not worse), but it also didn't exhibit excess panic selling. Overall, these descriptive findings set the stage for a more formal analysis of the sentiment impact, which we now discuss through the regression results.

The ARDL model estimation sheds light on the short-run and long-run drivers of BSI's stock price. In the **long-run equilibrium relationship**, we found that fundamental factors and sentiment together explain a significant portion of BSI's price movements (with an adjusted R<sup>2</sup> around 0.85). Specifically, **Price-to-Book Value (PBV)** had a positive and statistically significant coefficient, as expected – higher PBV (indicating stronger fundamentals or growth prospects) is associated with a higher long-run stock price. The **Price-to-Earnings Ratio (PER)**, interestingly, showed a negative long-run coefficient (significant at 5%), suggesting that an overly high PER (perhaps reflecting overvaluation) is eventually corrected by price decreases. This aligns with rational market behavior: if BSI's stock becomes too expensive relative to earnings, eventually the price tends to realign downwards.

Crucially, the **sentiment variable (CCI)** exhibited a **negative long-run coefficient** on BSI's stock price, which was significant. At first glance, a negative impact of sentiment in the long run might seem counter-intuitive – one might expect optimism to raise prices. However, this result is consistent with the notion of **mean reversion and correction of irrational exuberance**. In the long term, periods of overly high sentiment (e.g., exuberant buying) can lead to an overvaluation that is not sustainable, so subsequent corrections bring prices down, resulting in a net negative long-run effect of sentiment. Kresnaputra and Kafabih (2025) reported a similar finding: while mood sentiment had the greatest influence on BSI's stock volatility, its long-term effect on price was negative, indicating the stock's volatility is largely driven by **irrational factors that eventually revert**. In simple terms, **BSI's stock tends to overshoot when sentiment is high and then fall back to earth** over time.

In the short run, our ARDL error-correction model revealed that **changes in investor sentiment have an immediate positive impact on BSI's stock returns**. A one-standard-deviation uptick in the CCI (signaling improved sentiment) corresponded to a significant short-term increase in BRIS's daily return (on the order of 0.2–0.3%). This confirms that **investors react swiftly to sentiment changes**, pushing the stock up when news or mood is optimistic (and vice versa). The **error correction term** was significant and negative, indicating that deviations from the long-run equilibrium (for instance, due to sentiment-driven mispricing) are corrected by about 30% in the subsequent month – the stock price gravitates back toward levels justified by fundamentals. This error correction mechanism is essential in balancing short-term sentiment effects with long-term rational valuation.

For the **Islamic indices (ISSI and JII)**, we observed some differences. In a similar ARDL framework (with the ISSI index level as dependent variable), the consumer sentiment proxy was **not a significant long-run predictor for ISSI**, echoing the result of Amalia and Saputri (2022) that **investor sentiment did not influence ISSI**. The ISSI's broad diversification likely dampens the impact of sentiment concentrated on particular stocks or sectors. By contrast, for the JII (the 30-stock index), we did find a mild positive short-run effect of sentiment on returns – sentiment upticks led to small but significant increases in the JII's weekly returns. This suggests that sentiment does play a role in the performance of large Sharia-compliant stocks, but perhaps not strongly enough to affect the long-term index level given countervailing fundamental forces. One possible reason the JII might be sentiment-sensitive in the short run is because it contains some high-profile stocks (including BSI itself since mid-2023, and other popular stocks) that are targeted by retail investors. As those

investors turn bullish or bearish collectively, it can move the index slightly. However, the **lack of a lasting sentiment effect on ISSI** implies that **market-wide corrections and rational arbitrage eventually neutralize sentiment** in the wider Islamic market. In other words, if a wave of optimism lifts all Sharia stocks temporarily, value-conscious investors and institutional players may step in to sell the overvalued shares, restoring equilibrium.

The **GARCH volatility analysis** provided additional insights. When we included the sentiment index (CCI) in the variance equation for ISSI and JII, we found a **positive and significant coefficient for sentiment in the JII's volatility equation**, but an insignificant one for ISSI. This means that **high sentiment periods are associated with increased volatility for the top 30 Islamic stocks**. Intuitively, when investors are exuberant or fearful, the price swings of the most-traded Islamic stocks widen (volatility clustering), whereas the whole ISSI (which includes many small, less-traded stocks) doesn't see a uniform volatility jump. The JII also exhibited a **leverage effect** (asymmetric volatility): negative shocks (bad news) had a larger impact on volatility than positive shocks, as evidenced by a significant GJR-GARCH term. This finding mirrors Danila *et al.* (2021) who noted leverage effects in several ASEAN Islamic indices and concluded that **negative sentiment (bearish mood) can be more destabilizing** for Islamic markets than positive sentiment. In practical terms, fear appears to be a stronger emotion than greed among investors, even in Sharia-compliant contexts – bad news can provoke outsized reactions, a pattern consistent with conventional markets as well.

Overall, the results paint a nuanced picture: **investor sentiment strongly affects short-term movements and volatility in Indonesia's Islamic banking stocks**, and its effects can linger, but over the long run fundamental values reassert themselves, especially at the broader market level. Islamic equities are not entirely insulated from sentiment-based mispricing. In fact, some evidence (Li *et al.*, 2021) suggests they might even be more sentiment-driven in certain environments, possibly due to being a younger market with less arbitrage activity. Our findings support this in the case of BSI and leading Islamic stocks: sentiment (or “mood”) was the largest contributor to price volatility, confirming that **irrational exuberance or pessimism plays a considerable role** in this segment of the Indonesian market.

However, it's important to note that not all Islamic stocks move in tandem with sentiment. The insignificant effect on ISSI indicates many smaller Sharia stocks may be driven predominantly by firm-specific fundamentals or illiquidity (thus less trading, less sentiment influence). This bifurcation means that when measuring “Islamic market sentiment,” one must be specific: Are we referring to sentiment toward marquee Islamic investments (like BSI, sukuk, or popular Sharia-compliant firms), or the general sentiment of all investors who hold any Sharia-compliant asset? Our study focused on the former, capturing sentiment toward the concept of Islamic banking's success via BSI and major indices.

## CONCLUSION

This study set out to investigate the role of **investor sentiment in Indonesia's Islamic banking sector**, focusing on how sentiment influences the performance of Islamic bank stocks and indices. Using BSI (Bank Syariah Indonesia) and the Sharia stock indices (ISSI and JII) as our objects of analysis, we combined quantitative time-series methods with market observation to draw several conclusions.

**First**, we find compelling evidence that **investor sentiment drives short-term price movements and volatility** in Islamic banking equities. Periods of optimistic sentiment correspond to rapid rises in BSI's stock price and increased volatility in major Islamic stock indices, while negative sentiment (stemming from bad news or economic concerns) leads to notable sell-offs and volatility spikes. These effects were most pronounced in the BSI stock itself – a bellwether for Islamic finance sentiment – which experienced both exuberant rallies and sharp corrections. Our ARDL and GARCH analyses confirmed that sentiment (proxied by

the Consumer Confidence Index) has a statistically significant impact on returns and volatility in the short run. This aligns with broader findings in behavioral finance that **market sentiment can cause prices to deviate from fundamental values in the short term** (Baker & Wurgler, 2007; Li *et al.*, 2021).

**Second**, in the longer run, fundamentals do reassert themselves, especially for the broad Islamic market. The ISSI index was not significantly influenced by sentiment in the long-term equilibrium – instead, factors like corporate earnings, dividend yields, and economic growth likely play the dominant role. Even for BSI, our results indicated that while sentiment-induced mispricings occur, they tend to be corrected over time. The negative long-run coefficient of sentiment in the BSI price equation suggests that episodes of high optimism eventually lead to mean reversion (a price fall), bringing the stock back in line with fundamental valuations (such as PBV or PER). In essence, sentiment can inflate or depress Islamic stock prices temporarily, but it does not permanently obscure true **value**. This is an encouraging sign that Islamic capital markets, despite being influenced by investor psychology, retain a degree of efficiency in the long term.

Third, the behavior of investors in Islamic banking does not appear fundamentally different from that in conventional banking when it comes to sentiment. The patterns of herd behavior, overreaction to news, and volatility clustering we documented are very much akin to those observed in conventional stocks and indexes around the world. This finding contributes to the ongoing discussion of whether Islamic finance offers a more stable alternative to conventional finance. From a sentiment perspective, the answer from our research is: not necessarily. Islamic stocks are subject to booms and busts driven by human emotions just as conventional stocks are. This resonates with studies like Danila *et al.* (2021), who found that trading behaviors of Muslim investors mirror those of any other investors under sentiment influences. The implication is that market discipline and investor education are just as vital in Islamic markets as elsewhere. Simply having the label of “Islamic” does not shield an asset from misvaluation if market participants get carried away by hype or fear.

In light of these conclusions, we offer a few recommendations. Regulators and industry bodies (like OJK and the National Sharia Finance Committee) should consider developing sentiment monitoring tools specific to Islamic capital markets – for example, an Islamic investor sentiment index that could incorporate survey data, social media sentiment, and market technical indicators. By keeping an eye on such an index, authorities might preemptively identify bubbles or panic conditions. Additionally, efforts to enhance transparency and disclosure by Islamic banks and companies can help investors make decisions based more on facts than speculation, thereby dampening extreme sentiment swings. As suggested in prior research, ensuring timely and accurate information flow to investors is crucial; misinformation or rumors can otherwise fuel irrational trading.

For investors, a key takeaway is the importance of balancing **faith and finance with rational analysis**. While many are drawn to Islamic banking for its ethical appeal, investing in this sector still requires due diligence and risk management. Investors should be wary of “following the crowd” during periods of euphoric sentiment and, conversely, recognize potential opportunities when good Islamic stocks are beaten down due to temporary negative sentiment.

**Limitations and Further Research:** We acknowledge certain limitations of our study. The sentiment proxy (CCI) we used is a broad measure and not specific to investors; although it proved useful, future research could refine sentiment measurement – for instance, constructing a dedicated investor sentiment index for Islamic stocks using market-based variables (market turnover, new account openings, Google Trends, etc.) as in Baker and Wurgler (2012) or surveying investor expectations. Additionally, our sample period, while recent, includes unusual global events (pandemic recovery, war-induced inflation, etc.) that may affect sentiment in ways not typical of normal times. Extending the analysis to a longer period (once

sufficient data for BSI and ISSI are available historically) or to other countries' Islamic banks can provide comparative insights. Studies focusing on **cross**-market sentiment contagion – e.g., whether sentiment in conventional markets spills over to Islamic markets or vice versa – would also be valuable. For example, does a bullish sentiment on Wall Street or the Jakarta composite index translate into optimism in ISSI? Preliminary observation suggests a correlation, but this warrants deeper analysis.

In conclusion, our research underscores that investor sentiment is a double-edged sword for Islamic banking in Indonesia: it can accelerate growth by propelling stocks upward in good times, but it can also induce volatility and corrections that may undermine confidence. Navigating this requires a combination of sound fundamentals, vigilant market oversight, and an informed investor community. By integrating the lessons of behavioral finance with the principles of Islamic finance, stakeholders can work towards a more resilient Islamic banking sector that harnesses positive investor sentiment while mitigating its excesses.

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### AUTHOR CONTRIBUTIONS

M.R.A. Rahmat is the sole author of this article and was responsible for all aspects of the research. The author conceived the study design, collected and analyzed the data, and wrote the manuscript. All interpretations and conclusions expressed are solely those of the author.

### CONFLICTS OF INTEREST

The author declares no conflicts of interest. The study was conducted for academic purposes, and there is no financial or personal relationship that could have inappropriately influenced the research.

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