Research Article

Interest Rate Theory in Islamic Economic Perspective

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ABSTRACT

Inflation is a condition in which there is a sharp (absolute) increase in prices that lasts continuously for a long period of time followed by a decline in the real (intrinsic) value of a country's currency. Circulating through an increase in bank interest rates. For this reason, the government carries out monetary policy by suppressing the money supply through increasing bank interest rates. However, the interest rate has various kinds, namely classical interest rate theory, neo classical, modern keyness and hicks. Therefore, this study focuses more on interest rates and the theory of interest rates by experts. So that it produces descriptive research.

Keywords: Inflation, Interest Rates, Interest Rate Theory, Money.

Background

Inflation is one of the effects of a prolonged economic crisis that hit a country. Inflation is a condition where a sharp (absolute) increase in prices lasts continuously for an extended period, followed by a decline in the real (intrinsic) value of a country's currency. The interest given by banks to the public is the main attraction for people to deposit their money in banks. In contrast, for banks, the more considerable public funds raised can raise, the greater the ability of banks to finance their operational activities, which are primarily in the form of lending public. For this reason, the government implements monetary policy by suppressing the money supply by increasing bank interest rates. However, the interest rate has various kinds, namely classical interest rate theory, neo-classical, modern keyness and hicks. The four approaches have differences but the same because it is part of the theory of interest rates.

Problem

Based on the background above, the formulation of the problem can be taken as follows: What is the meaning of interest rate? What are the theories about interest rates? What are the factors of interest rates? Furthermore, How is the comparative analysis of the interest rate theory?

Purpose

Based on the formulation of the problem above, see can see that the purpose of these papers is so that academics, students and the general public know about interest rates.

As well as how the comparative analysis of the theory of interest rate.

Discussion

Interest Rate

Every money transaction, especially in conventional banks, must be related to interest. In-

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terest is a form of remuneration or compensation for borrowing money to benefit the money in the future to be invested. The loan amount is called the principal (principal), while the percentage of the principal paid as a fee (interest) in a certain period is called the interest rate. (Almilia et al., 2006) Interest rates are usually expressed in per cent (%) for a certain period.

Based on its understanding in the banking world, interest rates can be interpreted into two:

1. Deposit interest rate is the interest rate given by the bank as a reward because the customer entrusts his money to be saved or saved at the bank concerned.
2. Loan interest rate is the interest rate charged by banks to creditors who borrow money from banks.

Interest Rate Theory

1. The Classical Interest Rate Theory

The classical era revealed that the interest rate determines the amount of savings and investment made in the economy, which causes the savings created by the full use of labour will always be the same as those made by entrepreneurs. Apart from microeconomic theory, classical theory explains that the interest rate is the remuneration value of capital. In classical theory, the stock of capital goods is mixed with money, and the two are considered to have a substitute relationship. Investment is also a function of interest rates. The higher the interest rate, the fewer people's desire to invest. The reason is that an entrepreneur will increase his investment spending if the expected profit from the investment is greater than the interest rate that must be paid for the investment fund, which is the cost of using the funds (Cost of Capital). The lower the interest rate, the entrepreneurs will be more motivated to invest because the cost of using the funds is also getting smaller.

2. Neo-Classical Interest Rate Theory

The interest rate is the price of credit, where the loan depends on the demand and supply of credit. According to neo-classical, the interest rate is not determined by the supply and demand of saving in the saving market. However, the interest rate is

selected in the credit market or market of credit or need of loanable funds. Loanable funds or credit funds are and are intentionally provided to be loaned or credited. The demand for loanable funds comes from the desire for investment from either the public or the private sector, or the government. In addition, there is a desire to save wealth in the form of money or hoarding.

The offer of loanable funds comes from the people's desire to save, which is then offered for capital. In addition, there is the creation of new money or newly created money. Both currency and demand deposits. Thus, according to neoclassical, the balance between supply and demand for loanable funds determines the level of interest rates prevailing in society.

3. Keynes's Interest Rate Theory (Persaulian et al., 2013)

Keynes gave a different view. According to him, the funds it is a monetary phenomenon. The interest rate is determined by the supply and demand for money (specified in the money market). Money will affect economic activity (GNP) as long as this money affects interest rates. Changes in interest rates will then affect the desire to invest and thus will affect GNP (Nopirin, 1994). Keynes assumed that the economy had not yet reached full employment. Therefore, production can still be increased without changing the wage level or the price level. By lowering the interest rate, investment can be stimulated to grow the national product. Thus, at least for the short term, monetary policy in Keynes' theory plays a role in increasing national development.

First, Keynes stated that society has a belief that there is a standard interest rate. If they hold securities when interest rates are rising (prices are falling), they will suffer losses.

Second, concerning the cost of holding cash. The higher the interest rate, the greater the cost of maintaining currency, so the desire to save some money is also lower, and the demand for cash increases. The two explanations above explain that there is a negative relationship between the interest rate and the need for cash. This demand for

money will determine the interest rate. The interest rate would be in balance if the amount of money demanded equals the supply (Nopirin, 1994).

4. Hicks Interest Rate Theory

Hicks put forward his theory that the interest rate is in equilibrium in an economy if this interest rate meets the balance of the monetary sector and the real sector. This view is a combination of classical and Keynesian opinions. The classical school says that interest arises because money is productive, meaning that if someone has funds, they can increase their means of production so that the profits obtained increase. So money can increase productivity, so people want to pay interest. Meanwhile, according to Keynesian, capital can be productive using speculation in the money market to make a profit, and it is this advantage that people want to pay interest.

Factors Affecting Interest Rates

The factors that influence the size of the determination of interest rates (loans and deposits) are as follows.

1. Funding needs

Suppose the bank is short of funds while the loan application increases, then what is done by the bank so that the funds are quickly fulfilled by increasing the deposit interest rate. An increase in deposit interest will automatically increase loan interest.

2. Competition

In competing for deposit funds, apart from the promotion factor, the most important thing is that banks must pay attention to competitors. In a sense, if the average deposit interest is 16%, then if you want to need fast funds, we should increase the deposit interest above the competitor's good, for example, 16%. However, on the other hand, we have to carry competitors' interest rates for interest on our loans.

3. Government policy

Both our deposit interest and our loan interest must not exceed the interest set by the government.

4. The desired profit price

Following the desired target, if the expected profit is significant, the interest will be considerable and vice versa.

5. Term

The longer the term of the loan, the higher the interest; this is due to the greater possibility of risk in the future.

6. Quality guarantee

The more liquid the guarantee provided, the lower the loan interest charged and vice versa.

7. Company reputation

The bona fide of a company that will obtain credit will determine the interest rate charged later. Usually, a bona fide company has a relatively small credit default risk in the future and vice versa.

8. Competitive products

The funded product sells well in the market.

9. Good relationship.

Usually, banks classify their customers between primary (primary) customers and ordinary (secondary) customers. This classification is based on the activeness and loyalty of the customer concerned with the bank. The prior customer usually has a good relationship with the bank to determine the interest rate; it is different from ordinary customers.

10. Third party guarantee

In this case, the party providing guarantees to the credit recipient. Usually, if the party offers bona fide guarantees, both in terms of ability to pay, good name and loyalty to the bank, the interest charged is different.

Comparative Analysis of Interest Rate Theory Classic, Neo Classic, Modern Keynes and Hicks. Theory of Hicks Theory Modern theory Keynes Classical theory Neoclassical theory.

Interest rates are in balance in an economy if this interest rate meets the balance of the monetary sector and the real sector. Interest rates are determined by the government and the supply of money. Interest rates are determined by the people's desire to save and the desire of entrepreneurs to borrow capital

funds to invest. Interest rates depend on the demand and supply of credit. According to neoclassical.

National income factors of production available, but by aggregate expenditure, National income is determined by the ability of aspects of production to produce goods and services.

Government spending can increase economic growth without consumer spending/business investment Government spending can hinder a country's economic growth by increasing the public sector and decreasing the business sector.

The role of government, the government's position has a significant role in the economy, focusing on short-term goals. The part of the government has a minimal role in the economy, focusing on long-term goals. The government has interfered.

Interest rate the interest rate is in equilibrium in an economy if this interest rate meets the balance between the monetary sector and the real sector. The interest rate is not flexible because even if there is much unemployment, the wage rate will not fall, and unemployment will remain. The interest rate is adjustable; this will ensure a situation where labour demand will equal the supply. Credit. According to neoclassical, the interest rate is not determined by the supply and demand of saving in the saving market.

Consumption theory Consumption expenditure is mainly influenced by current income Consumption expenditure adjusts their spending to their income expectations over a more extended period.

The wage rate is "rigid (not volatile and especially difficult to bring down the bottom) Wage rate is determined by the government and labour supply. Unemployment The way to reduce unemployment is to increase investment. The way to reduce unemployment is to reduce the wage rate.

Theory of supply and demand assuming the "say" basis is wrong because usually, the market is less than collection. Based on the "say" law, the store will create its demand.

Determinants of the level of savings and the level of investment in the economy The amount of savings made by households does not

depend on the level of interest rates but depends on the size of the level of household income. Determination of the amount of savings and investment is the interest rate.

Money Emphasizes fiscal policy plays an essential role in determining economic activity Money and monetary policy plays a crucial role in determining economic activity.

Keynes's economic theory suggests that the economy should not be left to the market mechanism; to a certain extent, the role of the government is treated; for example, if unemployment occurs, the government can increase its spending on labour-intensive projects. The macroeconomy will grow if the economy is left to the market. Law enforcement issues keeping infrastructure development secure.

Conclusion

Based on its understanding in the banking world, interest rates can be interpreted in two ways:

1. Deposit interest rate is the interest rate given by the bank as a reward because the customer entrusts his money to be saved or saved at the bank concerned.
2. Loan interest rate is the interest rate charged by banks to creditors who borrow money from banks.

Several theories such as Hicks Theory, Modern Keynes Theory, Classical Theory and Neoclassical Theory Have a different understanding of interest rates where interest rates are in balance in an economy if this interest rate meets the balance of the monetary sector real sector (Hicks theory). Interest rates are determined by the government and the supply of money (modern Keynes theory). Interest rates are determined by the desire of people to save and the desire of entrepreneurs to borrow capital funds to invest (classical theory). Interest rates depend on the demand and supply of credit. (According to neoclassical) Other than that, interest rates also vary, namely the interest rate in Hicks theory, namely the interest rate is in balance in an economy if this interest rate meets the balance of the monetary sector and the real sector. Then in Keynes' modern theory, the interest rate is not flexible because even if there is much unemployment, the wage rate will not fall, and unemployment still exists.

Furthermore, the classical theory, namely the flexible interest rate, will guarantee a situation where labour demand will be equal to the supply. The last is the neo-classical theory. The interest rate is the price of credit, where the loan depends on the demand and supply of credit. According to neoclassical, the interest rate is not determined by the supply and demand of saving in the saving market.

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