Jurnal Pajak dan Analisis Ekonomi Syariah (JPAES)
Volume. 2 Nomor. 2 April 2025
e-ISSN : 3046-9260; p-ISSN : 3046-871X, Hal. 30-40
DOI: https://doi.org/10.61132/jpaes.v2i2.912
Available online at: https://ejournal.areai.or.id/index.php/JPAES

The Balance Of The Money And Goods Markets From An Islamic Economic Perspective

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Abstract*. This study aims to determine the balance of the money and goods markets from an Islamic economic perspective. The research method used is the study of literature from articles, papers, books, and other sources that support the problem under study. The results of this study indicate that Islamic economics states that when prices are fixed, income and interest, or the expected rate of profit, are at a level that balances the commodity market and the money market. The equilibrium level of income and welfare is at the intersection of the IS and LM curves, using the interest rate and the expected rate of return. In Islamic economics, a similar mechanism occurs in the economy that income and the anticipated rate of return lead to the equilibrium level. However, as previously mentioned, changes in income do not directly cause changes in the money market interest rate, which creates a balance between the demand for money and the money supply. Therefore, the interest rate on the interest income panel can only be determined by the IS curve without the LM curve. In other words, the interest rate always appears on the IS curve but can also occur outside the LM curve.*

Keywords*: Money Market, Goods Market, Islamic Economics*

1. INTRODUCTION

In the early days of Islam, the economic system was simply because there was no banking system, and the use of money was minimal (Fadilla, 2017). Monetary policy was unnecessary at that time because there was no sufficient reason to make the money supply (MS) a free policy. In addition, credit does not play a role in money creation because credit is only used between traders (Wicaksono, 2019). The commodity and money markets' equilibrium is based only on cash payments. In other words, money is exchanged for something that adds value to the economy. Other transactions, such as gambling, usury, and the like, are prohibited in Islamic economics (Ilyas, 2016).

The country's economy is based on two sectors: the real sector and the financial sector. The real sector is an economic sector stacked on top of the industrial and service sectors. The financial sector overlaps with the banking sector (Putri, 2014). Based on the operating system, banking in Indonesia is divided into two systems. First, the traditional banking system dominates the interest system, which means that interest is the same as compound interest, namely the increase in the equity value of the loan. The second is the Islamic banking system based on Islamic sharia principles based on the Al-Quran and Hadith, which is synonymous with profit sharing (Prasetyo, 2013).

Received: Februari 25, 2025; Revised: Maret 20, 2025; Accepted: April 10, 2025;
Online Available: April 15, 2025;

Governments' systems in relation to consumption, saving, investment, and trade create automatic tools for carrying out monetary policy (Triwahyuni, 2021). On the one hand, this system guarantees a balance of money and goods/services. On the other hand, it prevents savings from being used for purposes other than increasing the real wealth of society. The concept of Islam is to maintain a balance between the real sector and the financial sector so that growth financing cannot be separated from the growth of the real sector it finances (Risnaningsih & Mulyasari, 2021). Therefore, the financial factors used in Islamic banking have a critical position in maintaining the stability of the development of the real sector. In addition, it was reported from sharia and non-conventional perspective that the financial crisis did not affect sharia banking (Umi et al., 2022).

The market, in general, is a setting or a meeting place for sellers and buyers, either directly or indirectly, to complete buying and selling transactions. The market plays a vital role in the country's economy, although fraud and injustice often occur in the market, especially regarding prices (Wulandari & Zulqah, 2020). Islamic economics sees the market, the state, and the individual as balanced. The market is guaranteed freedom in Islam. The free market determines the means of production and prices, and no disturbances should affect the market balance. In Islamic economics, prices are determined by market forces, namely supply and demand. Meetings of supply and demand must be voluntary so that no party feels compelled, deceived, or wrong in making a specific commodity agreement at a certain price level so that no party feels disadvantaged (Mishkin, 2008).

The goods and money markets are the most important structures for forming aggregate demand in macroeconomics. With harmony between the two sectors, economic stability will work well. The tendency for the money sector to rotate faster in a traditional economy is due to the circulation of money using interest instruments which is less followed by a balanced circulation of the real sector (Wicaksono, 2019). Market balance is one of the goals of achieving the ideality of a country's economy where supply and demand are at an equilibrium point. In Islam, besides the forbidden benefits, blessings and other benefits or maslaha are prioritized when asking and offering. The values applied to it must be within the framework of halal, benefits, maslaha, and justice. The balance of the Islamic economy as a whole is usually adjusted to the theory of balance, which is corrected and then wrapped in Islamic values (Sya'diah, 2021).

Based on the description of the problem above, this study aims to understand the concept of the balance of the money market and the goods market from the perspective of Islamic economics.

2. THEORITICAL

Money Market

The money market is the total supply and demand for assets or securities with a maximum maturity of one year that can be channeled through banks. This money market activity is due to the existence of two parties, one does not have short-term funds, and the other has excess funds, even short-term ones. They unite in the money market so that the units that do not have the funds they need, while the units that are in surplus receive income from this excess money (Kasmir, 2012).

Money market participants are banks or financial institutions that need short-term funds and usually only buy money market instruments in secret because money market instruments usually do not have specific collateral. Therefore, the trust factor is dominant before investors buy the chart, apart from other factors (Riva'i, 2013).

The function of the money market, which is closely related to the world of banking and money, is the function of liquidity as a channel for monetary policy and an information function.

1. As an alternative source, especially for financial institutions and other participants, to meet short-term financial needs and provide additional liquidity related to investment funds.
2. As a means of indirect monetary control by monetary authorities in open market operations, because in Indonesia, the implementation of open market operations of the Indonesian Central Bank is carried out through the money market, using Bank Indonesia certificates (SBI) and Monmerkata Securities (SBPU) as instruments.
3. According to the information function, the money market can inform corporations, governments, individuals, the foreign sector, and other money market players about the condition of the money economy, the preferences and behavior of money market players, and the influence of monetary policy. And the impact of the interaction of economic activities at home and abroad.

Islam views money only as a medium of exchange, not as a commodity or commodity. Therefore, the demand for money is to meet transaction needs (demand for transaction money) and not speculation. Islam does not recognize speculation (demand for money related to speculation). Because basically, the money belongs to Allah SWT, who is entrusted to us to spend as much as possible for the benefit of society. According to Islamic understanding, money is a flow concept, so it must constantly circulate in the economy; the higher people's income, the better the economy will run(Machmud & Rukmana, 2010).

Pasar Barang

The commodity (goods) market is where buyers and sellers interact to determine the number of goods and prices of goods traded. The market for goods is expressed by the IS curve, which states the relationship between interest rates and income in the market for goods and services (Mankiw, 2007).

The balance of the goods market is expressed by the IS curve, which shows the relationship and combination between the level of income and interest rates in the balance of the money market. Interest rates and investment heavily influence commodity markets. When interest rates are high, investment falls, which in turn causes total spending to fall, and vice versa. The change in total consumption creates a new equilibrium level in the goods market.

3. RESEARCH METHOD

The method used by the author is qualitative, with a review of the literature. Literature research is a way to find relevant references to problems that arise. The literature study represents theoretical analysis, scientific studies, and literature relating to community traditions and the norms and values that emerge in the observed field conditions. In addition, library research can review various reference literature and previous studies that are aligned and valuable to obtain a theoretical basis related to the problem under study.

In this study, the data used were secondary: based on previous references/references, which were contained in scientific papers, literature, encyclopedias, and other reference sources related to the problem under study. The method applied in this study is the assessment of various observed data sources to produce results that are appropriate to the subject of the research topic.

4. RESULT AND DISCUSSION

The market is the economic backbone of society and is between the regular and upper classes. All elements related to economic issues exist in the market, starting from production, distribution, or consumption. Producers and consumers participate in the activities carried out in the market, each playing a critical role in market prices (Hakim, 2017).

A market is a place or situation that brings together requests (buyers) or offers (sellers) to buy and sell goods and services. Finally, determine the equilibrium price (market price) and the amount traded. So every process that brings buyers and sellers together results in a price that is agreed upon between the seller and the buyer. The market mechanism from an Islamic point of view indeed contains sharia principles in the form of values which, in public, place more emphasis on the notion of interest, namely those that support the principles of justice, ethics, and law in economic activity. Sharia principles can also be divided into two perspectives, namely, the macro perspective and the micro perspective. From the micro perspective, sharia values emphasize competence/professionalism and reliability. From the macro perspective, Islamic values emphasize distribution, prohibition of usury, and financial activities that do not bring tangible benefits to the economic system. Therefore, the benefits of the Islamic economic system in the market are not only for Muslims but for all humanity (Wulandari & Zulqah, 2020).

In Islamic economics, the money belongs to the community (money is public goods), so hoarding money or remaining unproductive means reducing the amount of money in circulation, which can lead to a cessation of economic activity. The LM curve connects the level of national income with various possible interest rates that maintain the balance of the money market (Hasyim, 2016). The process of decreasing balance in the money market (LM). The initial condition is that there is a balance between money demand and money supply at point A with an interest rate of I with an income of Y. Then, suppose income rises from Y to Y'. This will cause money demand to increase so that it will shift the Md curve, Md'which has an impact on an increase in the interest rate from I to i' so that a new balance is formed from A to A' (Huda, 2012). By increasing or decreasing the money supply, monetary policy causes a shift in the LM curve. When the central bank increases the money supply, the LM curve shifts downward; conversely, the LM curve shifts to the left when the money supply decreases.

While the goods market is a market where a country produces all goods and services in a certain period, a graphical approach describes equilibrium in the goods market. From this equilibrium in the goods market, the IS curve can be derived. In this section, IS is no longer autonomous but influenced by interest rates and income. If it is assumed that there is an increase in the interest rate, then this will affect the amount of investment. An increase in interest rates will cause investment to fall. Because, with rising interest rates, making investments requires a higher rate of return so that the interest costs on loans are covered. In addition, people prefer to save their money in the bank, which is relatively high and not at risk (Mishkin, 2008).

Economic growth in the Islamic economic system is always based on actual conditions. The monetary sector is not independent of changes in the real sector. The two are integrated into one unit, the real sector will determine the level of balance in the monetary sector, but that does not mean that the monetary sector causes the movement of the real sector. Monetary policy to stimulate the real sector will only create money illusions that have a temporary impact on the real sector. In the long term, the balance of the real sector will return to its initial balance. However, the balance of the monetary sector has changed. Therefore, none of the three existing Islamic economics schools provides a recommendation to make the monetary sector an independent variable.

Demand for money is directed to meet the needs of productive transactions and investments. Speculative motives in demand for money will result in the misallocation of funds and inefficiencies in demand for money for business activities that do not add value to the real sector. Islamic monetary theory has also stated that speculation-motivated demand for money will never have an impact on increasing real income. The existence of speculative motives in demand for money will cause the money supply to move only in the monetary sector and will not be in direct contact with the real sector.

The demand for money for speculative motives occurs because some borrow money using an exciting system. The movement of money demand, influenced by speculative motives, does not cause an increase in people's actual income. Money demand caused by speculation is called imaginary money demand or pseudo money demand because it is unrelated to the real sector and does not affect the volume of actual transaction capacity.

The figure below shows the relationship between the real and monetary sectors in Islam if there is a demand for money for speculative purposes. The balance of the economy moves when there is a shift in the money demand curve due to speculative motives.

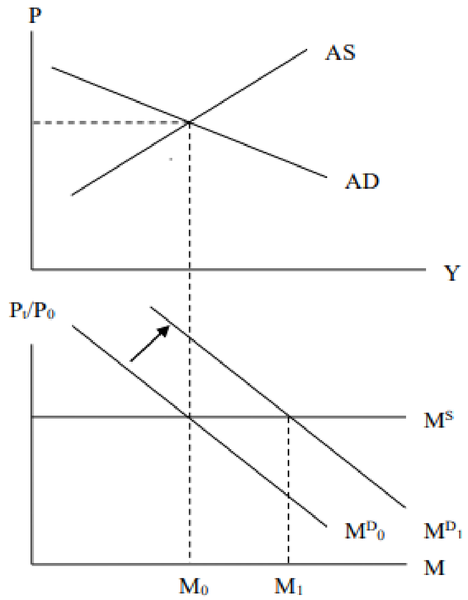

Figure 1. The curve of the relationship between the real sector and the monetary sector in Islam if there is a demand for money for speculative purposes, according to the first school

The picture above explains the first school of thought approach (iqtisaduna) in explaining the impact of speculative motives. When the demand for money shifts from MD 0 to MD 1 due to increased demand for money for speculation, the new equilibrium point in the monetary sector will change, and this change causes the money supply to increase to M1. However, the increase in M0 to M1 does not affect the increase in aggregate demand. In economics, it is known that aggregate demand (AD) is a function of consumption, investment, government spending, and net export-import of goods. The shift from MD 0 to MD 1 is apparent (imaginary demand for money). The amount of money demanded speculation is ΔMdspec = MD 1 - MD 0. Because there is no demand for specular money transacted to increase the real sector, the existence of ΔMdspec does not affect any of the variables in the aggregate demand function (AD). In conclusion, imaginary money demand will not have an impact on increasing real income.

Meanwhile, the second (mainstream) school's explanation of speculative money demand behavior is as follows:

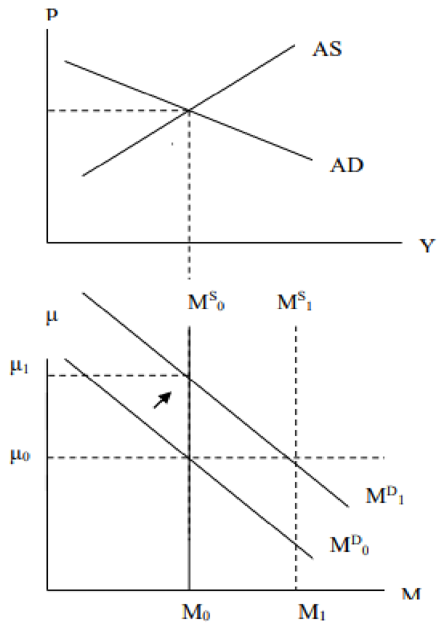

Figure 2. The curve of the relationship between the real sector and the monetary sector in Islam if there is a demand for money for speculative purposes, according to the second school of thought

The existence of speculation causes MD 0 to shift to MD 1. MD 1 is an imaginary demand for money where the increase in demand is not intended to meet the needs of productive transactions or investments but to trade money. To eliminate this speculative motive, the central bank will increaseμ. If the central bank letsμremains constant, then there is pressure from the central bank to increase the amount of money in circulation at the MS 1 level, even though the additional need for money supply is only fake, namely to trade money to eliminate this speculative motive, namely to return the balance level to MS = MD, so that the government should increase taxes on productive assets that are idle (idle funds) byμ0μ1. A concrete example is imposing a tax on funds kept in the form of SBI because SBI is considered idle funds.

In Islam, the demand for money is generally grouped into two motives, namely, the transaction motive and the precautionary motive. The more idle money, the greater the demand for money for precautionary motives (MD prec). Meanwhile, the higher the tax levied on idle money is inversely proportional to the demand for money, just in case. Dues of idle funds are policy instruments imposed on all productive assets that are idle.

If the demand for money for precautionary purposes increases (MD prec↑), then the government's efforts to bring the demand for money (MD) back to equilibrium by increasing idle funds' dues. The higher the dues of idle funds imposed on idle money, the more people are reluctant to keep idle money. Consequently, people who have idle money will voluntarily allocate their wealth to productive investments.

In the interest economy, the interaction of saving and investment is the interaction of demand and supply of capital with interest as price. The interest rate will lead to the level at which there is a balance between national savings and investment. An increase in national income will increase the value of saving at various interest rates. As a result, there is an excess supply of capital at the prevailing interest rate. To compete in offering their capital, bidders are willing to reduce the interest rate they receive. The interest rate will fall until the demand for capital equals the supply. The above relationship is described as the IS curve. This curve represents the interest rate that can balance saving and investment at different income levels.

In the Islamic economic system, interest is not enforced, so the balance in the goods market in the Islamic economy is very different from the balance in the goods market in a conventional economic system. This is because the interest system is abolished and replaced with the expected rate of profit (π). In an Islamic (non-interest) economy, the demand for and supply of capital is positively influenced by the expected rate of profit. An increase in the expected rate of profit due to, for example, a reduction in taxes will encourage companies to increase their purchases of capital goods. The company will seek capital to finance its investment. On the side of capital owners, an increase in the expected rate of profit will encourage them to allocate more of their savings for investment even though the profit-sharing ratio has not changed if the expected rate of profit from investment increases, the supply, and demand for capital will increase simultaneously at a fixed profit-sharing ratio.

Although both are positive, the elasticity of the supply of capital is less than the elasticity of demand for capital because the expected rate of profit has only a slight effect on saving. His income influences a person's savings. As a result, the difference between saving and investment narrows, and aggregate demand increases. The profit-sharing ratio affects the demand for and supply of capital differently. The supply of capital is more significant if the profit-sharing ratio increases because the expected profit level for capital owners increases. Conversely, an increase in the profit-sharing ratio will reduce the level of expected profits for company owners so that demand will decrease.

In conventional and Islamic economics, it is explained that at fixed prices, income and interest or the expected rate of profit will be at a level that balances both the goods market and the money market. The equilibrium level of income and interest is located at the intersection of the IS and LM curves, using both the interest basis and the expected rate of profit. Conventional economics assumes that income and interest will always lead to the simultaneous equilibrium level of the goods market and money market because each market has a balancing mechanism. In Islamic economics, a similar mechanism occurs in the economy in that income, and the expected rate of profit will lead to this equilibrium level; however, as has been explained that changes in income do not immediately cause changes in interest rates in the money market which bring about the balance of demand and supply of money. Therefore, the interest rate in the interest-income panel can only be determined by the IS curve without involving the LM curve. In other words, the interest rate always occurs on the IS curve but can occur outside the LM curve.

Economic balance is the goal of the economy. In the classical view, economic balance can be measured by calculating employment opportunities, while the Keynesian view is through the intersection between actual expenditure and planned expenditure or a combination of aggregate expenditure and total income, measured by the output level. The two models are then developed into a synthesis of the two. This curve is known as the IS-LM curve.

So far, economic balance is a condition of balance between the two main economic markets: the real market (goods and services) and the monetary market (financial). This leading indicator becomes inapplicable if used as a reference in Islam. The main reason is the principle of Islamic law which prohibits the practice of interest in the economy because interest is categorized as usury in Islam. The absence of interest certainly makes one of the leading markets in the conventional economy, namely the monetary market, irrelevant in discussing the general balance of Islamic economics.

This study of the goods and money markets should be included as part of an Islamic macroeconomic study. However, some things make it inappropriate or contrary to Islamic values, mainly when it is associated with the existence of the interest factor, which plays an essential variable in these two markets. However, the discussion on the IS-LM concept is in a conventional context. It accommodates several thoughts that bring this study of money and goods markets into an Islamic analysis.

The perfectly inelastic shape of the LM curve shows that the state controls the money supply in Islam as the holder of monetary authority and a monopoly on legitimate money issuance. In this case, the role is carried out by the central bank. Because the LM curve is perfectly inelastic, the money supply is free from the influence of the expected rate of profit (π). The money supply by the monetary authority is determined proportionally to the income or transaction value level. Therefore, regardless of the rate of profit which has implications for changes in the level of national income, the government will adjust the money supply needed in the economy so that the condition of the money supply is always the same as the money demand (MS = MD).

5. CONCLUSION

The balance of the goods market and the money market, or in other words, the balance of the natural and monetary sectors, is essential in the economy. The goods and money markets are the primary constructs for forming aggregate demand in the economy within the economic system. In Islamic economics, it is explained that at fixed prices, income and interest or the expected rate of profit will be at a level that balances both the goods market and the money market. The equilibrium level of income and interest is located at the intersection of the IS and LM curves, using both the interest basis and the expected rate of profit. In Islamic economics, a similar mechanism occurs in the economy, that income and the expected rate of profit will lead to this equilibrium level; however, as has been explained that changes in income do not immediately cause changes in interest rates in the money market which bring about the balance of demand and supply of money. Therefore, the interest rate in the interest-income panel can only be determined by the IS curve without involving the LM curve. In other words, the interest rate always occurs on the IS curve but can occur outside the LM curve.

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