

Analysis of the Effect of Provincial Minimum Wage and Inflation on Household Expenditure Levels in Java Island

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Keywords

PMW, Inflation, Household Expenditure, Random Effect

Abstract

The economic condition of Java Island, as the centre of national industrial and trade activities, is strongly influenced by the dynamics of wages and the prices of goods and services. Changes in **the** Provincial Minimum Wage (PMW) and inflation rate are two key factors that can affect purchasing power and household spending patterns. Based on this, this study aims to analyse the effects of PMW and inflation on household expenditure levels in Java Island over the period 2018–2024. This research employs a panel data regression analysis using the random effects model. The results show that PMW has a positive and significant effect on household expenditure, indicating that an increase in the minimum wage can enhance purchasing power and drive **consumer** spending. Conversely, inflation has a minimal impact on household expenditure. Simultaneously, both PMW and inflation significantly influence household expenditure, underscoring the importance of synergy between wage policy and price control in maintaining economic stability and public welfare.



INTRODUCTION

Indonesia's economy shows dynamic development in line with global and domestic changes that affect people's consumption behaviour. As the centre of national economic activity, Java Island has a significant contribution to the Gross Domestic Product (GDP) and is a barometer of the purchasing power of the Indonesian people (Rahmawati & Intan, 2020; Septriani, 2024). The level of household spending in the region reflects not only economic well-being, but also the effectiveness of the macro policies implemented by the government (Aida et al., 2022; Sari, 2025).

In the macroeconomic framework, the policy of setting the Provincial Minimum Wage (UMP) and controlling inflation is a strategic instrument in maintaining purchasing power (Priyatna & Suryadi, 2025; Salah, 2025; Wartoyo et al., 2024). UMP is designed as a social safety net that ensures workers earn a decent minimum income to meet their living needs (Aziz and Husenudin, 2024). Meanwhile, inflation affects the real value of income through changes in the prices of goods and services. Based on the Phillips Curve theory, moderate inflation can encourage economic growth, but high inflation actually erodes people's purchasing power (Mankiw, 2021). The relationship between the two creates a complex dynamic: the UMP hike is expected to boost consumption, but the impact may diminish if inflation increases.

Several previous studies have examined the influence of UMP and inflation on various economic indicators. Habibi, Taufiq, and Utami (2024) found that an increase in UMP accompanied by low inflation will strengthen people's purchasing power, and simultaneously UMP and inflation have a significant effect on household consumption in Indonesia. Suwarni's

research (2024) confirms that UMP is effective in increasing consumption, especially in low-to middle-income groups, who have a tendency to spend most of their additional income on daily needs. Meanwhile, Nuzulaili (2022) shows that although inflation is not necessarily significant in the short term, its impact on purchasing power remains relevant as it has the potential to create economic inequality in the long term, especially in regions with high cost of living.

Although various studies have highlighted UMP and inflation in their respective contexts. Most studies focus on the effect of UMP on labour absorption or inflation on poverty, without simultaneously examining its impact on public spending, especially on the island of Java which has unique economic and social characteristics (Yusuf et al., 2022). It is important to fill this research gap, considering that the interaction between wage policy and price dynamics can significantly affect consumption behaviour, both in the short and long term.

This study offers novelty by simultaneously analyzing the influence of UMP and inflation on the level of public spending in Java using a panel data approach with a random effect model. This method allows for the control of heterogeneity between regions, resulting in more accurate and relevant estimates for policy-making.

Based on this framework, the purpose of this study is to examine the relationship between UMP and inflation to the level of public spending in Java, both partially and simultaneously, in order to provide a comprehensive and evidence-based understanding to support the formulation of effective wage and price stability policies. The results of this research are expected to make a theoretical contribution to the development of economics, especially related to public consumption behaviour, as well as practical implications for local governments in formulating equitable UMP policies and targeted inflation control strategies.

METHOD

This study employed a quantitative approach with an explanatory research design to examine the effect of the Provincial Minimum Wage (PMW) and inflation on household expenditure levels across six provinces of Java Island (*DKI Jakarta, West Java, Central Java, DI Yogyakarta, East Java, and Banten*) over the period 2018–2024. This approach was selected for its capacity to test causal relationships between variables empirically and objectively through inferential statistical analysis (Sugiyono, 2019).

The data used are annual secondary data obtained from the Central Statistics Agency (*Badan Pusat Statistik, BPS*), Bank Indonesia (BI), and the Ministry of Manpower. The dependent variable is household expenditure level, measured through the logarithm of per capita expenditure (*log LPCE*), while the independent variables include PMW (in logarithmic form) and inflation, measured as the percentage change in the Consumer Price Index (CPI, 2010 = 100). The use of secondary data is justified by the availability of standardized, reliable, and relevant data for macroeconomic analysis.

The analysis was conducted using panel data regression, which combines time-series and cross-sectional dimensions to capture temporal dynamics as well as inter-provincial heterogeneity. The advantages of this method include greater data variation, increased degrees of freedom, and higher estimation efficiency (Ghozali, 2018). Model estimation considers three approaches: the Common Effect Model (CEM), the Fixed Effect Model (FEM), and the

Random Effect Model (REM), with the optimal model selected through the Chow test, the Hausman test, and the Lagrange Multiplier test.

Prior to estimation, classical assumption tests were conducted, including tests for normality (Jarque–Bera), multicollinearity (Variance Inflation Factor and inter-variable correlation), and heteroscedasticity (Glejser), in accordance with the selected panel model. Hypothesis testing was performed using the F-test for simultaneous effects, the *t*-test for partial effects, and the coefficient of determination (R^2) to assess the model's explanatory power over the dependent variable. All analyses were processed using EViews software. This methodology is expected to produce robust and relevant estimates that can serve as a reference for policymakers in formulating effective minimum wage and inflation control strategies in high-density economic regions such as Java Island.

RESULT AND IDISCUSSION

Results

1. Overview of Research Variables

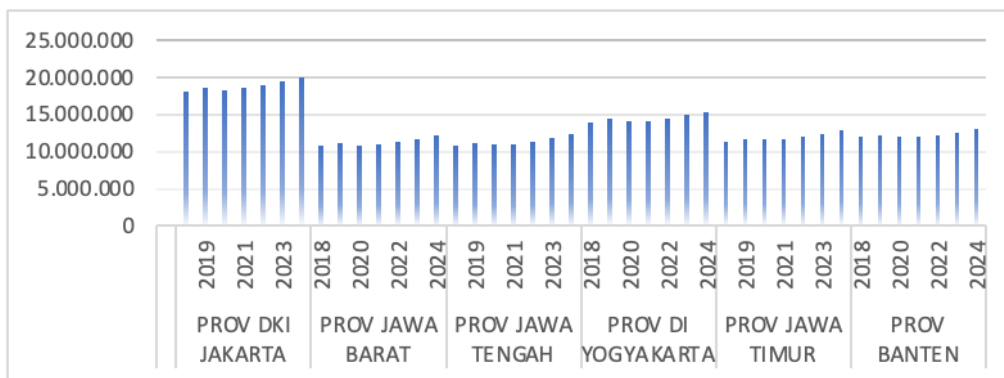


Figure 1 Development of the Level of Public Expenditure on the Island of Java, 2018–2024 (Rupiah)

In Figure 1 above, the level of public expenditure shows a consistent increasing trend in all provinces. Despite the slowdown in growth during the pandemic in 2020–2021, the level of public spending continues to show a positive direction, indicating the resilience of domestic consumption to economic pressures. DKI Jakarta is recorded as the province with the highest level of public expenditure every year, reflecting people's purchasing power that is stronger than other provinces. In contrast, DI Yogyakarta Province consistently has the lowest level of public spending, reflecting the difference in purchasing power between provinces. Overall, this trend shows that public consumption on the island of Java continues to experience stable growth despite facing external pressures.

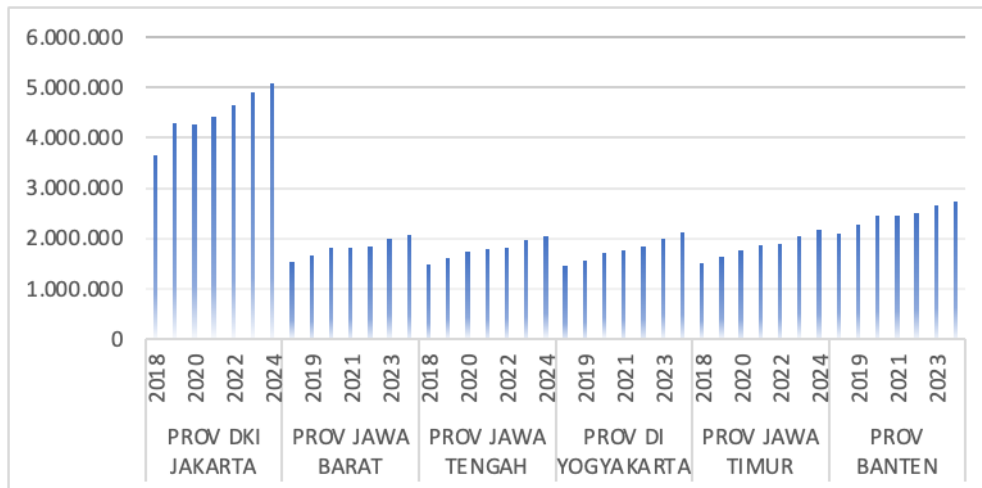


Figure 2 Development of UMP in Java, Year 2018–2024 (Rupiah)

Figure 2 above shows the development of the Provincial Minimum Wage (UMP) in six provinces of Java Island during the period 2018 to 2024. In general, the UMP shows a gradual upward trend from year to year across the province, reflecting the efforts of local governments in adjusting the minimum wage to inflation and the need for a decent living.

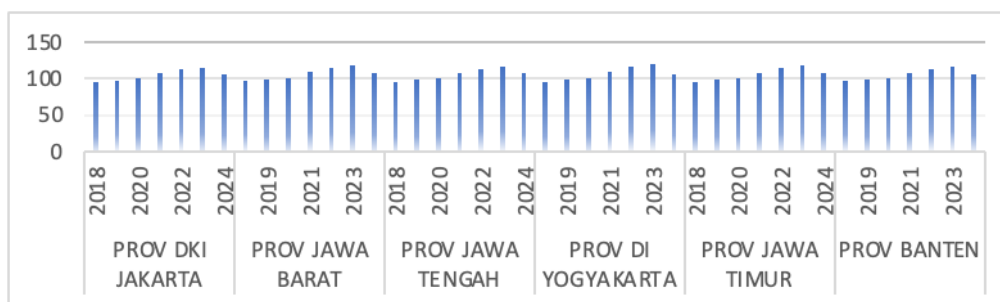


Figure 3 Inflation Development on the Island of Java, 2018–2024 (%)

The figure above shows inflation data measured based on changes in the Consumer Price Index (CPI), which is an indicator that represents the rate of price change of goods and services consumed by the public. In this figure, the CPI is used as an inflation proxy and is presented in the form of an index number with the base year 2020 which is equalized at 100%. An increase in the value of the CPI from year to year reflects inflation or an increase in prices in general, while a decrease or slowdown in the increase indicates slowing inflation or even the potential for deflation.

Table 1 Descriptive Statistics

Statistics	LUMP	INF	LPPP
Mean	14,60191	105,6998	23,29705
Median	14,49351	106,8400	23,22359
Maximum	15,43833	119,2300	23,71665
Minimum	14,18993	95,42000	23,10068
Std, Dev,	0,354459	7,545334	0,187055
Skewness	1,200298	0,219597	1,034733
Kurtosis	3,268886	1,702904	2,772275

Jarque-Bera	10,21153	3,281863	7,585465
Probability	0,006062	0,193799	0,022534
Sum	613,2801	4439,390	978,4762
Sum Sq, Dev,	5,151283	2334,215	1,434569
Observations	42	42	42

Source: BPS, 2025, Data processed by Researchers.

The Provincial Minimum Wage (UMP) variable shows the minimum wage standard set by the provincial government as the lowest wage that workers must receive. The average UMP recorded at 14.60%, illustrates the minimum wage standard that applies in the research area. The maximum score reached 15.44%, while the minimum score was recorded at 14.19%. The maximum UMP value will occur in DKI Jakarta Province in 2024, while the minimum UMP will occur in East Java Province in 2018. This shows that there is a variation in the minimum wage level between provinces and also between years during the study period. The standard deviation value of 0.35% indicates that the variation in UMP data is not too large, so that the difference in minimum wage between regions and times is still in a relatively narrow range.

2. Best Model Selection Test

a. Chow Test Results

Table 2 Chow (Redundant Fixed Effect Test) Results

Effects Test	Statistic	d.f.	Prob.
Cross-section F	171,307913	(5,34)	0,0000
Cross-section Chi-square	137,149614	5	0,0000

Based on the test results in Table 2, the *probability* value for the *Cross-section F* and *Cross-section Chi-square* tests is 0.0000 or less than the significance level of 0.05. This shows that there is a significant difference between the *Common Effect* model and the *Fixed Effect* model. Thus, the *Fixed Effect* model is more appropriate to be used than the *Common Effect* model in analyzing panel data in this study.

b. Hausman Test Results

Table 3 Hausman Test Results

Test Summary	Chi-Sq. Statistic	Chi-Sq. d.f.	Prob.
Cross-section random	1,155283	2	0,5612

Based on the results of Table 3, the probability value of the Hausman test is 0.5612 which is greater than the significance level of 0.05. This shows that there is no significant difference between the *Fixed Effect* and *Random Effect* models. Therefore, the more appropriate model to use is the *Random Effect model*.

c. LM Test Results

Table 4 Lagrange Multiplier Test Results (LM)

Metode	Cross-section	Time	Both
Breusch-Pagan	113,5976 (0,0000)	2.670980 (0,1022)	116,2686 (0,0000)

Based on the results in Table 4, it can be seen that all *probability* values for *cross-section* testing and *both* have significance values below 0.05. This shows that there are significant individual effects, so the *Random Effect* model is more appropriate to use than the *Common Effect* model. *The Random Effect* model is more suitable than *the Fixed Effect*, so the best model used in this study is the *Random Effect model*.

3. Classic Assumption Test

a. Normality Test

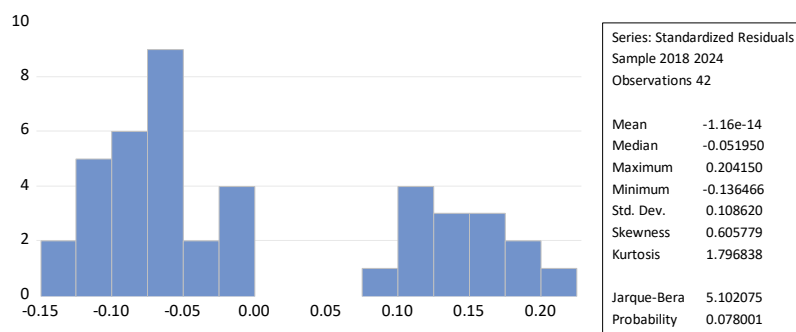


Figure 4 Normality Test

The Jarque-Bera value is 5.102075 with a probability value (p-value) of 0.078001, which is greater than the significance level of 5% (0.05). Thus, it can be concluded that the residual data is normally distributed due to the $p\text{-value} > 0.05$, so that the assumption of normality is met and the panel regression model is feasible for use in further analysis.

b. Multicollinearity Test

Table 5 Multicollinearity Test Results

Variable	Centered VIF
LUMP	2,212533
INF	2,212533

Based on Table 5, all independent variables have a *Centered VIF* value below 10, which is 2.212533. This shows that there is no multicollinearity between independent variables in this regression model.

c. Heteroscedasticity Test

Table 6 Heteroscedasticity Test Results

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	0,300501	0,519129	0,578856	0,5660
LUMP	-0,012072	0,038253	-0,315590	0,7540

INF	-0,000269	0,000602	-0,445863	0,6582
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Based on these results, the probability value for all independent variables (UMP and Inflation) is greater than 0.05, as well as the Prob(F-statistic) value of 0.655660. This shows that there is no significant influence of independent variables on residual variables, so it can be concluded that the model does not experience heteroscedasticity.

4. Random Effect *Panel Data Regression Test Results*,

Table 7 Random Effect Panel Data Regression Coefficient Test

Components	Value
Variable	
C (Constanta)	11,38183
Std. Error (C)	0,657936
t-Statistic (C)	17,29929
Probability (C)	0,0000
Coefficient LUMP	0,348954
Std. Error (LUMP)	0,048464
t-Statistic (LUMP)	7,200224
Probability (LUMP)	0,0000
Coefficient INF	-0,000832
Std. Error (INF)	0,000685
t-Statistic (INF)	-1,214314
Probability (INF)	0,2319
Effect Specifications (Swamy dan Arora)	
Cross-section random (S.D.)	0,127142
Idiosyncratic random (S.D.)	0,022188
Rho (Variations between cross-sections)	0,9704
(Weighted Statistic)	
R-squared	0,700698
Adjusted R-squared	0,685349
S.E. of regression	0,021947
F-statistic	45,65163
Components	Nilai
Prob(F-statistic)	0,000000
Mean dependent var	1,078706
S.D. dependent var	0,039125
Sum squared resid	0,0187885
Durbin-Watson stat	1,157277
(Unweighted Statistic)	
R-squared	0,662806
Mean dependent var	16,38930
Sum squared resid	0,483728
Durbin-Watson stat	0,044958

In the panel data regression coefficient test, the model used in this study is as follows:

$$LPPP_{it} = 11,38 + 0,35LUMP_{it} - 0,00083INF_{it} + \epsilon_{it}$$

$LPPP_{it}$ = The Rate of Public Expenditure in provinces i and year t (in the form of natural logarithms)

$LUMP_{it}$ = Provincial Minimum Wage in provinces i and year t (in the form of natural logarithms)

INF_{it} = Inflation rate in provinces i and year t (percentage)

ε_{it} = *An error term* that represents another variable outside the model.

- 1) The constant value of 11.38 in this model shows that if the value of the Regional Minimum Wage and inflation is equal to zero, then the value of the level of public expenditure is 11.38%.
- 2) The regression coefficient for the Provincial Minimum Wage (UMP) in this regression equation is 0.35, which indicates that for every increase in the Regional Minimum Wage by one percent, the level of public expenditure will increase by 0.35%, assuming that inflation is constant.
- 3) The regression coefficient for inflation is -0.00083 which means that every one percent increase in inflation, it will decrease the level of public spending by 0.000832%, assuming the Regional Minimum Wage is constant.

5. Coefficient Determination Test,

Table 8 Determination Test

<i>R Squared</i>	0,70069
<i>Adjusted R Squared</i>	0,685308

In the determination coefficient test, the *Adjusted R square value* was obtained of 0.685. The value of *R square* indicates the proportion of variation in dependent variables that can be explained by the variation of independent variables with *the value of the Adjusted R square* of 0.685, it can be concluded that 68.5% of the variation in *the level of public expenditure* can be explained by changes in independent variables, namely *UMP* and *inflation*.

6. T Test

Table 9 T Test

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	11,38183	0,657936	17,29929	0,0000
LUMP	0,3489654	0,048464	7,20024	0,0000
INF	-0,000832	0,000685	-1,214314	0,2319

The results of the analysis showed that the UMP variable had a significance value of 0.0000, which was smaller than the significance level of 0.05. This value indicates that UMP has a positive and significant influence on the level of public spending. For the Inflation variable, the regression test results showed a significance value of 0.2319, which is greater than the significance level of 0.05. This shows that Inflation does not have a significant influence on the level of public spending at a significant level of 5%. In other words, the inflation rate is not influential enough to significantly change people's purchasing power in the context of this study.

7. Test F

Based on the results contained in Table 7, the calculated F value obtained is 45.65, with a significance value of 0.000. Since this significance value is smaller than the significance level of 0.05, the null hypothesis (H₀) is rejected. This means that overall, the independent variables in this model, namely UMP and inflation, simultaneously have a significant effect on the level of public spending.

The Effect of Provincial Minimum Wage (UMP) and Inflation on the Rate of Public Expenditure in Java

The level of public expenditure on the island of Java is the main indicator to measure economic welfare, because of its significant contribution to Gross Domestic Product (GDP) and its ability to reflect purchasing power. Two factors that are very influential in determining expenditure are UMP and inflation, which have a mutually attractive relationship (Daniel et al., 2021; Muhammad, 2023). UMP acts as an instrument to increase income, while inflation can erode this purchasing power. In the framework of the Keynesian consumption function, consumption increases as incomes rise, but inflation can restrain the rate of increase in consumption. Research by Habibi et al. (2024) shows that an increase in UMP accompanied by low inflation will strengthen people's purchasing power, while Suparta et al. (2021) emphasize the importance of a balance between rising income and price stability to keep consumption high. The results of the analysis of panel data in this study prove that UMP and inflation simultaneously have a positive effect on the level of public spending on the island of Java. The increase in UMP encourages an increase in average spending, while the effects of inflation in this context tend to be controlled. This condition reinforces the importance of synergy between wage policy and price control. Thus, UMP policies at the provincial level should consider the economic conditions of each region and be accompanied by effective inflation control measures so that their effect on public consumption is more optimal.

The Effect of the Provincial Minimum Wage (UMP) on the Level of Community Expenditure in Java Island

Based on the results of the random effect model regression, UMP has a positive and significant influence on the level of public spending, with a coefficient of 0.35 and a significance of 0.000. This means that a 1% increase in UMP has the potential to increase spending by 0.35% assuming constant inflation. These findings are in line with the wage-led growth theory which states that wage increases are able to drive aggregate demand through an increase in household purchasing power. Suwarni (2024) emphasized that UMP is effective in increasing consumption, especially in low- to middle-income groups, who have a tendency to spend most of their additional income on daily needs. A clear example can be seen in DKI Jakarta, which recorded the highest UMP on the island of Java, rising from Rp 3.65 million (2018) to Rp 5.07 million (2024). This increase encourages diverse consumption patterns, ranging from basic necessities to urban lifestyles. Meanwhile, provinces such as West Java and Banten took advantage of the UMP increase to strengthen household spending on basic needs and long-term investment, such as education and housing. Valentine et al. (2024) show that the increase in UMP increases spending significantly in working households, while Farooq and

Siddique (2023) found a similar pattern in other countries with low wage levels, where consumption is mainly increased in the food and transportation sectors. This confirms that the right UMP policy can be a driver of consumption in various economic contexts.

The Effect of Inflation on the Rate of Public Expenditure on the Island of Java

Inflation in this study has a negative coefficient of -0.000832 on public spending, but it is not statistically significant (p-value 0.23). Theoretically, inflation has the potential to suppress consumption through an increase in the price of goods and services. However, the insignificance of these results can be explained by several mitigating factors, such as the annual increase in UMP that maintains purchasing power, government social assistance that suppresses the impact of prices, and adaptive consumption behaviour that leads people to switch to cheaper substitute goods. Nuzulaili (2022) emphasized that although it is not significant in the short term, inflation is still relevant because it has the potential to cause economic inequality in the long term, especially in areas with high living costs such as DKI Jakarta and Banten. In addition, the impact of inflation is highly dependent on the prevailing market structure and price policies. In areas with strong price controls and subsidies, the effect of inflation on consumption may not be immediately felt, while in areas with high dependence on imported goods, inflation can quickly suppress purchasing power. Therefore, even though the results of this study do not show a significant influence, local governments still need to be vigilant about the rate of inflation and integrate price control strategies with wage policies to ensure that public consumption remains the driving force of domestic economic growth.

KESIMPULAN

This study showed that the Provincial Minimum Wage (UMP) and inflation simultaneously affect the level of public spending on the island of Java. Partially, UMP has a positive and significant influence, where an increase of 1% in UMP tends to increase public spending by 0.35%. These findings are in line with wage-led growth theory which emphasizes the role of wage increases in driving aggregate demand, particularly for low- to middle-income groups. On the other hand, inflation shows a negative but insignificant influence on public spending. This insignificance is caused by balancing factors such as annual UMP adjustments, social assistance programs, and adaptation of people's consumption patterns in response to price increases. Nonetheless, inflation remains an important variable that needs to be controlled due to its potential impact on purchasing power and economic inequality in the long run. Based on these findings, it is recommended that local governments on the island of Java continue to improve the coordination of wage policies and inflation control in an integrated manner. The determination of the UMP should take into account the inflation rate and the need for a decent living in each region, while the price control strategy needs to be strengthened through stabilization of the supply of basic goods and efficient distribution. For future research, it is recommended to expand the scope of the region and add other variables such as unemployment or investment rates, as well as use a qualitative approach to better understand people's consumption behaviour in response to changes in wages and prices.

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