



## Hedging from the Perspective of Maqasid Shariah

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### ABSTRACT

The growing volatility of global exchange rates presents significant risks for emerging economies, particularly those heavily reliant on foreign-denominated debt, such as Indonesia. Conventional hedging instruments, while mitigating currency risk, often conflict with Islamic financial principles due to elements of *riba* (interest), *gharar* (uncertainty), and *maisir* (speculation). This study proposes a Shariah-compliant hedging framework grounded in Maqasid al-Shariah to offer an ethical and sustainable alternative to conventional risk management tools. Through simulation modeling, the study explores the potential of Islamic forward contracts and cross-currency swaps in strengthening external debt resilience while adhering to Islamic principles. The research anticipates that Maqasid al-Shariah will significantly drive the adoption of Islamic hedging mechanisms, enhancing financial stability in both local and international contexts. Moreover, Shariah-compliant instruments are expected to mediate the relationship between ethical objectives and exchange rate stability, offering dual benefits of compliance and economic resilience. By addressing the intersection of Islamic finance, global economic risk, and sustainable development, this study provides theoretical contributions and practical policy recommendations. The findings aim to support regulators, financial institutions, and international stakeholders in promoting Shariah-based financial innovation as a critical component of global financial stability in the face of ongoing economic uncertainties.

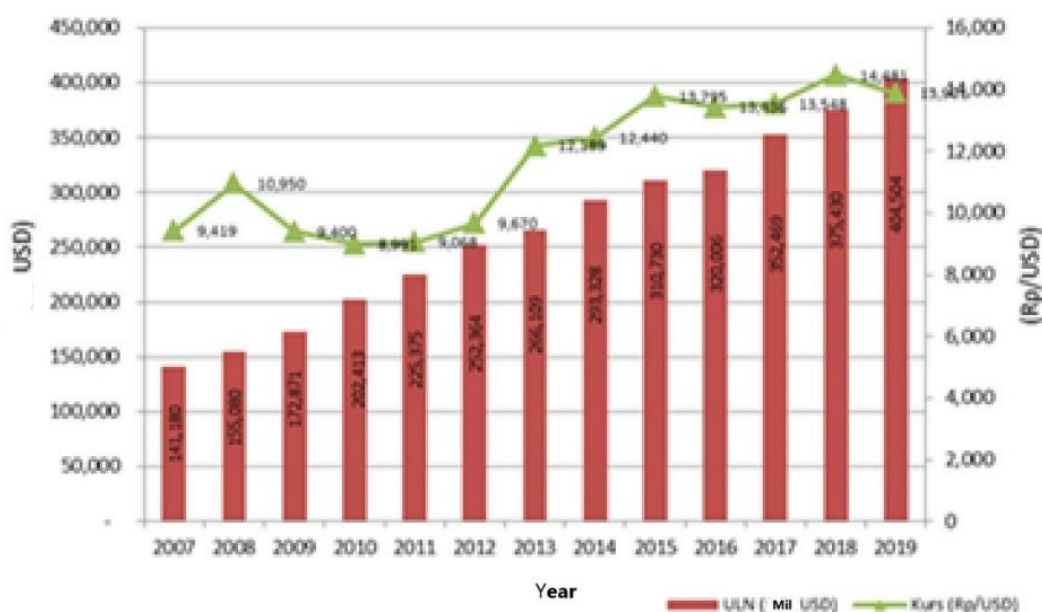
**Keywords:** islamic finance, shariah-compliant hedging, maqasid shariah, exchange rate risk.

### INTRODUCTION

The 1997 financial crisis, which originated in Thailand, fundamentally disrupted the financial stability of many Southeast Asian countries, including Indonesia. This crisis exposed inherent vulnerabilities in the financial systems of developing economies, particularly those overly dependent on external capital and foreign exchange stability. In response, Indonesia adopted stringent monetary policies, including raising interest rates and liberalizing its financial

markets, to stabilize the Rupiah and attract foreign reserves.<sup>1</sup> However, while financial liberalization promised economic growth, it often introduced significant risks by increasing exposure to external shocks in under-regulated financial systems.<sup>2</sup>

The dominance of the U.S. dollar in international finance compounds these vulnerabilities. Established through the Bretton Woods system, the U.S. dollar became the global reserve currency, a position further entrenched by the petrodollar system. After the collapse of the Bretton Woods gold standard in 1971, countries like Indonesia faced greater exposure to exchange rate volatility.<sup>3</sup> For Indonesia, the reliance on the U.S. dollar to finance development projects has created a persistent challenge: external debt denominated in dollars increases vulnerability to fluctuations in the Rupiah's exchange rate, particularly during periods of global economic instability.<sup>4</sup>



**Figure 1. Correlation Between External Debt Growth and Rupiah Exchange Rate Fluctuations (2007-2019).**

<sup>1</sup> Muhammad Pathi Farhan, Desmintari Desmintari, and MB Nani Ariani, "Determinasi Pertumbuhan Ekonomi Indonesia Dalam Sudut Pandang Moneter," *Jurnal Indonesia Sosial Sains* 3, no. 3 (2022).

<sup>2</sup> Iriana Wihardja and Jayadi Jayadi, "Hubungan Antara Liberalisasi Keuangan Terhadap Pertumbuhan Ekonomi: Tinjauan Meta Analisis," *Labs: Jurnal Bisnis dan Manajemen* 28, no. 4 (2023).

<sup>3</sup> Alain Naef, "Britain, Nixon and the End of Bretton Woods," in *An Exchange Rate History of the United Kingdom*, 2022.

<sup>4</sup> I Putu et al., "Analysis of Factors Affecting the Rupiah Exchange Rate Against the US Dollar 2000-2022," *Loka: Journal Of Environmental Sciences* (2024).

Figure 1 illustrates the correlation between Rupiah exchange rate volatility and Indonesia's external debt burden from 2007 to 2019. Over this period, the Rupiah experienced significant depreciation, particularly during global financial crises and periods of U.S. monetary tightening. This depreciation directly inflated the cost of servicing Indonesia's external debt, which rose steadily from \$141 billion in 2007 to \$404 billion in 2019. Even in periods of Rupiah appreciation, such as between 2009 and 2012, external debt continued to grow, albeit at a slower rate, reflecting Indonesia's sustained reliance on external financing. The persistent upward trend in debt, coupled with exchange rate fluctuations, underscores the critical importance of effective risk management strategies to mitigate these challenges.<sup>5</sup>

Hedging has emerged as a pivotal strategy to mitigate the financial risks associated with currency volatility. Conventional hedging tools, such as forward contracts, options, and swaps, have been widely employed in conventional financial systems to stabilize cash flows and minimize exposure to foreign exchange risks.<sup>6</sup> However, the use of such instruments within the Islamic financial framework is constrained by strict adherence to Shariah principles, which prohibit interest (riba), excessive uncertainty (gharar), and speculation (maisir). These prohibitions necessitate the development of innovative, Shariah-compliant hedging mechanisms, such as Islamic forwards, cross-currency swaps, and profit-sharing contracts, which align with Maqasid Shariah principles while effectively addressing risk.<sup>7</sup>

Islamic finance offers unique advantages in managing financial risks, as it emphasizes ethical practices and equitable distribution of risks and rewards. Research highlights that Islamic hedging mechanisms can effectively mitigate exchange rate risks while reducing non-performing financing (NPF) in Islamic financial institutions.<sup>8</sup> However, challenges persist in the adoption of these instruments, including low public awareness, limited regulatory frameworks, and the technical complexity of Islamic financial contracts. As a result, Islamic banks and financial institutions remain disproportionately exposed to currency risks.

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<sup>5</sup> Muhammad Rafi Fernanda Nayottama and Thomas Andrian, "Analisis Pengaruh, Neraca Transaksi Berjalan, Jumlah Uang Beredar, Inflasi, Suku Bunga, Dan Utang Luar Negeri Terhadap Nilai Tukar Di Indonesia," *Jurnal Impresi Indonesia* 1, no. 12 (2022).

<sup>6</sup> Manuela Gutierrez-Salazar, Miguel Jiménez-Gómez, and Natalia Acevedo-Prins, "Evaluation of Efficiency of Hedging Strategies with Option Portfolios for Buyers of the Currency US Dollar/Colombian Peso," *IAES International Journal of Artificial Intelligence* 11, no. 2 (2022).

<sup>7</sup> Misbahul Khoer and Acim Acim, "Analisis Kebijakan Hedging Dalam Mengelola Risiko Pembiayaan Pada Bank Syariah Di Indonesia," *KHITABAH: Khazanah Penelitian Perbankan Syariah* 1, no. 2 (December 17, 2024): 84-90, <https://journal.putragaluh.ac.id/index.php/khitabah/article/view/78>.

<sup>8</sup> Mohammad Alsharif, "Interest Rate, Foreign Exchange and Stock Performance in a Dual Banking Industry: Evidence from Saudi Arabia," *Journal of Money and Business* 3, no. 1 (2023).

Therefore, this research seeks to bridge the gap between Islamic finance theory and the practical demands of risk management in emerging markets. Specifically, it proposes a conceptual framework that leverages Maqasid Shariah principles to develop Shariah-compliant hedging mechanisms capable of mitigating Indonesia's external debt risks. The study aims to contribute to the theoretical discourse by expanding the application of Maqasid Shariah into risk management fields and offer practical insights for policymakers, regulators, and financial institutions striving for financial resilience aligned with Islamic ethical norms.

The key research objectives are: (1) to assess the influence of Maqasid Shariah on the development of Islamic hedging mechanisms, (2) to evaluate the effectiveness of these mechanisms in stabilizing exchange rate risks, and (3) to explore the mediating role of Shariah-compliant hedging in achieving macroeconomic stability. Through these objectives, the research endeavors to present a viable alternative to conventional financial risk management models, providing an ethically sustainable pathway for Indonesia's economic future.

## Literature review

### Maqasid Shariah and Its Application in Finance

Maqasid Shariah, representing the higher objectives of Islamic law, fundamentally shapes the ethos of Islamic finance. It emphasizes the preservation of religion (al-Din), life (al-Nafs), intellect (al-Aql), lineage (al-Nasl), and wealth (al-Mal), thereby ensuring that financial practices uphold ethical, social, and economic justice.<sup>9</sup> This framework distinguishes Islamic finance from conventional systems by prioritizing risk-sharing, equitable wealth distribution, and social welfare over mere profit maximization.<sup>10</sup>

Recent scholarship has highlighted the growing relevance of Maqasid Shariah in addressing contemporary socio-economic challenges, such as financial inclusion, poverty alleviation, and sustainable development.<sup>11</sup> Notably, Güney critically examines the integration of Maqasid Shariah principles within modern Islamic financial discourses, aligning them with global Sustainable Development Goals (SDGs).<sup>12</sup> This synergy illustrates how

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<sup>9</sup> Akilu Aliyu Shinkafi, Nor Aini Ali, and Masudul Choudhury, "Contemporary Islamic Economic Studies on Maqasid Shari'ah: A Systematic Literature Review," *Humanomics* 33, no. 3 (2017).

<sup>10</sup> Mohammad Hashim Kamali, *Maqasid Al-Shari'ah, Ijtihad and Civilization Renewal*, vol. 20 (Herndon, VA: International Institute of Islamic Thought (IIIT), 2012).

<sup>11</sup> Burhanudin Harahap, Tastaftiyan Risfandy, and Inas Nurfadia Putri, "Islamic Law, Islamic Finance, and Sustainable Development Goals: A Systematic Literature Review," *Sustainability (Switzerland)*, 2023.

<sup>12</sup> Güney, Necmeddin. "Maqāsid al-Sharī 'a in Islamic Finance: A Critical Analysis of Modern Discourses." *Religions* 15.1 (2024): 114.

Islamic financial institutions can ethically contribute to global development agendas.

Furthermore, Maqasid Shariah guides the creation of Shariah-compliant financial products. Risk-sharing contracts like *mudarabah* (profit-sharing) and *musharakah* (partnership) embody principles of fairness and mutual benefit, ensuring adherence to Islamic ethical standards.<sup>13</sup> These instruments have been lauded for their ability to promote economic resilience while minimizing systemic risks. Tumewang et al underscore this trend through a bibliometric analysis, indicating the increasing scholarly focus on Maqasid Shariah's theoretical and practical applications in Islamic banking.<sup>14</sup>

Despite its potential, operationalizing Maqasid Shariah within financial systems remains challenging. Issues such as limited public understanding, regulatory inconsistencies, and the technical complexity of Shariah-compliant product design persist.<sup>15</sup> However, integrating Maqasid Shariah into financial decision-making frameworks offers a strategic pathway to creating ethical, sustainable, and resilient financial systems, particularly for managing external debt and mitigating financial risks.

### Hedging in Islamic Finance

Hedging, as a critical financial strategy for managing risks such as currency volatility, assumes a distinctive form within Islamic finance due to strict adherence to Shariah principles. These principles prohibit *riba* (interest), *gharar* (excessive uncertainty), and *maisir* (speculation), necessitating the development of innovative risk management instruments that align with Islamic ethical standards.<sup>16,17</sup>

Islamic hedging mechanisms, including *wa'ad*-based swaps, Islamic forwards, and profit-sharing contracts, have been designed to address these Shariah constraints. These tools provide robust alternatives to conventional derivatives, enabling financial institutions to mitigate risks without violating Islamic legal

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<sup>13</sup> Iqbal, Zamir, and Abbas Mirakhor. *An introduction to Islamic finance: Theory and practice*. Vol. 687. John Wiley & Sons, 2011.

<sup>14</sup> Yunico Karina Tumewang, Herlina Rahmawati Dewi, and Hanudin Amin, "Over a Decade of Maqashid Sharia Studies: A Bibliometric Analysis and Direction for Future Research," *Journal of Islamic Accounting and Business Research*, 2023.

<sup>15</sup> Shinkafi, Akilu Aliyu, and Nor Aini Ali. "Contemporary Islamic economic studies on Maqasid Shari'ah: a systematic literature review." *Humanomics* 33.3 (2017): 315-334.

<sup>16</sup> Auwal Adam Saad and Syed Musa Syed Jaafar Alhabshi, "Debt Theories in Islamic Commercial Transactions and Their Implications for the Islamic Capital Market," *International Journal of Management and Applied Research* 6, no. 4 (2019).

<sup>17</sup> Khoer and Acim, "Analisis Kebijakan Hedging Dalam Mengelola Risiko Pembiayaan Pada Bank Syariah Di Indonesia."

prohibitions.<sup>18</sup> Research by Güney critically analyzes the alignment of these instruments with Maqasid Shariah principles, emphasizing their potential in reducing financial risks without compromising ethical values.<sup>19</sup>

However, the adoption of Islamic hedging tools faces significant challenges. Limited public awareness and the technical complexity of Shariah-compliant instruments hinder their widespread use. Moreover, the regulatory environment often lags behind the innovation of these tools, creating additional barriers to implementation. Yusof and colleagues highlight the importance of regulatory frameworks and education in promoting the adoption of Islamic hedging mechanisms, particularly in emerging markets like Indonesia.<sup>20</sup>

Despite these challenges, Islamic hedging instruments are increasingly recognized for their ability to mitigate financial risks in a manner consistent with Maqasid Shariah. Their application in managing external debt and currency volatility presents a viable alternative to conventional financial tools, particularly for economies heavily reliant on foreign capital. As such, the development and promotion of Islamic hedging mechanisms are critical for enhancing the resilience of Islamic financial systems.

### External Debt and Islamic Financial Solutions

The management of external debt is a critical challenge for developing economies, particularly in the context of currency volatility and high-interest burdens associated with conventional financing. Islamic finance, with its emphasis on risk-sharing and ethical practices, offers alternative solutions that align with Maqasid Shariah. Auwal Adam Saad and Syed Musa Syed Jaafar Alhabshi argue that equity-based financing, such as *mudarabah* and *musharakah* contracts, is more effective in promoting fairness and reducing systemic risks compared to debt-based models.<sup>21</sup>

Conventional external debt financing often exacerbates economic vulnerabilities by increasing exposure to exchange rate fluctuations and interest rate volatility. In contrast, Islamic financial solutions, such as *sukuk* (Islamic bonds), offer fixed profit-sharing arrangements that shield borrowers from rising interest costs. Yusof and colleagues emphasize the role of *sukuk* in

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<sup>18</sup> Zamir Iqbal and Abbas Mirakhor, *An Introduction to Islamic Finance: Theory and Practice* (Singapore: Wiley, 2011).

<sup>19</sup> Necmeddin Güney, "Maqāsid Al-Sharī'a in Islamic Finance: A Critical Analysis of Modern Discourses," *Religions* 15, no. 1 (2024).

<sup>20</sup> Alsharif, "Interest Rate, Foreign Exchange and Stock Performance in a Dual Banking Industry: Evidence from Saudi Arabia."

<sup>21</sup> Auwal Adam Saad and Syed Musa Syed Jaafar Alhabshi, "Debt Theories in Islamic Commercial Transactions and Their Implications for the Islamic Capital Market," *International Journal of Management and Applied Research* 6, no. 4 (2019).

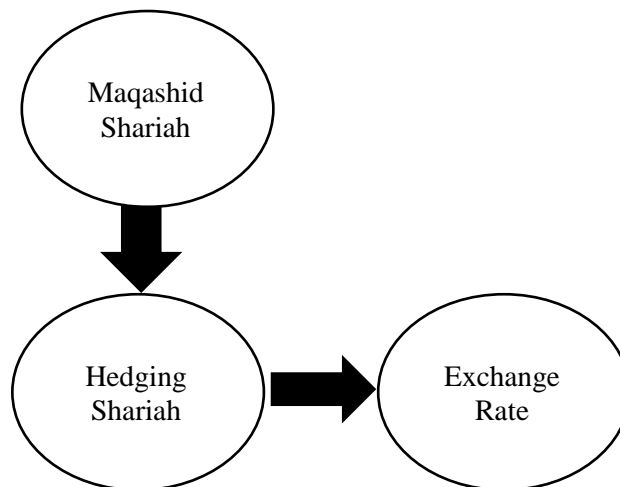
managing external debt sustainably while ensuring compliance with Islamic ethical principles.<sup>22</sup>

Furthermore, Islamic finance emphasizes transparency and accountability in financial transactions, reducing the likelihood of debt mismanagement. Tumewang highlight that the integration of Maqasid Shariah in financial decision-making enhances economic stability and promotes ethical risk management practices.<sup>23</sup>

The application of Islamic financial principles in external debt management has significant implications for developing economies like Indonesia. By adopting Shariah-compliant instruments, these countries can achieve greater economic resilience while ensuring adherence to ethical and religious values. However, the successful implementation of these solutions requires strong regulatory support, enhanced public awareness, and capacity building within Islamic financial institutions.

### Conceptual Framework

To illustrate the theoretical foundation of this study, Figure 2 presents the conceptual framework, which outlines the relationships between Maqasid Shariah, Shariah-compliant hedging mechanisms, and exchange rate stability.



**Figure 2. Conceptual Framework**

The conceptual framework depicted in Figure 2 highlights the interrelationships among Maqasid Shariah, Shariah-Compliant Hedging Mechanisms, and Exchange Rate Stability, offering a structured approach to addressing financial risks within the Islamic finance context. This framework reflects the core principles of Maqasid Shariah and their operationalization

<sup>22</sup> Eddy Yusuf et al., "Islamic Finance: Debt Versus Equity Financing in the Light of Maqasid Al-Shari'ah," *Munich Personal RePEc Archive* (2009).

<sup>23</sup> Tumewang, Rahmawati Dewi, and Amin, "Over a Decade of Maqashid Sharia Studies: A Bibliometric Analysis and Direction for Future Research."

through Shariah-compliant hedging tools, ultimately contributing to macroeconomic outcomes such as exchange rate stability.

Maqasid Shariah, as the foundational construct, embodies the higher objectives of Islamic law, including the protection of wealth (hifdh al-mal), social justice, and equitable distribution of resources. It serves as the ethical guide for designing financial instruments that comply with Shariah principles while addressing practical economic challenges.<sup>24</sup> Within this framework, Maqasid Shariah influences the development of hedging mechanisms by providing a moral and practical foundation for risk management tools.

Shariah-Compliant Hedging Mechanisms serve as a critical mediating construct. These tools, such as Islamic forwards, wa'ad-based swaps, and structured profit-sharing contracts, operationalize Maqasid Shariah principles by mitigating financial risks without violating prohibitions against riba (interest), gharar (excessive uncertainty), and maisir (speculation). Research demonstrates that these mechanisms not only reduce exchange rate volatility but also promote economic stability in a manner consistent with Islamic ethics.<sup>25</sup> Moreover, these tools align with the Maqasid Shariah objective of protecting wealth by offering practical solutions to manage financial risks faced by businesses and financial institutions.

Exchange Rate Stability emerges as the primary outcome within the framework. Volatility in exchange rates poses significant risks for economies with high exposure to foreign currency-denominated debt, such as Indonesia. Shariah-compliant hedging mechanisms play a pivotal role in stabilizing exchange rates by reducing the adverse effects of currency fluctuations. Auwal Adam Saad and Syed Musa Syed Jaafar Alhabshi highlight the contribution of Islamic financial instruments<sup>26</sup>, such as sukuk and equity-based models, in enhancing macroeconomic resilience and mitigating exchange rate risks.

From this conceptual framework, the following hypotheses are proposed:

1. H1: Maqasid Shariah has a significant positive influence on the development of Shariah-compliant hedging mechanisms.
2. H2: Shariah-compliant hedging mechanisms have a significant positive effect on exchange rate stability.
3. H3: Maqasid Shariah indirectly influences exchange rate stability through Shariah-compliant hedging mechanisms.

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<sup>24</sup> Shinkafi, Ali, and Choudhury, "Contemporary Islamic Economic Studies on Maqasid Shari'ah: A Systematic Literature Review."

<sup>25</sup> Güney, "Maqāsid Al-Sharī'a in Islamic Finance: A Critical Analysis of Modern Discourses."

<sup>26</sup> Saad and Syed Jaafar Alhabshi, "Debt Theories in Islamic Commercial Transactions and Their Implications for the Islamic Capital Market."

4. H4: Shariah-compliant hedging mechanisms mediate the relationship between Maqasid Shariah and exchange rate stability.

## METHODS

This study adopts a quantitative research approach utilizing simulation modeling to assess the effectiveness of Shariah-compliant hedging mechanisms in mitigating Indonesia's external debt risks. Given the volatility of the Rupiah against the U.S. dollar, this research aims to explore how Islamic financial instruments provide a cost-effective and ethically compliant alternative for risk management. By using a simulation-based methodology, the study can comprehensively analyze the performance of Islamic hedging tools under different exchange rate scenarios.

The population for this study consists of Indonesia's external debt obligations, particularly those denominated in foreign currencies, which are highly susceptible to exchange rate fluctuations. The sample is drawn from Bank Indonesia's External Debt Statistics, ensuring a reliable and comprehensive dataset. The selection of U.S. dollar-denominated debts is justified due to their exposure to macroeconomic risks and the need for stable repayment mechanisms. The study focuses on the ability of Shariah-based hedging instruments to mitigate these risks while adhering to Maqasid Shariah principles.

To evaluate the performance of Shariah-compliant hedging, the research simulates various exchange rate fluctuation scenarios, including extreme depreciation conditions during financial crises, moderate volatility under stable economic conditions, and high-growth periods characterized by currency strengthening. These scenarios help to measure the resilience of Shariah-based forward contracts, which are tested for their effectiveness in stabilizing external debt repayments. Unlike conventional derivatives, which incorporate elements of *riba* (interest) and *gharar* (excessive uncertainty), the Islamic hedging instruments analyzed in this study are structured to comply with Maqasid Shariah principles, ensuring risk-sharing and ethical alignment.<sup>27</sup>

The study employs scenario-based modeling to assess the cost savings and risk mitigation potential of Islamic hedging instruments. The effectiveness of these mechanisms is measured through performance indicators such as total cost savings achieved through hedging strategies, reduction in financial volatility of debt repayment obligations, and comparative efficiency between Shariah-compliant and conventional hedging tools. The analysis ensures robustness by applying reliability tests to validate the accuracy of the simulated data, stress testing under various economic conditions, and conducting

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<sup>27</sup> Shinkafi, Ali, and Choudhury, "Contemporary Islamic Economic Studies on Maqasid Shari'ah: A Systematic Literature Review."

comparative analyses with conventional hedging to highlight the unique benefits of Islamic financial solutions.<sup>28</sup>

Ethical considerations are embedded within the research methodology to ensure full compliance with Shariah principles. The study strictly adheres to Islamic financial ethics, ensuring that all financial mechanisms analyzed align with the principles of risk-sharing, fairness, and social justice. Regulatory frameworks such as Bank Indonesia's hedging regulations (PBI No. 18/2/PBI/2016) and Fatwa DSN-MUI No. 96/2015 are referenced to ensure the research's relevance to current policy developments.<sup>29</sup> Moreover, data integrity is maintained through rigorous verification processes, ensuring that all findings contribute meaningfully to the body of knowledge in Islamic financial risk management.

The expected contribution of this research extends to both theoretical advancements and practical implications. The study aims to bridge the gap between Islamic finance principles and real-world risk management applications, offering policy recommendations for optimizing Shariah-based hedging strategies to improve Indonesia's financial stability. Additionally, the research provides empirical evidence for financial institutions on the benefits and challenges of implementing Islamic risk mitigation instruments.<sup>30</sup>

This methodology ensures a comprehensive, ethical, and empirically robust analysis of Islamic hedging mechanisms, reinforcing their potential as viable financial solutions. The integration of Maqasid Shariah in risk management practices highlights the importance of Islamic financial tools in achieving sustainable economic stability. By demonstrating how Shariah-compliant hedging mechanisms mitigate currency risk, the research contributes to both Islamic finance theory and policy implementation, offering valuable insights for regulators, financial institutions, and policymakers in emerging economies.

## RESULTS AND DISCUSSION

The proposed study aims to evaluate the effectiveness of Shariah-compliant hedging mechanisms in mitigating Indonesia's exchange rate risk and ensuring the stability of external debt servicing within the framework of

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<sup>28</sup> Alsharif, "Interest Rate, Foreign Exchange and Stock Performance in a Dual Banking Industry: Evidence from Saudi Arabia."

<sup>29</sup> Dewan Syari'ah Nasional Majelis Ulama Indonesia, *Fatwa Dewan Syari'ah Nasional Nomor: 28/DSN-MUI/III/2002 Tentang Jual Beli Mata Uang (Al-Sharf)* (Jakarta, 2002).

<sup>30</sup> Saad and Syed Jaafar Alhabshi, "Debt Theories in Islamic Commercial Transactions and Their Implications for the Islamic Capital Market."

Maqasid Shariah. As an emerging alternative to conventional financial risk management, Islamic hedging mechanisms, particularly Islamic forward contracts and cross-currency swaps, present an opportunity for reducing financial vulnerabilities while upholding ethical and religious principles.

The anticipated findings of this research are expected to highlight the strategic importance of Islamic financial instruments in stabilizing external debt payments, particularly for economies that experience high exposure to currency volatility. By simulating various economic conditions – ranging from periods of economic expansion to crisis-induced exchange rate depreciation – the study is expected to reveal how Shariah-based hedging tools compare to conventional derivatives in ensuring financial stability. Existing literature suggests that Islamic hedging mechanisms, when structured according to Maqasid Shariah principles, can offer viable alternatives to risk mitigation, avoiding elements of speculation (*maisir*) and excessive uncertainty (*gharar*).<sup>31</sup>

The conceptual framework suggests that Maqasid Shariah principles will significantly influence the development and adoption of Islamic hedging mechanisms. Islamic finance prioritizes risk-sharing, social justice, and ethical wealth management, which differentiates it from conventional financial systems. If the anticipated results confirm this hypothesis, it would reinforce the argument that Shariah-compliant hedging instruments can function as ethical financial tools while maintaining economic resilience.<sup>32</sup>

Another expected finding is the potential role of Shariah-compliant hedging mechanisms in stabilizing exchange rates. Given that currency fluctuations remain a key challenge for external debt management, Islamic hedging tools may serve as an effective strategy to limit financial uncertainty and create more predictable debt repayment conditions. While conventional hedging tools rely on speculative market instruments, Islamic hedging mechanisms emphasize real economic transactions, aligning with both Shariah objectives and sustainable financial stability.<sup>33</sup>

Despite the potential benefits, the study also anticipates key challenges in the adoption of Islamic hedging mechanisms. Regulatory constraints, lack of market awareness, and limited adoption by financial institutions remain critical barriers to implementing Shariah-compliant financial products on a large

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<sup>31</sup> Güney, "Maqāsid Al-Sharī'a in Islamic Finance: A Critical Analysis of Modern Discourses."

<sup>32</sup> Shinkafi, Ali, and Choudhury, "Contemporary Islamic Economic Studies on Maqasid Shari'ah: A Systematic Literature Review."

<sup>33</sup> Saad and Syed Jaafar Alhabshi, "Debt Theories in Islamic Commercial Transactions and Their Implications for the Islamic Capital Market."

scale.<sup>34</sup> The findings are expected to highlight the need for stronger regulatory frameworks and financial education initiatives to promote the practical application of Islamic risk mitigation strategies.

Overall, this study aims to contribute both theoretically and practically to the growing field of Islamic finance and risk management. The anticipated findings could provide empirical support for the integration of Maqasid Shariah principles into financial stability strategies while offering policy recommendations for financial institutions and regulatory bodies.

## CONCLUSION

This study proposes an empirical investigation into Shariah-compliant hedging mechanisms and their role in mitigating exchange rate risk for external debt management in Indonesia. By utilizing simulation modeling, the research seeks to provide evidence-based insights into how Islamic financial instruments can be structured to stabilize external debt repayments while adhering to Maqasid Shariah principles.

If the anticipated findings align with existing theories, this research could validate the argument that Islamic finance offers ethical yet effective risk management tools. The study expects to demonstrate that Shariah-compliant hedging instruments can serve as a legitimate alternative to conventional financial derivatives while reducing exposure to exchange rate fluctuations. Additionally, it is projected that integrating Maqasid Shariah into hedging practices can enhance economic resilience by promoting risk-sharing and fairness in financial transactions.<sup>35</sup>

The practical implications of this research extend beyond academic contributions. If validated, the study could provide guidelines for policymakers and financial institutions on how to implement Shariah-based hedging mechanisms to reduce financial vulnerabilities. These insights may encourage regulatory advancements, such as updated fatwas on Islamic financial instruments, and foster broader adoption among Islamic financial institutions.

Despite these optimistic projections, the study acknowledges the potential challenges and limitations. Given that Shariah-compliant hedging remains an emerging area of research, regulatory complexities and limited market awareness may hinder widespread adoption. Future research could

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<sup>34</sup> Alsharif, "Interest Rate, Foreign Exchange and Stock Performance in a Dual Banking Industry: Evidence from Saudi Arabia."

<sup>35</sup> Tumewang, Rahmawati Dewi, and Amin, "Over a Decade of Maqashid Sharia Studies: A Bibliometric Analysis and Direction for Future Research."

expand on this study by incorporating comparative analyses between different Islamic financial markets (e.g., Malaysia, Saudi Arabia) to further test the generalizability of the findings.

In conclusion, this study seeks to bridge the gap between Islamic finance theory and financial risk management applications, offering a structured pathway for developing Shariah-compliant hedging tools. If successful, the findings will contribute to a sustainable and ethically sound financial system, reinforcing the long-term viability of Islamic financial instruments in mitigating macroeconomic risks.

#### **Author's Contribution**

Hernawaty: Contribute to formulating research ideas, collecting data, processing data, and interpreting data.

Nurhayati: Contributing to writing systematics, research methods, analyzing interpretation results.

Isnaini Harahap: Contributed to compiling a literature review.

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#### **Declaration of Competing Interest**

The author declares that there is no conflict of interest.

#### **Ethical Approval**

Ethical approval No patient-identifying parts in this paper were used or known to the authors. Therefore, no ethical approval was requested.

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