Does Islamic Banking favors Price Stability? An Empirical evidence from the GCC, Iran and Sudan

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Abstract

This paper studies the relationship between Islamic banking growth and inflation in the Gulf Cooperation Council (GCC), Iran and Sudan using monthly time series and unbalanced monthly panel data covering the period 2001 - 2015. Several econometrics models are applied including single equation model, panel ordinary least squares (OLS) and Vector error correction model (VECM). The empirical findings revealed that Islamic banking does not increase domestic prices in all the models applied. According to the single equation OLS results, Islamic banking growth dampen domestic prices in Oman, Qatar and Iran. From VECM analysis, in the short-run, Islamic banking decrease inflation in Iran and Sudan and in the long run, Islamic banking growth dampen inflation in Bahrain and Iran. The panel regression results revealed no indication that Islamic banking growth increases inflation. Five out of seven countries considered in the study revealed that Islamic banking dampened domestic price inflation. Inflation inertia, monetary growth and exchange rate depreciation are the main factors that increase inflation in these economies. The impact of an increase in international food and oil prices on domestic prices revealed mixed results. While an increase in international food and oil prices increases domestic prices in certain countries, it dampens inflationary pressure in some other countries, which could be due to government subsidies. The empirical results call for the need for economic diversification and reduce heavily dependent on oil. It also requires the need for the monetary authorities to implement tighten monetary policy. The results offer new views and insight for further empirical work on Islamic banking and macroeconomic stability.

JEL: C1, E5, E41, E51, F31

Keywords: Islamic banking growth, domestic inflation, Sharia, The GCC, Iran, Sudan

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