

## Accepted Manuscript

Islamic finance and economic growth: The Malaysian experience

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PII: S1044-0283(16)30042-4  
DOI: doi: [10.1016/j.gfj.2015.11.007](https://doi.org/10.1016/j.gfj.2015.11.007)  
Reference: GLOFIN 338

To appear in: *Global Finance Journal*

Received date: 17 March 2015  
Revised date: 25 May 2015  
Accepted date: 9 November 2015



Please cite this article as: Kassim, S., Islamic finance and economic growth: The Malaysian experience, *Global Finance Journal* (2016), doi: [10.1016/j.gfj.2015.11.007](https://doi.org/10.1016/j.gfj.2015.11.007)

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**Islamic Finance and Economic Growth: the Malaysian Experience****Salina Kassim**

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**Abstract**

The increasing presence of Islamic banking and finance in Malaysia's financial sector and the country's exemplary role in the global Islamic finance industry has called for an evaluation of the contribution of Islamic finance to the real economic activity. In order to empirically investigate the impact of Islamic finance on performances of major macroeconomic indicators, this study applies the ARDL approach on quarterly data set for Malaysia covering the period from 1998 to 2013. The results suggest that Islamic finance has started to make important contributions to the real economy by effectively carrying-out the financial intermediation role of pooling and channeling funds to the investment activities. In view of the important contributions of Islamic finance to the Malaysian economy, continuous efforts need to be undertaken to further expand the industry. This includes refinement of the legal and regulatory framework to enable healthier growth of the industry, thus further strengthens Malaysia's position as the leader in the Islamic finance industry at the global level.

*Keywords:* finance-growth nexus, Islamic banking and finance, real economy, Malaysia, ARDL

**1. INTRODUCTION**

Islamic finance was considered as a new phenomenon in the global financial scenario in the 1970s, starting with the establishment of the first Islamic commercial bank, namely Dubai Islamic Bank in 1975. Since then, the Islamic finance industry continues to record remarkable progress. Today, total Islamic banking asset is estimated to reach US\$1.7 trillion, recording an annual growth of 17.6% since 2000 (Bank Negara Malaysia, 2014). Amid the rapid growth of the industry globally, Malaysia has been at the forefront with total Islamic asset accounting for nearly 13% of the global Islamic finance industry and 8% of the global Islamic banking assets (SESRIC, 2012; Ernst and Young, 2013). At the domestic front, the Islamic banking

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