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THE INTERPLAY BETWEEN THE GLOBAL ISLAMIC FINANCE AND ECONOMIC GROWTH OF MUSLIM COUNTRIES

Abstract. The article discloses development peculiarities of the global Islamic financial industry and determines its interplay with the economic growth of Muslim countries. The aim of the article is to reveal current trends in key segments of the global Islamic finance market (Islamic banking, capital market and Iinsurance) and analyze the impact of each of them on the economic growth of the countries, which are most developed in the field of Islamic finance.

The countries surveyed were selected according to the Islamic Finance Development Indicator (IFDI), which reflects the general state of the Islamic financial industry worldwide and in each country. IFDI is based on five indicators: quantitative development (QD), knowledge, governance, corporate social responsibility (CSR) and awareness.

In 2019, the United Arab Emirates (UAE), Bahrain, Indonesia, Malaysia and Saudi Arabia were the most developed countries in terms of Islamic finance. Examining the impact of different types of Islamic financial assets on the GDP of these Muslim countries, we used Eviews10 to conduct a regression analysis, which showed a positive relationship between GDP and only two types of assets, namely bank and Islamic bonds (sukuk). associated with significant volumes of these segments of the global Islamic financial market and the tradition of investing in key sectors of the economy.

We discovered the negative relationship between GDP and Islamic insurance (Takaful) in all countries studied, which can be explained by ineffective investment strategies of Islamic insurance companies, which suffer from low profitability and are unable to increase their assets in line with current trends in innovation and development. We also found the inverse relationship between Islamic funds and GDPs of the UAE, Malaysia and Saudi Arabia, which may be related to the distribution of financial resources from these countries to other parts of the world and investment cycles, including the waiting period before repatriation of profits and interest; the concentration of funds in major markets makes it impossible to scale their activities in the global market.

Keywords: Global islamic finance, Islamic banking, Islamic capital market, Sukuk, Islamic funds, Takaful, Economic growth.

JEL Classification G15, O43, O53, Z12

Formulas: 1; fig.: 1; tabl.: 5; bibl.: 20.

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ВЗАЄМОЗ`ВЯЗОК МІЖ ГЛОБАЛЬНИМИ ІСЛАМСЬКИМИ ФІНАНСАМИ ТА ЕКОНОМІЧНИМ ЗРОСТАННЯМ МУСУЛЬМАНСЬКИХ КРАЇН

Анотація. Присвячено виявленню особливостей розвитку глобальної індустрії ісламських фінансів і визначенню її взаємозв’язку з економічним розвитком мусульманських країн. Метою статті є розкриття сучасних тенденцій розвитку ключових сегментів глобального ринку ісламських фінансів (ісламський банківський бізнес, ринок капіталів та ісламське страхування) s аналіз впливу кожного з них на економічне зростання найбільш розвинених е галузі ісламських фінансів країн.

Країни, що стали об’єктом дослідження, були обрані на основі показника, що має назву «Індикатор розвитку ісламських фінансів» (Islamic Finance Development Indicator, IFDI) і відображає загальний стан галузі ісламських фінансів у всьому світі та в кожній країні окремо. IFDI базується на п’яти індикаторах: кількісний розвиток (QD), знання, управління, корпоративна соціальна відповідальність (CSR) та обізнаність.

Найбільш розвиненими країнами стосовно ісламських фінансах 2019 року виявились Об’єднані Арабські Емірати (ОАЕ), Бахрейн, Індонезія, Малайзія і Саудівська Аравія. Перевіряючи вплив різних типів ісламських фінансових активів на ВВП зазначених мусульманських країн, ми застосували Eviews10 для проведення регресійного аналізу, який показав позитивну залежність між ВВП і лише двома видами активів, а саме банківськими та ісламськими облігаціями (сукук). Вважаємо, що це пов’язано зі значними обсягами цих сегментів глобального ісламського фінансового ринку і традицією інвестування в основні сектори економіки.

Було виявлено негативну залежність між ВВП та ісламським страхуванням (такафул) у всіх досліджених країнах, що можна пояснити недостатньо ефективними інвестиційними стратегіями ісламських страхових компаній, які отримують низьку прибутковість і не здатні примножувати свої активи відповідно до сучасних тенденцій інновацій та розвитку. Також виявлено обернену залежність між ісламськими фондами і ВВП ОАЕ, Малайзії і Саудівської Аравії, яке може бути пов’язане з розподілом фінансових ресурсів із цих країн в інші частини світу та інвестиційними циклами, що включають період очікування перед репатріацією прибутку і відсотків; концентрація фондів на основних ринках унеможливлює масштабність їхньої діяльності на глобальному ринку.

ISSN 2306-4994 (print); ISSN 2310-8770 (online)

Ключові слова: глобальні ісламські фінанси, ісламський банкінг, ісламський ринок капіталів, сукук, ісламські фонди, такафул, економічне зростання.

Формул: 1; рис.: 1; табл.: 5; бібл.: 20.

The problem statement. The Islamic economy and finance focus the activities of economic entities not only on ensuring the well-being of their families, but also on important social goals. They stimulate the development of trade and the provision of various financial services, but at the same time prevent usury, unjustified growth of debt, significantly limit the opportunities for unfair trade and trading in imaginary financial assets, tie financial obligations to real economic effects and assets.

Islamic financial institutions can become the fresh momentum for the global economy, as they prove their ability to operate almost smoothly during global crises. The population growth rate of Islamic countries is projected to be twice that of non-Muslim one, as a result, Muslims will represent 30 percent of the world's youth in the nearest future [16]. Islamic funding develops all over the world, both in Muslim and non-Muslim countries. Due to the growing Muslim population and impetus for geographical diversification of investments, interest in Islamic financial products has recently increased significantly.

Therefore, determining the impact of different segments of global Islamic finance on national economic growth, especially Muslim countries, is a matter of great scientific interest.

Analysis of the **last research and publications.** There is a substantial number of publications on different aspects of Islamic finance. For instance, Bekkin disclosed modern peculiarities of the Islamic economy and its institutions [20]. Analysing the macroeconomic effects of financial openness on volatility of business cycles, Diennas discovered that Islamic countries tended to be slightly more competitive compared with other in terms of resistance index [4].

Griraa and Labidib shed light on modern academic understanding of Islamic banking, fund and risk management [6]. Batorshyna, Igonina, Vagizova and Sabirzynaov showed the usage of the liquidity-optimization model for determining the maximum of possible profitability of the Islamic bank by maintaining the optimal level of risk liquidity [2]. Sidak, Yegorova-Gudkova, Bojko, Krygin, and Zvirkov insisted on combining traditional and Islamic banks, using partner financing system, to improve the quality of banking services and expand the range of banking products offered even in non-Muslim countries [17]. Akhter, Pappas, and Khan discovered the negative influence of GDP per capita on Islamic and conventional insurance [1]. Paltrinieri, Dreassi, Migliavacca, and Piserà demonstrated the link between Islamic finance and sensitivity to social implications [14].

Juhro, Narayan, Iyke, and Trisnanto explained Indonesia's economic growth by a semi-endogenous growth model driven by research activity and access to the financial system, particularly the Islamic financial market [12]. Pepinsky examined the socioeconomic origins of consumer demand for Islamic financial products based on original survey data from Indonesia, where there is a combination of both growing Islamic financial market and conventional financial system [15]. Kassim argued that Islamic finance contributed to the real economy development in Malaysia boosting the investment activity [13]. Belouafia, Belabes, and Daoudi pinpointed the drastic increase of Islamic finance education all over the world [3].

Despite the above-mentioned scientific findings, the issue of the impact of global Islamic finance on economic growth is not fully covered. This is especially true for the group of Muslim countries, as in non-Muslim countries Islamic financial services are partially represented.

Purpose of the article. The aim of the article is to disclose current trends in key segments of the global Islamic finance market and determine the impact of each of them on the economic growth of the most developed countries in the field of Islamic finance.

Results of a research. Islamic finance plays more and more significant role in the global economy. There were 1526 Islamic Institutions, 46 countries with Islamic finance regulation, 1170 Shariah scholars representing Islamic financial institutions; $1.16 billion CSR funds disbursed by Islamic financial institutions, 2566 Islamic finance research papers, 463 Islamic finance events, 12181 news on Islamic finance, 428 commercial and 57 investment Islamic banks; 124 general, 115 composite, 76 family Islamic insurance operators (Takaful); 288 investment firms, 125 financing companies, 66 leasing companies, 35 microfinancing companies in 2019 [9].

The demand for Shariah approved services and product keeps steadily growing. Since 1970s, the starting point for the Islamic financial industry, the total global assets have exceeded $2.9 trillion. In spite of slowing down of this industry, it still tends to reach $3.69 trillion by 2024, even though Islamic financial institutions are suffering from the Coronavirus pandemic destroying the business as usual [9].

The total quantitative analysis of the negative impact of the pandemic on Islamic finance is still to be conducted, but some Islamic financial institutions, including Islamic banks, faced losses or at least drastic downward movement of profits.

At the same time, the pandemic drew attention of the regulatory bodies to the potential of Islamic finance in conditions of uncertainty. For instance, Algeria tries to return the trust of local savers by increasing the share of Islamic finance in the national financial system. The new era of sovereign sukuk (Islamic bonds) started in the GCC and Southeast Asia as it is considered to be a better than traditional financial tool. In line with governments, corporations and Islamic multilateral organizations increased the issue of corporate and quasi-sovereign sukuk. In compliance with the sustainability target, public and private cooperation aims at mitigating the heated problem of mass unemployment in most Muslim countries.

We used the Islamic Finance Development Indicator (IFDI), which reflects the overall state of the Islamic finance industry worldwide using a single composite and weighted numerical indicator, for selection of the analysed countries. It provided the ranking for 135 countries in 2019.

The IFDI consists of five major components evaluating the overall Islamic finance ecosystem, namely, Quantitative Development (QD), Knowledge, Governance, Corporate Social Responsibility (CSR), and Awareness [7; 9]. *Table 1* indicates that the United Arabic Emirates, Bahrain, Indonesia, Malaysia, and Malaysia were the most developed countries considering Islamic finance.

Table 1

Top 5 IFDI markets and global average IFDI values for 2020

Country	Ranking	Indicator Value					
		IFDI 2020	Quantitative Development	Knowledge	Governance	Awareness	CSR
Malaysia	1	111	94	185	86	149	41
Indonesia	2	72	27	181	67	60	23
Bahrain (MENA)	3	67	38	68	88	103	38
United Arab Emirates (MENA)	4	66	31	67	79	91	60
Saudi Arabia (MENA)	5	64	59	52	41	50	119

Source. Compiled using [Islamic Finance Development Report 2020].

Indonesia became one of the leading countries for the first time since 2012, when the indicator was first introduced. This rise is mostly due to the Knowledge indicator increasing value. It is at the first position by the Education sub-indicator and second by Research thanks to the growing number of educators, research papers and peer-reviewed journal articles. The Awareness sub-indicator nearly doubled due to the threefold growth in Islamic finance events within National Sharia Economy and Finance Committee's (KNEKS) implementation of the Islamic Economic Masterplan 2019—2024. This country can also boast the improving Governance indicator covering regulations concerning the Islamic finance industry.

It is worth mentioning, that there is still the handicap of Malaysia considering IFIDI value. This country leads in three out of five components (Quantitative Development, Knowledge, and Awareness) and stays second in Governance.

The Islamic finance industry consists of three main sectors [19]:

• Islamic banking;

ISSN 2306-4994 (print); ISSN 2310-8770 (online)

• capital markets, including Sukuk (Islamic bonds) and Islamic funds;
• Takaful (Islamic insurance).

Figure 1 proves that Islamic banking plays a major role in the structure of the global Islamic financial services industry.

Despite the small share of global financial assets, Islamic banks have their branches in more than 60 countries and have become systemic in 14 countries. Islamic banks provide financing for various economic sectors. The distribution of Islamic banking financing is as follows: consumer durables (more than 25 percent); real estate and construction (16 percent); production (12 percent) and trade (8 percent) [18].

The Islamic capital market is represented by the Sukuk market and Islamic funds. Since the early 1990s, the Islamic capital market has developed rapidly. This growth was due to higher incomes of oil-exporting countries as a result of rising world oil prices. The Islamic capital market is an important part of the Islamic financial system. It enables the mobilization and optimal allocation for financial resources, implementing the intermediary role of Islamic financial institutions in the investment process (*Fig*.).

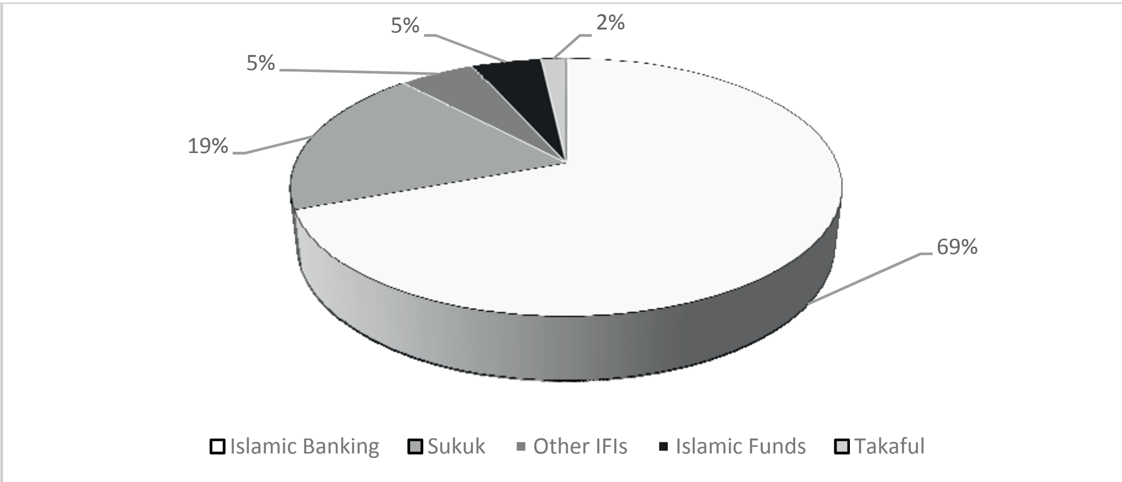

Fig. **Global Islamic Finance Asset Distribution 2019**

Note. [9].

Today, the Sukuk market is a fast-growing segment of the Islamic capital market. It is the second largest asset after Islamic banking ($ 1,993 billion) in the field of Islamic finance and in 2019 reached $538 billion. The Sukuk market has become an important tool for investing in various fields without violating Sharia law. During 2012—2019, the Sukuk market increased by 107% (*Table 2*).

Table 2

Islamic Finance Asset Growth in 2012—2019, billion $

Assets	Years								Change 2012—2019	
	2012	2013	2014	2015	2016	2017	2018	2019	absolute	%
Total Islamic Finance Assets	1,761	2,060	1,975	2,201	2,307	2,461	2,513	2,875	1,114	63
Islamic Banking Assets	1,305	1,560	1,444	1,600	1,673	1,727	1,745	1,993	688	53
Takaful Assets	31	36	36	47	48	46	46	51	20	65
OIFI Assets	107	119	130	141	142	142	145	153	46	43
Sukuk value outstanding	260	284	299	342	345	426	470	538	278	107
Islamic funds value outstanding	58	61	66	71	99	120	108	140	82	141

Source. Compiled using [9].

The global Islamic assets growth in 2019 was partly due to increased levels of Sukuk issuance in traditional markets of the Gulf countries (Gulf Cooperation Council, GCC) and Southeast Asia.

Table 2 shows that all types of Islamic financial assets grew in 2012—2019 in the range from 53% to 141%. The lowest growth was in the Islamic banking sector and the highest in the Islamic funds sector. No wonder that the correlation analysis showed the strong and very strong correlation between different components of the global Islamic financial assets (*Table 3*).

Table 3

Correlation between different components of the global Islamic financial assets in 2012—2019

TAKAFUL	1.000000	0.807374	0.958579	0.818584	0.889596
SUKUK	0.807374	1.000000	0.850100	0.943939	0.930043
OIFI	0.958579	0.850100	1.000000	0.830542	0.886524
FUNDS	0.818584	0.943939	0.830542	1.000000	0.917053
BANKING	0.889596	0.930043	0.886524	0.917053	1.000000

Source. Calculated using [9].

The number of Islamic funds increased in 2019 equalling to 1749 (compared with 1704 in 2018) [9]. Islamic funds are located in 28 jurisdictions with the dominance of five of them claiming over 90 percent of total $ 100 billion worth assets under management [11]. The Islamic assets under management in commodity and money market grew in 2019, while the equity funds showed the opposite tendency due to the higher volatility caused by the global uncertainty.

Table 4 demonstrates that Islamic financial institutions were registered in 28 countries as of 2019. Malaysia and Saudi Arabia accounted for about 65 percent of the Islamic assets under management [Islamic Financial Services Board (2019), «Islamic Financial Services Industry Stability Report 2019»].

Table 4

Global Islamic Finance Asset Distribution 2019

Sector of Islamic finance	**Size, $ billion**	**Share of Islamic Finance Assets, %**	**Number of Institutions / Instruments**	**Number of countries involved**
Islamic Banking	1993	69	526	74
Sukuk	538	19	3420	25
Other IFIs	153	5	645	54
Islamic Funds	140	5	1749	28
Takaful	51	2	336	47

Source. Compiled using [9; 11].

The Islamic insurance (Takaful) is one of the most important elements of the Islamic financial system. Takaful acts as a risk-sharing channel, helping to withstand financial shocks. The Islamic insurance market is relatively young, but its potential is huge. 1.5 billion Muslims all over the world are a potential customer base that no insurer can afford to ignore resulting in the growing Islamic segment of the global insurance market. Nowadays, there is a great concentration in this market. UAE, Indonesia, Iran, Malaysia, and Saudi Arabia accounted for about 91 percent of the total world insurance market [11]. Assuming the tendency for growth of all above-mentioned components of the global Islam financial assets, we can suggest that they have a significant impact on the economic development of Muslim countries in general, and especially actively introducing and improving the Islamic segment in national financial systems.

In this context, it is important to shed the light on the interplay between the development of the global Islamic finance and GDP of selected countries, namely, the most developed Muslim countries considering Islamic financial industry (*Table 5*).

ISSN 2306-4994 (print); ISSN 2310-8770 (online)

Table 5

GDP of Selected Muslim Countries, billion $

Country	Years								Change 2012—2019	
	2012	2013	2014	2015	2016	2017	2018	2019	absolute	%
UAE	374.59	390.11	403.14	358.14	357.05	385.61	422.22	421.14	46.55	12.43
Bahrain	30.75	32.54	33.39	31.05	32.23	35.47	37.65	38.57	7.82	25.45
Indonesia	917.87	912.52	890.81	860.85	931.88	1,015.62	1,042.24	1,119.19	201.32	21.93
Malaysia	314.44	323.28	338.06	301.35	301.26	319.11	358.72	364.68	50.24	15.98
Saudi Arabia	735.97	746.65	756.35	654.27	644.94	688.59	786.52	792.97	56.99	7.74

Source. calculated using [5].

Checking the impact of different types of Islamic financial assets on GDP of selected leading Muslim countries, namely, UAE, Bahrain, Indonesia, Malaysia, and Saudi Arabia, we have applied Eviews10 for building the following regression:

$$GDP = C + C1 \cdot Takaful + C2 \cdot Sukuk + C3 \cdot OIFI + C4 \cdot Funds + C5 \cdot Banking,$$

where Ci — coefficients;

C — constant value with no influence of variables;

Takaful — value of takaful in $ billions;

Sukuk — value of Sukuk in $ billions;

OIFI — value of other Islamic financial instruments in $ billions;

Funds — value of Islamic funds in $ billions;

OIFI — value of Islamic banking assets in $ billions.

Our computations enabled us to receive the following results.

$$GDP_{UAE} = 224.40 - 8.29 \cdot Takaful + 0.31 \cdot Sukuk + 2.11 \cdot OIFI - 0.42 \cdot Funds + 0.10 \cdot Banking.$$

It means that there is a positive connection between GDP of UAE and Sukuk, OIFI and Banking; at the same time there is a negative connection between the dependent variable and Takaful, Funds. R^2 equals 0.9786 meaning that Islamic assets explain up to 97.86 percent of GDP variation.

$$GDP_{Bahrain} = 16.32 - 0.53 \cdot Takaful + 0.02 \cdot Sukuk + 0.15 \cdot OIFI + 0.01 \cdot Funds + 0.01 \cdot Banking.$$

It means that there is a positive connection between GDP of Bahrain and Sukuk, OIF, Funds, and Banking; at the same time there is a negative connection between the dependent variable and Takaful. R^2 equals 0.9820 meaning that Islamic financial assets explain up to 98.20 percent of GDP variation.

$$GDP_{Indonesia} = 905.32 — 4.52 \cdot Takaful + 0.70 \cdot Sukuk - 2.58 \cdot OIFI + 1.72 \cdot Funds + 0.11 \cdot Banking.$$

It means that there is a positive connection between GDP of Indonesia and Sukuk, OIF, Funds, and Banking; at the same time there is a negative connection between the dependent variable and Takaful. The Islamic financial assets explain up to 99.16 percent of GDP variation.

$$GDP_{Malaysia} = 180.59 - 6.73 \cdot Takaful + 0.33 \cdot Sukuk + 1.66 \cdot OIFI — 0.47 \cdot Funds + 0.08 \cdot Banking.$$

It means that there is a positive connection between GDP of Malaysia and Sukuk, OIF, and Banking; at the same time there is a negative connection between the dependent variable and Funds, as well as Takaful. The Islamic financial assets explain up to 95.38 percent of GDP variation.

$$GDP_{Saudi\ Arabia} = 552.74 - 16.44 \cdot Takaful + 0.87 \cdot Sukuk + 2.17 \cdot OIFI - 1.51 \cdot Funds + 0.24 \cdot Banking.$$

It means that there is a positive connection between GDP of Saudi Arabia and Sukuk, OIF, and Banking; at the same time there is a negative connection between the dependent variable and Funds, and Takaful. The Islamic financial assets explain up to 95.02 percent of GDP variation.

Conclusions. We expected that the impact of all components of Islamic finance on the GDP growth of selected Muslim countries would be positive. However, the results obtained showed the stable positive influence only of two key Islamic financial assets: banking and Sukuk. We believe that this is due to the significant volumes of these segments of the global Islamic financial market, and the lasting tradition of investment in major economic sectors.

We found the negative relationship between GDP and Takaful in all observed countries, that could be explained by ineffective investment strategies of Islamic insurance companies receiving low returns and not able to multiply their assets in compliance with modern innovative and development tendencies.

It is also worth mentioning, the negative interplay between Islamic funds and GDP of UAE, Malaysia, and Saudi Arabia, which could be attributed to the allocation of financial resources from these countries to other parts of the world and investment cycles involving awaiting period before getting back profits and interest.

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Статтю рекомендовано до друку 08.04.2021

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The article is recommended for printing 08.04.2021