The effect of Islamic Banking and Macroeconomic Variables on Economic Growth: A comparative study of Pakistan

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ABSTRACT

The investigation of influence of macroeconomic variables on economic growth remained hot issue for decades. And nowadays increasing importance of Islamic banking and finance industry in Pakistan and its tremendous role in global financial sector has also called for an examining of contribution of Islamic finance in economic growth of Pakistan. This study also compared result of both variables in order to show whether Islamic banking showing great progress or not. So, in order to investigate impact of Islamic finance and macroeconomic variables on economic growth this study used quarterly data from 2009-16 and applies bound testing cointegration technique made within in “Autoregressive distributed lag model”. The result shows that both variables have an influence on economic growth in short run as well as in long run. By comparison of both variables it is shown that Islamic banking possess great potential of growth. So, government may need to refine its legal and regulatory framework in order to increase its impact on economy up to many folds.

Key Words: Islamic Banking, Macroeconomic Variables, Economic Growth

1. Introduction

Economic growth appertains to ability of a country to produce more goods and services then previous year. The economic growth can be calculated in nominal terms, in which inflation excluded. The growth and development of a country can be calculated by number of economic indicators such as Total Factor Productivity (TFP), Human Development Index (HDI), and Gross Domestic Product Growth Rate (GDP) and so on. From many decades, the non-sustainable and low rate of economic growth in developing countries is making problems for experts, professional, Government and economists (Muhammad Waqas Chughtai, 2015). The main reasons of non-sustainable development rate comprises number of factors such as (1) rising foreign debt, (2) consume more and save less, (3) trade imbalance, (4) high inflation rate, (5) currency exchange rate volatility, (6) political instabity, (7) energy and water shortages etc. consistent increase in sustainable development with very little inflation rate is one of prime focus and objective of policy makers during policy making process about economic growth. The association between major macroeconomics variable i.e. GDP, CPI, Consumer Confidence Survey, Inflation, Currency exchange rate Interest rate, PPI, Current Employment Statistics with GDP rate depends on the current condition of economic development. Economic development with low level of inflation is very beneficial for economy.

Economic growth has a ripple effect. By expansion of economy businesses start to see profit, which result in growth of stock prices. Then businesses generate large profit to invest more.

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So, result in increased employment rate. That leads to an increase in income which inspires the costumers to buy more. The higher purchasing accelerates economic growth more. So, almost every country is concerned about it. This makes economic growth the most watched economic indicator.

If we look at the countries that have achieved rapid and sustain economic growth contain two features. Firstly, they invest in education sector. Investment in education provides two benefits. Firstly, it increases the productivity of labor. And secondly, it decreases the poverty in a country. Second features of countries who achieve good economic growth is that they provide good capital market. As a result, the foreign investors attract there and it overall result increase of foreign direct investment. Which ultimately increase economics growth.

Regardless, of the concept of economic boom that dealt with many prominent economists who searching to find out whose variable & instruments effect economic growth most. Despite of the large number of researches in determining the best instrument for economic growth. Still, we are unable to show why some countries grow faster and some at a low pace.

The process of economic growth is very complicated and there are too much factors who contribute in increasing economic growth. Now we will show some theoreticians and researchers that pitch in this precious area According to Artelarisit (2007) we up till now do not have a general hypothesis about economic growth which help us in order to understand this concept. This is due to lack of unified theory.

2. Objectives of The Study

Following are the objectives of this study:

- Check the effect of macroeconomic variables on economic growth
- Check the effect of Islamic banking variables on economic growth
- Compare the effect of both variables

3. Theories on Economic Growth In History

The first one who made the theory of economic growth was Adam Smith. He considered that economic growth did not only effect by human capital, labor, technology, export etc yet of combined effect of everyone in immediate manner (Kryeziu, 2016).

The best and the biggest addition of Adam Smith was the addition of the word “incremental revenue” in the economy which was founded on the division of labor and specialization. Other things that was added by Adam Smith was that exchange of labor and free trade are the strong process of economic growth. (“The Wealth of the nation”, 1776).

The theory of economic growth also explained by Harrod and Domer in 1946. They said that rate of economic growth depends on relation between savings and coefficients of capital.

The theory of economic growth got also attention in 50s. In that time this theory was made by neo classical mainly by Robert M. Solow. That also won Nobel Prize in economics for his Solow growth model. Solow gave his all attention to only three variable technology, labor and capital. From this he concluded “less than half of the productivity growth in U.S per
capita productivity and real rent ability payments can be attributed to the increase of its capital”.

In mid 80s except the theories of neo classical no other special theory on growth was developed. But in this year the empirical studies and research on economic growth was established. And the first one was “endogenous growth theories”. These theories are linked with names of G. Grossman Heplman etc. These theories were emerged on only one supposition that a single decision taker is rational, and he is not adopter.

The major factors on which economic growth depend was interest rate, government expenditure and inflation rate. The effect of interest rate and government expenditure is quite identical in most cases. But effect of inflation with economic growth is not linear. The inflation effect positively at its threshold level. And then after that level it start to effect negatively (Mbulawa, 2015).

3.1. Influence of Major Economic Variables on Global Economy

It was foreseen earlier in the world economic report that global economy become considerably debilitate in the year 2012-13. Effect of economic Boom on the developed countries are decreasing which result in decrease demand for their exports, high fluctuations in capital flows and high prices for their products. Overall the world economy is constantly in state of ups and downs (Muhammad Waqas Chughtai, 2015). Lots of the developed countries are struggling continuously to overcome the financial crisis large number of the developed countries facing large unemployment rate, high rate of public debt and constant fluctuation in the rate of inflation. Most of the countries that have low level of income are caught up in “adverse spillover” impact due to slowdown of both developed and middle-income countries (Galbis, 1995). There are many more things that are modifying world economic states (1) inflation almost out (Muhammad Waqas Chughtai, 2015) in world but still concern for some countries, (2) rising food prices, (3) exchange rate are continuously fluctuating, (4) globalization, (5) and continuously increasing unemployment rate. The impact of above variable is different from country to country due to their own difference economic structures and scenarios.

3.2. Influence of Major Economic Variables on South Asian Economy

The economy of South Asian country increases at a rate of 5.6% in 1990s which was greater than low income countries (Muhammad Waqas Chughtai, 2015). The economic reforms in south Asian countries brings a lot of political and economic changes. These economic reforms includes (1) since 1991political consensus has survived government changes in India, shift of power to Pakistan, Bangladesh and Sri Lanka.(2) overall economies of the south Asian countries show improvement in resource utilization. But yet most the countries facing hurdles by moving to economic growth such as low level of tax revenue, large investment to energy crises, law and order situation, and the burden of high subsidies on food items by government are problems that causing low level of economic growth in South Asian countries (Malik & Chaudhry, 2001). The economic growth of India was recorded very low in 2010 and 12. This decrease result due to high budget deficit, high unemployment rate, high inflation rate and political instability. Political instability and security concern create a very
pivotal effect in declining the growth of South Asian countries. In Pakistan inflation rate decreases after continuously increase from 2004 to 2008 due to better macroeconomic policy.

Another South Asian country that are facing low level of economic growth is Afghanistan. It was in a constant state of war against Taliban. And due to security issues Afghanistan is in a state of economic shutdown. During 2000-2013. Bhutan inflation rate is low than any other Asian countries and Bangladesh is free from this issue due to moderate inflation rate.

4. Influence of major economic variables on Pakistan economy

After the freedom, the economic growth of Pakistan remained very high from other Asian countries. But as time passes Pakistan start to face low level of economic growth due to many issues such that high import and low export, political instability and un-implementation of economic growth policy for many years (Khalid, 2005). Wars with India first one in 1965 and second one in 1971 causes a lot of troubles for Pakistan in relating to economic growth. Moreover, Pakistan also caught up in floods and with other issues like Nationalization. Nationalization did a very worst thing in making Pakistan suffer by losing trust of private investors.

The economy started to recover in 1980s by adopting denationalization policy by government and policy makers. Economic growth decreases in 1990s due to continuously changing of governments and poor governance. These policies go without doing anything.

So, overall Pakistan speed of economic growth is not found to be very attractive. From 1967 to 2005 Pakistan economic growth is approximately increasing at 8% per year. But after 2005 it started to increase at only 3-4% per year. This growth rate is an alarming situation for politician. Because, they are unable to do increase in economic growth at some attractive level.

The financial sector of any country played a critical role in increase of economic growth. But the financial sector of Pakistan is in very worst condition. Pakistan was facing a problem of severe financial debt. And most part of the earnings was going for the repayment of debt. Which resulted in decrease of government expenditure on many productive sectors. Which ultimately effect economic growth.

The many great organizations came into existence after the establishment of this new concept. Such that IIFS (International Islamic Financial Service Board) and AAOIFI (Accounting and Auditing Organization for Islamic Financial Institution). These organizations work day and night in order to make rules and regulations for Islamic financial system. The beauty of these organization is that they make rules by consultation of all schools of fiqh. So, nobody got any objection on these rules. And now the rules which was made by AAOIFI are applied worldwide in Islamic financial institutions.

There are many factors contributed to such development of Islamic banking like interest free banking, risk sharing, and lesser dependency on loan instruments and restrict the gap between short term and long-term financing.

Some researches do talk about the effect of Islamic banking on economic growth. But these researches were limited in quantity. (P. Imam, 2013), and the first empirical research about
effect of Islamic banking on economic growth was based on checking the Islamic banking growth causality (Mohammad Abduh, 2012). And second study talks about inheritance stability of Islamic banks against crisis (p. Abdefir, 2016). The other limited researches that are carried out for checking causality include researches carried out by (Majid, 2010) and (Mulya, 2010). Both of these researches do not use too much different time span but they are different in their relationship findings. (Majid, 2010) Found that Islamic banking variables and economic growth have a “demand following” association. Means economic growth causes Islamic banking to develop and flourish. But the (Mulya, 2010) found that association between Islamic banking and economic growth is “supply following” means increase or expanding in Islamic banking increases economic growth. But overall, the combined results of the studies remained inconclusive about whether the Islamic banking effect economic growth or not (Jamel Boukhatem, 2018). But in this research we are not going to check its causality instead of that we are going to check whether Islamic banking have a positive impact on economic growth. And the variables we will use are Islamic banking deposits and total net financing. Which was taken from Islamic bulletin of state bank of Pakistan.

The influence of macroeconomic variables on economic growth was very hot issue for researcher from decades. But the research on influence of Islamic banking on economic growth found its heat only few decades ago. So, this paper is aim to find out who effect the economic growth most. And which variable is best for boosting the economic growth.

5. Islamic Banking in Pakistan

The efforts to Islamize the banking industry of Pakistan started in 60s. But the actual efforts on this subject started in 80s. And for this purpose the Banking company ordinance of 1962 was amended to facilitate non interest based transaction and a set of time was given to industry to convert itself into full fledge Islamic system. In early 90s, this whole effort was challenged in shariah court. Which reject some products and tag them as haram or un-Islamic.

Before officially launching the Islamic banking system in Pakistan a delegation from ministry of Finance led by Dr. Taqi Usmani visited many Islamic countries in which Islamic banking was present like Malaysia, Indonesia etc. to get an overview of how Islamic banking industry work. And then after reviewing everything the committee gives his recommendation to state bank of Pakistan. And SBP set an extensive criterion for Islamic banking on December 2001.

Al-Meezan was first bank who applied in State bank of Pakistan to convert itself into a fully Islamic bank. The SBP reviewed everything about Meezan Bank. And grant him license to be the first Islamic bank of Pakistan on 2002. Assets and Deposits of Islamic Banking Industry (IBI) were recorded at Rs.1, 885 billion and Rs.1, 564 billion respectively by end March, 2017. Market share of Islamic banking assets and deposits in overall banking industry stood at 11.7 percent and 13.2 percent, respectively by end March, 2017. Profit after tax (PAT) of IBI was recorded at Rs.3.8 billion. Among other profitability indicators, return on assets (ROA) and return on equity (ROE) were recorded at 0.8 percent and 12.2 percent, respectively “(SBP Bulletin Mar 17).

At now there are 5 fully Islamic banks plus 16 traditional banks have standalone Islamic banking branches. The total number branches of Islamic banking were 2317. And Sindh and Punjab hold 77.2 percent of Islamic banking industry alone (SBP Bulletin Mar 17).
The efforts are continued in Pakistan in order to convert its financial system into full Islamic system. And these efforts achieved results as well. But in now a day’s Islamic financial industries is facing decline. Due to the fact that they have to do investment according to shariah. And Islamic financial industry in Pakistan facing problem of non-available investment areas. Such that they cannot invest on bonds and on shares etc. which ultimately limits their investment. And as a result, Islamic financial industry face decline. And this issue is not only limited to Pakistan. It started to arise in other countries as well.

6. Literature Review

The term economic growth means to increase in the ability of a country to make more goods and services then previous year. When we talk about per capita then we divide the total GDP with total population to get our result. Economic growth expressed in both real and in nominal terms. In nominal terms it is easy to understand this concept due to simple math without any complication.

But in real terms this concept is not easy to comprehend. Because there is a lot of researchers and authors who criticized economic growth due to its inability to tells the whole situation of an economy. According to them it only tells us numerical values but tells nothing about actual living standards of the citizens of a country. The only increase in the level of output tells nothing about actual standard of living of a country (Lewis 1978). So, these authors suggested not to give fully attention only to numerical statistics. But focus things in real terms as well.

Economic growth refers merely the positive increase in the ability of a country to make more goods and services then previous year. But economic development means the constant increase in the capacity of a country with taking everything others into account as well like improving living standard, improving food quality, improving health services and others such things.

Iqbal (1998) while studying relationship of economic variables with economic growth and development of Pakistan during 1959-60 to 1996-97 found out primary education and trade openness have a direct relationship with economic growth. While external debt, budget deficit and per capita real income have inverse relationship with economic growth.

Evans et al (2013) while studying relationship between major macroeconomic variable and gross domestic product of Ghana during 1980 to 2010 found out that inflation have direct while interest rate had an indirect relation with gross domestic product. But these two explanatory variables explain dependent variable up to 44 percent. Which is too low.

Umar et al (2014) while investigating relationship between major macroeconomic variable and economic growth of Pakistan during 1980-2013 found that inflation and interest rate have negative while exchange rate & FDI have positive relation with economic development. So, government have to check the rate of inflation. And also continue the direct foreign aid into program because, of its crucial nature for economic growth.

Mbulawa (2015) while studying macroeconomic determinants of economic growth in Zimbabwe during 1975-2012 found out that inflation had negative while trade openness had
positive relation with GDP. Growth fixed capital formation and FDI had negative & insignificant association with economic growth.

Uwakaeme (2015) while checking causal relationship between economic growth and its major macroeconomic variables in Nigeria during 1980-2012 dig out that inflation and excessive fiscal debt have negative association with economic growth. But trade openness was found to have a positive relation.

Chugtai et al (2015) demonstrating relationship of macroeconomic variable with economic growth of Pakistan 1981-2013 found out that inflation and interest rate had inverse relationship with economic growth. But exchange rate had positive relationship. But this study had some limitation because of absence of some important variables that effect Pakistan economic growth very intensively like water shortage etc.

Kryeziu (2016) while evaluating relationship between macroeconomic determinants of economic growth of Kosovo from 2004-2014 found out that budget deficit had negative while public debt had direct effect on economic growth. Inflation have indirect relation with economic growth. But inflation can prove to be helpful during controlled stage. But overall the result was not so reliable due to multicolinearity problems between explanatory variables e.g. public debt and budget deficit.

Hussain et al (2016) while doing research on relationship of macroeconomic variables with economic growth and development of Pakistan during 1980-2011 found out that inflation have negative while interest rate and exchange rate have a direct relationship with economic growth during specified period.

Forgha et al (2016) while doing research relationship of macroeconomic variables with economic growth of CEMAC Zone from 1981-2015 dig out that inflation rate and interest rate make economic growth unstable. So, government have to design a strong monetary policy to tackle this serious issue.

Dietmar Meyer and Adela Shera (2016) while checking the impact of remittance on panel data of six countries during 1999-2013 found out that remittance have strong and direct relationship with economic growth and development. In case of best utilization upon consumption and investment purpose. We can see a very good results in economic growth.

And if we talk about influence of Islamic banking on economic growth

Mohammad abduh and Mohdzami (2012) while working on association between Islamic banking and economic growth in Indonesia found out that in the long run Islamic financial development had significant relation with economic growth and capital accumulation. So, Islamic banking is performing well as an intermediary who facilitate in transfer of funds to poor people from rich people. But the relationship was bi directional means development in Islamic financial industry produce economic growth and that increase in economic growth result in increase of Islamic financial industry

Abduh et al. (2012) while attempting to find the impact of both conventional and Islamic financial industry on economic growth of Bahrain found that in the long run financial
industry had significant effect on economic growth. It also reveals that financial industry are doing well at domestic level. But the relation in Islamic financial industry and economic growth found to be bi directional. Means Islamic financial industry promotes economic growth and also propel Islamic financial industry to grow as well.

Abdul Manap et al. (2012) while checking effect of “Islamic financial development on economic growth of Malaysia” by applying “Toda and Yamamoto”wald test found out that Islamic banking do have an influence on economic growth. And the relationship between them supply leading. But at the same time the test result of Bootstrap shows that the result of Granger causality test is not so significant. So author suggest that further development in Islamic banking will lead to economic growth.

Salina (2015) while studying the influence of Islamic bank on economic growth of Malaysia found out that Islamic bank deposit do not show large impact in short run. But in long run the impact was huge. So, bank have to make them shariah compliant in order to attract long term depositors. Moreover, bank have to avoid time lag in investment as well.

Noman et al. (2016) while working on influence of Islamic banking products on economic growth and development of Pakistan found out that all products do have an influence on economic growth in the long time. Ijara was the product who is significant in both long run as well as in short run.

From all above discussion it was concluded that Islamic banking and macroeconomic variables do have an impact on economic growth. And researchers from many decades are trying to find the exact relationship between them. But no one is goes in direction of checking both variables impact on economic growth. So, this study fills this gap and may prove to be helpful for government in order to taking decision about Islamic banking industry.

7. Methodology and research model

The objective of this study is to find that’s both Islamic banking\(^1\) and major macroeconomic variables\(^2\) have an impact on economic growth or not. And also to show that Islamic banking can enhance economic growth more efficiently by giving him some more focus and attention.

The data of Islamic banking variables have been taken quarterly from 2008-16 from State Bank of Pakistan. And data of macroeconomic variables had been taken from World Bank website\(^3\). The unit root test has been conducted in order to check stationarity among variables. For this Philips perron test and Augmented Dickey Fuller was used. Results are as follows.

<table>
<thead>
<tr>
<th></th>
<th>ADF(0)</th>
<th>ADF(1)</th>
<th>PP(0)</th>
<th>PP(1)</th>
<th>Results</th>
</tr>
</thead>
<tbody>
<tr>
<td>GDP</td>
<td>0.2984</td>
<td>0.0000</td>
<td>0.9715</td>
<td>0.1571</td>
<td>Order (1)</td>
</tr>
<tr>
<td>Deposit</td>
<td>1.0000</td>
<td>0.9630</td>
<td>0.9630</td>
<td>0.0000</td>
<td>Order (1)</td>
</tr>
<tr>
<td>FDI</td>
<td>0.3811</td>
<td>0.0741</td>
<td>0.0026</td>
<td>0.05</td>
<td>Order (0)</td>
</tr>
<tr>
<td>TNFI</td>
<td>0.9910</td>
<td>0.022</td>
<td>0.9971</td>
<td>0.0057</td>
<td>Order (1)</td>
</tr>
<tr>
<td>INFL</td>
<td>0.1760</td>
<td>0.0024</td>
<td>0.5859</td>
<td>0.0023</td>
<td>Order (1)</td>
</tr>
</tbody>
</table>

\(^1\) Islamic banking variables: Islamic banking Deposit, Islamic Banking net financing

\(^2\) Macroeconomic Variables: Government Expenditure, Inflation

\(^3\) (bank, https://data.worldbank.org, 2018)
The above table shows that every variable is stationary at its first order except FDI which is stationary at level.

So, by looking at above table, I used “Autoregressive Distributive Lag Model” (ARDL) with bound cointegration approach to find long run as well as short run association among dependent and independent indicators.

The following research model is proposed for this study

\[ G = f (DEP, FDI, INF, TFIN) \]

**Equation form:**

\[ G = \alpha_0 + \alpha_1 DEP + \alpha_2 FDI + \alpha_3 INF + \alpha_4 TNFI + \epsilon \]

Where’s

- \( G \) = Nominal GDP
- \( DEP \) = Total Deposits of Islamic Banks
- \( FDI \) = Foreign Direct Investment
- \( INF \) = Inflation
- \( TNFI \) = Total Net Financing by Islamic Banks

### 8. Results And Discussions

8.1. Serial Correlation test

<table>
<thead>
<tr>
<th>DEPOSIT</th>
<th>FDI</th>
<th>TNFI</th>
<th>INFL</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>0.2356366419</td>
<td>0.9740954892</td>
<td>-0.939770846</td>
</tr>
<tr>
<td>0.2356366419</td>
<td>1</td>
<td>0.2704242922</td>
<td>-0.473506766</td>
</tr>
<tr>
<td>0.9740954892</td>
<td>0.2704242922</td>
<td>1</td>
<td>-0.922208721</td>
</tr>
<tr>
<td>-0.939770846</td>
<td>-0.473506766</td>
<td>-0.922208721</td>
<td>1</td>
</tr>
</tbody>
</table>

The above table shows the correlation among dependent variables. Variables like Islamic banking deposit and financing have a strong association between them. And it was obvious due to fact that Islamic banks only invest if have money in form of deposit. So, it explains this relationship among that variables.
8.2. CUSUM test

Both of the above graphs shows that data and model is stable because blue line is between two red lines.
8.4. Test for cointegration

The cointegration test is used to measure whether there exist long run relationship among between dependent and independent variables. For this purpose we find F-statistics. And if F-statistics is high than upper critical bound value at 5% significance. Then we summarize that there exist a long run association among dependent and explanatory variables. The Hypothesis for cointegration test is:

H0: No long run relationship exists

H1: Long run relationship exists

ARDL Bounds Test
Date: 12/18/18  Time: 11:26
Sample: 2009Q2 2016Q1
Included observations: 28
Null Hypothesis: No long-run relationships exist

<table>
<thead>
<tr>
<th>Test Statistic</th>
<th>Value</th>
<th>k</th>
</tr>
</thead>
<tbody>
<tr>
<td>F-statistic</td>
<td>24.72499</td>
<td>4</td>
</tr>
</tbody>
</table>

Critical Value Bounds

<table>
<thead>
<tr>
<th>Significance</th>
<th>I0 Bound</th>
<th>I1 Bound</th>
</tr>
</thead>
<tbody>
<tr>
<td>10%</td>
<td>2.45</td>
<td>3.52</td>
</tr>
<tr>
<td>5%</td>
<td>2.86</td>
<td>4.01</td>
</tr>
<tr>
<td>2.5%</td>
<td>3.25</td>
<td>4.49</td>
</tr>
<tr>
<td>1%</td>
<td>3.74</td>
<td>5.06</td>
</tr>
</tbody>
</table>

The above table shows that our F-statistics is greater than upper critical bound of 5.06 at 1% significance level. So, we reject $H_0$ and conclude that there exist a long run relationship between dependent and explanatory variables.
8.5. Long Run Coefficients

<table>
<thead>
<tr>
<th>Variable</th>
<th>Coefficient</th>
<th>Std. Error</th>
<th>t-Statistic</th>
<th>Prob.</th>
</tr>
</thead>
<tbody>
<tr>
<td>DEP</td>
<td>4.158277</td>
<td>2.963631</td>
<td>1.403102</td>
<td>0.2552</td>
</tr>
<tr>
<td>TNFI</td>
<td>6.264197</td>
<td>2.013308</td>
<td>3.111395</td>
<td>0.0528</td>
</tr>
<tr>
<td>FDI</td>
<td>13.938616</td>
<td>1.806089</td>
<td>7.717568</td>
<td>0.0045</td>
</tr>
<tr>
<td>INFL</td>
<td>-238626169900</td>
<td>151384871654</td>
<td>-1.576288</td>
<td>0.2130</td>
</tr>
<tr>
<td>C</td>
<td>203557625099</td>
<td>29.393</td>
<td>1983759970443</td>
<td>0.6500</td>
</tr>
</tbody>
</table>

The above table shows that in the long run FDI & TFIN have a significant influence on economic growth. Effect of FDI was great. Moreover, the effect of deposit on GDP is also positive but insignificant because of high probability value. The effect of inflation is negative and very high with probability being greater than 0.05. This large negative impact is obvious because, in 2008 world economy got hit by a greatest recession. In which inflation increases many folds.

The effect Islamic banking investment on GDP is great even in the period of recession. This shows that Islamic banks is resistant to shock. And in long run financing have positive, the similar results were found by Abduh and Omar (2012) in Indonesia and Gudarzi and Sadr (2012) for Indonesian and Iran economy. The effect of FDI is even greater than Islamic banks investment but it was obvious due to its large size in economy. And if we talk about effect of Islamic banks deposits it have his impact but due to probability value greater than 0.05 we are not sure. The above results shows that Islamic banking do add there share in economic growth of Pakistan economy. And this impact can be increase up to many folds by giving more attention to Islamic banks.

8.6. Short Run Coefficients

<table>
<thead>
<tr>
<th>Variable</th>
<th>Coefficient</th>
<th>Std. Error</th>
<th>t-Statistic</th>
<th>Prob.</th>
</tr>
</thead>
<tbody>
<tr>
<td>D(GDP(-1))</td>
<td>1.228431</td>
<td>0.230804</td>
<td>5.322391</td>
<td>0.0130</td>
</tr>
<tr>
<td>D(GDP(-2))</td>
<td>1.243163</td>
<td>0.267971</td>
<td>4.639176</td>
<td>0.0189</td>
</tr>
<tr>
<td>D(GDP(-3))</td>
<td>1.016426</td>
<td>0.190355</td>
<td>5.339637</td>
<td>0.0128</td>
</tr>
<tr>
<td>D(DEP)</td>
<td>8.822983</td>
<td>4.214675</td>
<td>2.093396</td>
<td>0.1274</td>
</tr>
<tr>
<td>D(DEP(-1))</td>
<td>-2.816090</td>
<td>1.433064</td>
<td>-1.965084</td>
<td>0.1441</td>
</tr>
<tr>
<td>D(DEP(-2))</td>
<td>-6.868118</td>
<td>2.727751</td>
<td>-2.517868</td>
<td>0.0863</td>
</tr>
<tr>
<td></td>
<td>D(DEP(-3))</td>
<td>D(TNFI)</td>
<td>D(TNFI(-1))</td>
<td>D(TNFI(-2))</td>
</tr>
<tr>
<td>------------------------</td>
<td>------------</td>
<td>--------</td>
<td>-------------</td>
<td>-------------</td>
</tr>
<tr>
<td></td>
<td>8.912328</td>
<td>0.073756</td>
<td>-2.565812</td>
<td>-3.465373</td>
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<td>0.2689</td>
<td>0.9528</td>
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The CoinEq (-1) was negative and significant which shows that explanatory variables do have an impact on economic growth of Pakistan. Islamic banks deposit and financing have positive result but become negative when goes in lag terms. But both variables results are unsure due to probability value greater than 0.05. The same goes for FDI its impact on GDP is positive and become negative when goes for lag terms. But the effect of FDI is significant shows that it have a great impact on GDP. And the last variable inflation have a very large negative and significant impact on GDP. And this large impact is obvious because of recession in 2008.

9. Conclusion

From results it was concluded that in long run Islamic bank investment and FDI have positive influence on economic growth. In short run only inflation & FDI are significant. Inflation show negative while FDI show positive effect on economic growth. And if we compare the results of macroeconomic variables and Islamic banks variables which was our objective also, then we conclude that there is no doubt that macroeconomic variables have strong & large influence on economic growth than Islamic banks variables due to their large share in economy. But we have to keep in mind that Islamic bank started just a decade ago and its
impact on economic growth is fantastic. So, if government may promote Islamic banks then their effects on economic growth can be increase up to many folds.

10. Recommendations

Islamic banks show great impact on economic growth. As a corollary to this, government may first need to encourage Islamic banks in every possible way. And then also promote the establishment of new Islamic banks as well as new Islamic windows too. Secondly, as the number of institutions and Islamic banks increases then there is an increase demand of skilled worker who can work and promote Islamic banks. So, government may encourage people to get education of shariah in order to be a part of Islamic banks in future. As we know according to the result of this study Islamic banks are resistant to shock. So, going further in Islamic banks means going further away from shocks. In this way economy becomes more stable and less exposed to shocks. And ultimately Pakistan grows.

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