

The impact of Islamic banking development and inflation rate on investment: A panel approach based on data from Iran, Malaysia and Turkey

Hasan Bakhtar Chouri^a, Alireza Amin Khaki^{a,*}, Beitollah Akbari Moghadam^a, Arash Hadizadeh^a

^aDepartment of Economics, Qazvin Branch, Islamic Azad University, Qazvin, Iran

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Abstract

One of the factors affecting the economic growth and development of countries is an investment, so it is very important to pay attention to the growth and expansion of investment and the factors affecting it. Therefore, the main purpose of this study is to investigate the impact of the development of Islamic banking and inflation on an investment. This research is descriptive in nature and applied in purpose. The relationships between the variables have been studied using the data panel method based on statistical data from Iran, Malaysia and Turkey for the period 2005 to 2020. To collect the necessary data and information to test the hypotheses, the data of the Central Bank of Iran and the World Bank have been used. Findings show that the variable of Islamic banking development has a positive and significant relationship with investment in selected countries and the variable of inflation rate has a significant but negative relationship with investment. Also, based on the results, a positive and significant relationship between GDP variables, the degree of trade openness with investment was determined.

Keywords: Investment, Islamic Banking, Inflation, Data Panel Approach
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1 Introduction

Capital is the driving force of economic growth and development in all theories and models of economic growth. Therefore, attracting sufficient capital to finance financial projects is one of the most important concerns of economic decision makers in any society [16]. Capital is also one of the areas for the implementation of various projects at the micro and macro levels of infrastructure investment development [41]. By creating infrastructure through these investments that can be financed from both domestic and foreign sources, it is possible to design and plan for the production and provision of new services. Iran has many fields and investment capabilities. These capabilities can be considered both in the human element and in the element of natural resources [42].

In the last twenty years, Islamic banking has become a very fast-growing element in the global capital markets and the international banking system. Neither turmoil in the Middle East nor economic crises will prevent Islamic banks

*Corresponding author

Email addresses: Hasan.bakhtar1970@gmail.com (Hasan Bakhtar Chouri), Aminkhaki@chmail.ir (Alireza Amin Khaki), akbari.beitollah@gmail.com (Beitollah Akbari Moghadam), hadizadeh@qiau.ac.ir (Arash Hadizadeh)

from gaining access to new markets and companies. Interest in Islamic banking has been accepted not only by Islamic law but also on a global scale [31].

The phenomenon of inflation, especially at high rates, directly and indirectly, imposes a high cost on society [35]. Today, there is a consensus that stable high inflation rates in a country are not only problematic for some people but also affect the performance of the economy as a whole. This consensus only expresses a small part of the reality, because determining the effects of a permanent increase in inflation on the long-term performance of the economy seems quite complex [33].

The purpose of this article is to investigate the effect of Islamic banking development and inflation rate on investment in a number of countries with Islamic banking in the period 2020-2020. The structure of the article is as follows: First, the literature related to the subject of the article is examined. Then the experimental research is done in Iran and other countries are reviewed. The next part of the article is dedicated to the research method, introducing the model and then analyzing the data. In the end, the conclusions of this research will be presented.

2 Literature Review

2.1 Investment

In today's complex and turbulent world, many developing countries have prioritized investment in various sectors of the economy in order to be on the path of development and increase economic growth, and capital formation is considered as one of the vital variables of economic growth. Which increase the productive forces of society through the production of capital goods so that they can produce consumer and essential goods [17].

National production is one of the most prominent symbols of economic development in any country, the favourable conditions of which indicate an acceptable situation in the field of economic activities. Therefore, supporting domestic labour and capital at the community level can play an irreplaceable role in the field of economic prosperity and effectively provide suitable economic conditions for growth and development to create any incentives for human resources and investors. In fact, one of the main drivers of economic progress and development is the increase in investment, which can use the correct and desirable allocation of resources between different sectors of the country's economy to strengthen domestic production. Regarding investment, there are various theories, each of which has tried in some way to introduce the determinants of investment and capital formation. In fact, every investment theory tries to give a definite answer to these two issues; A) How is the desired amount of capital stock determined, what are the factors affecting it and what is its amount? B) What adjustment speed does the firm adopt in achieving the desired capital stock and what factors determine this adjustment speed? [19, 24].

Acceleration theory is one of the investment theories that analyze the relationship between investment and market demand. According to this theory, net investment is a factor of changes in total market demand. The second investment theory is the neoclassical theory. This theory was proposed by Jorgenson in the 1960s. According to this theory, investment behaviour is explained using conventional microeconomic optimization theory and the desired capital stock is extracted. According to this theory, net investment is a direct function of the level of total demand and an inverse function of the actual cost of renting capital and capital stock of the previous period. The third investment theory is the Q theory, proposed by Tobin in 1969. This theory is based on the stock market and stock pricing and sets the standard for investor decisions in the selection of investment projects. In this theory, by using the stock price in the market and comparing it with the cost necessary to form capital, it is concluded about the necessity or non-necessity of investment [22, 37].

2.2 Development of Islamic banking

It has been more than four decades since the establishment of interest-free banks in Islamic countries. Interest-free banks or Islamic banks were established with the aim of basing the activities of conventional banks (which have previously found their way into Islamic societies) on Islamic law [20]. Islamic banks can be divided into three categories based on their environment and status [3]:

- Banks that operate in countries where the laws of those countries are in accordance with Islamic law and the common banking there is Islamic banking, such as Iran, Pakistan and Sudan;
- Banks operating in countries where the majority of the population is Muslim and the usual banking there is traditional banking, such as Arab Muslim countries;

- Banks that operate in countries where the majority of people are non-Muslims and the usual banking there is traditional banking, such as Western countries.

The principles governing Islamic banking, which are based on the prevailing interpretation of Islamic law and despite the disagreement of Islamic economists and experts in many cases, are agreed upon and agreed upon in two basic principles: First, the prohibition Receipt and payment of interest; And the second based on the principle of participation in profit and loss [5]. The following characteristics can be mentioned for Islamic banking [30]:

Justice: The concept of justice means that an Islamic bank should not impose a high fee on applicants.

Profit distribution: Profit distribution should be based on the risk that individuals bear.

Loss distribution: Loss distribution should be based on the ability of individuals to bear these losses.

In addition, Islamic banking is participatory. Islamic Bank takes into account all the risks faced by a business unit or a business person. Profit and loss, regardless of the amount and amount, must be distributed between the bank and the customer. The return on bank investment is not a function of time and is not predetermined [10]. Islamic banking has advantages over conventional banking, which include [21, 29]:

Encourage lending

- Increase savings
- Increase financial stability
- Financing ethically acceptable projects

2.3 Inflation

Inflation is a continuous decrease in the purchasing power of money or a continuous increase in the general level of prices, and in the case of severe inflation, it disrupts private investment decisions. Thus, high inflation, in addition to disrupting the price system, reduces savings and eliminates investment incentives and shifts investment from the real sector of the economy to speculative sectors. Also, by increasing the risk of investing in an uncertain environment, it causes losses for investments that return with several periods of delay. Finally, severe inflation will lead to inefficient allocation of resources in the economy [22].

According to Bange et al., [6], inflation is recognized as one of the most fundamental problems during the economic life of any country. Inflation is a continuous increase in the general level of prices or a continuous decrease in the purchasing power of a country's money, which will impose serious costs on society. Mild and not too high inflation is a natural phenomenon and does not seem to interfere with private investment decisions, temporarily increase interest rates and share of business owners and create favourable conditions for savings and, consequently, investment. Provides favourable conditions for investment in terms of changing the distribution of income in favour of profiteers and the channel of creating savings. This phenomenon at high levels, in addition to disrupting the price system, reduces savings, loss of investment incentives, capital flight from the public sector to speculative and brokerage activities [34].

Inflation reduces the present value of investments that return with several periods of delay and causes losses to late-return investments. Inflation and its many changes cause uncertainty and as a result, lack of motivation and delay in decision-making for investment and disrupt the allocation of resources, also have a negative effect on the profitability of investment [4]. There are different theories about inflation, some of which are:

Monetary theory: Proponents of monetary theory believe that inflation is a phenomenon exclusively derived from an increase in the money supply. When the money supply is controlled by the central bank, the extra release of money by the central bank, which is probably ordered by the government, will increase prices [8].

Structural Inflation Theory: Structuralists in their methodological framework believe that the money supply is often endogenous and passive and is adjusted to the level of economic activity and inflation. Structuralisms' argue that inflation is a dual process that inevitably has a monetary dimension. High growth in the economy is considered as a structural factor of inflation because if the economy does not have the necessary growth, it is prone to widening bottlenecks and restrictions such as exchange rate restrictions, inflexibility of taxes and government spending, inability to increase domestic savings, supply constraints Energy and transportation facilities, limited credit and lack of supply of intermediate inputs. Structuralists acknowledge that economic schools have paid

attention to only one aspect of inflation, namely its monetary aspect, while to fully understand inflation in any economy, we must pay attention to both dimensions [36, 39].

Theory of demand pressure: The main basis of this theory is Keynesian theories. According to this theory, inflation is the result of an increase in aggregate demand relative to aggregate supply in full employment conditions. In this situation, an increase in the general level of prices is inevitable. The reason for this increase must be sought in both the real and monetary sectors of the economy. In the real sector, factors such as increasing consumer spending, increasing investment spending, increasing exports and reducing imports can increase aggregate demand or, in other words, move the aggregate demand curve upward. On the other hand, increased demand can be the result of monetary factors. Increasing the money supply due to expansionary monetary policies increases aggregate demand and increases the general level of prices [28].

Cost pressure theory: Proponents of the cost pressure school, as opposed to the monetary school, see the main source of inflationary pressures as factors that are not fundamentally economic, and believe that a more useful way to study inflation is a sociological analysis of class antagonisms. Social groups receive a larger share of financial income. In short, according to the followers of the school of cost pressure, it is not possible to explain inflation regardless of how prices and wages are set. Since prices and wages in different market structures are determined by different institutions, the factors that cause inflation are essentially non-economic [8].

2.4 Background research

Diamond [9] showed in his study that financial intermediaries allocate portfolios to more profitable investment options by providing liquidity to investors, reducing liquidity risk, reducing resource mobilization costs, and enforcing participatory controls. Tabash and Dahankar [40] concluded that in the long run, the relationship between Islamic banks' budgets and economic growth in Qatar is positively and significantly and that Islamic banks' budgets increase investment in the long run and in a positive way in Qatar has helped. Kassim [25] showed that Islamic finance contributes significantly to the real economy by effectively performing the role of financial intermediary in raising funds and directing them to investment activities. Naz and Golzar [32] showed that in the long run, the assets of Islamic banks, the budgets of Islamic banks and Islamic bonds have a significant relationship with real GDP in Muslim countries.

Fakhimi Azar and Ramozi [13] showed that inflation and investment uncertainty have a negative and significant relationship with each other. In their view, economic policymakers should consider the negative effects of increasing inflation uncertainty in their decisions. Bani Asadi and Mohseni [7] in their research concluded that there is a negative relationship between inflation uncertainty and investment in the agricultural sector and recommended that policymakers while considering economic growth, the policy of adjusting and stabilizing prices in order to stabilize the economy and reduce uncertainty. Dodangi [11] in his study showed that high inflation has increased the desire to attract foreign direct investment to achieve stable and positive economic growth in Iran. Rahimi and Hori [38] conducted a study entitled "The effects of exchange rate uncertainty and inflation on investment opportunities of companies listed on the Tehran Stock Exchange" and showed that the effect of real exchange rate uncertainty and inflation rate on investment function is negative and significant. Abu Turabi et al. [1] concluded that Islamic contracts have the ability to through financial stability, profit and loss sharing, increase savings and investment, prosperity in financial markets, diversity of Islamic contracts and microfinance with Improving the efficiency of capital allocation, developing production bases, equipping small and scattered savings, and technological innovations will affect economic growth endogenously. Hassanzadeh and Ahmadian [18] in their research concluded that as the number of years of issuance of Sukuk increases, so will the investment due to people's trust in this market and the increasing trend of its use. Pajouyan and Khosravi [34] showed that public sector investment, inflation, corporate taxes and interest rates had a negative relationship with private sector investment, but facilities, adjustment policies and foreign exchange reserve funds had a positive effect on investment. They had a private. Farzinoush and Azir Mohammadlou [14] stated in their study that banking and non-banking financial institutions lead to the allocation of assets to higher-efficiency investment projects by providing savings liquidity, reducing liquidity risk, reducing resource mobility costs and exercising control over investment operations.

3 Methodology

This research is applied in terms of purpose and descriptive-correlational in terms of implementation. In this study, the investment variable is considered a dependent variable. We use the data panel method to measure the effect of Islamic banking development and inflation on an investment. This research has been conducted in three countries:

Iran, Malaysia and Turkey. Statistical data of Islamic banks of Iran have been prepared from the data of the Central Bank of Iran and other countries from the data reported by the World Bank for the period 2005 to 2020.

3.1 Research hypotheses

Hypothesis 1: The development of Islamic banking has a significant effect on investment.

Hypothesis 2: Inflation rate has a significant effect on investment.

3.2 Research models and variables

In order to investigate the effect of Islamic banking development and inflation rate on investment, we used the following models.

The first model: The following model has been used to investigate the impact of the development of Islamic banking on investment.

$$INV_t = \beta_0 + \beta_1 IBD_t + \beta_2 EXC_t + \beta_3 GDP_t + \beta_4 INT_t + \beta_5 OPEN_t$$

The second model: The following model has been used to investigate the impact of inflation on investment.

$$INV_t = \beta_0 + \beta_1 INF_t + \beta_2 EXC_t + \beta_3 GDP_t + \beta_4 INT_t + \beta_5 OPEN_t$$

In which:

IBD (Development of Islamic Banking): This variable indicates the development of Islamic banking and is obtained from the ratio of financial facilities (in the form of Islamic contracts) provided by Islamic banks (private sector financing) to GDP.

INV (Investment): This variable indicates the amount of investment made, which is obtained from the amount of capital accumulation reported by the World Bank.

INF (Inflation Rate): This rate is obtained from changes in the consumer price index (CPI) or changes in the price index of consumer goods and services and is one of the macroeconomic control variables. The base year is 2005 [12].

EXC (Annual Average Exchange Rate): All foreign exchange data are given in US dollars to take into account the effects of exchange rates and ease of comparison in countries.

GDP (GDP): GDP is the monetary value of goods and services produced within a country's geographical borders. GDP at a fixed price in 2005 is extracted based on World Bank statistics [12].

INT (interest rate): is the rate that is received from the borrower to prevent the devaluation of money paid today and received in the future (due to the time value of money and inflation rate) [27]. This study uses real interest rates.

OPEN (degree of trade openness): is obtained from the ratio of total exports and imports to GDP [23].

4 Data analysis and presentation of research findings

The classical linear regression model is based on a few simple assumptions and the researcher can use linear regression if we do not face any problem in terms of dependent variable normality, alignment test, mania and variance homogeneity test. Given that the normality of model residues is one of the main assumptions of regression models, to establish this assumption, the investment dependent variable has been normalized by the Johnson test and by Minitab 17 software.

Since one of the assumptions of using causal relationships is the absence of multiple alignment relationships between variables, it is necessary to evaluate the alignment between independent variables in the research before performing causal analyzes to examine the absence of multiple common linear relationships between variables. For this purpose, the VIF index (variance inflation factor) has been used to investigate multiple alignments between independent variables. Regarding the VIF index, values less than 5 are considered desirable for this index [15], in other words, according to Table 1, there are no multiple alignments between the independent variables.

In order to ensure the results of the research and the non-artificial relationships in the regression and the significance of the variables, the manoeuvre test was performed and the unit root of the research variables was calculated by Levin, Lin and Chou [26] test in the models. The results of the unit root test for the variables of the final models are described in Table 2. In the case of variables that did not have mana, first-order differentiation was used to make mana.

Table 1: Investigation of alignment between research variables

variable	Inflation factor variance
IBD	1.648
INF	1.359
EXC	1.955
GDP	2.001
INT	4.253
OPEN	2.551

Table 2: Mana test results

variable	Levin, Lane and Chou test I (0)		Test result
	Probability	statistics	
<i>IBD</i>	-1.500	0.066	It is not stable
<i>INF</i>	-1.354	0.087	It is not stable
<i>EXC</i>	-3.055	0.998	It is not stable
<i>GDP</i>	-1.551	0.939	It is not stable
<i>INT</i>	-0.730	0.232	It is not stable
<i>OPEN</i>	-0.134	0.553	It is not stable
<i>INV</i>	-0.120	0.547	It is not stable
variable	Levin, Lane and Chou test I (0)		Test result
	Probability	statistics	
<i>IBD</i>	-5.348	0.000	It is stable
<i>INF</i>	-6.796	0.000	It is stable
<i>EXC</i>	-2.557	0.000	It is stable
<i>GDP</i>	-5.465	0.000	It is stable
<i>INT</i>	-4.922	0.000	It is stable
<i>OPEN</i>	-6.169	0.000	It is stable
<i>INV</i>	-8.145	0.000	It is stable

Variance homogeneity is one of the most important assumptions of the linear regression model. Thus, the components of the eight disorders that appear in the regression function of society have the same variance. If this assumption is not met, we will have variance inequality. In this study, the variance heterogeneity test was performed and the results of this test for the research model are shown in Table 3. Due to the variance heterogeneity, the generalized least squares (GLS) are used to fix it.

Table 3: Output of variance heterogeneity test of research models

<i>Model 1: $INV_t = \beta_0 + \beta_1 IBD_t + \beta_2 EXC_t + \beta_3 GDP_t + \beta_4 INT_t + \beta_5 OPEN_t$</i>			
Methods of testing	<u>degree of liberation</u>	test statistic	confidence level
Bartlett	5	9499.644	0.000
Leven's Test	(5.498)	95.639	0.000
Brown-Forsythe	(5.498)	43.739	0.000
<i>Model 2: $INV_t = \beta_0 + \beta_1 INF_t + \beta_2 EXC_t + \beta_3 GDP_t + \beta_4 INT_t + \beta_5 OPEN_t$</i>			
Methods of testing	<u>degree of liberation</u>	test statistic	confidence level
Bartlett	5	13079.110	0.000
Leven's Test	(5.498)	131.250	0.000
Brown-Forsythe	(5.498)	75.378	0.000

First, it is necessary to determine which of the aggregate or panel approaches is suitable for the implementation of the model using the F-Limer test (Chow test). The cumulative approach is used when the F-Limer test shows that there are no individual differences between sections and periods. The panel approach is used when the F-Limer test shows that there are significant individual differences between sections or periods. In other words, each of the sections

or periods includes effects that cannot be observed accurately but affect the results. This approach is adopted when the F-Leimer statistic is significant (the probability is less than the significance level of 0.05).

The result of the model L-test (Chao) is shown in Table 4. Given that the test statistic is greater than the critical point (95% confidence level) or in other words, the probability value (statistical significance level) is less than 0.05, therefore, the hypothesis based on the use of The integrated model is rejected. Therefore, the panel data method should be used to estimate the models.

Statistics of the degree of freedom

Table 4: Output of F-Limer test of research model

Redundant Fixed Effects Tests			
<i>Model 1: $INV_t = \beta_0 + \beta_1 IBD_t + \beta_2 EXC_t + \beta_3 GDP_t + \beta_4 INT_t + \beta_5 OPEN_t$</i>			
Significance level	<u>Degree of freedom</u>	Statistic	Test effect
0.002	(2.76)	2.038	Cross-Section F
Redundant Fixed Effects Tests			
<i>Model 2: $INV_t = \beta_0 + \beta_1 INF_t + \beta_2 EXC_t + \beta_3 GDP_t + \beta_4 INT_t + \beta_5 OPEN_t$</i>			
Significance level	<u>Degree of freedom</u>	Statistic	Test effect
0.004	(2.76)	2.941	Cross-Section F

Another point is that this study has examined the data of three countries: Iran, Malaysia and Turkey. Due to the limited number of panels, it is only possible to use the fixed effects method and the random effects method is not significant. The results of estimating the research model for the first hypothesis of the research using the fixed effects method and considering the heterogeneity of variance and fixing it using generalized least squares (GLS) are shown in Table 5. As can be seen, based on the results of estimating the research model, according to the significance level of F statistic, it is determined that the model is 99% confirmed with confidence. Also, the value of Watson's camera is in the range of 1.5 to 2.5 with a value of 2.335, which indicates a lack of autocorrelation between errors. Also, the adjusted coefficient of determination of the variables used in the model shows that in total, these variables explain 55.8% of the variance of the investment dependent variable in the research sample.

Regarding the first hypothesis, the Islamic banking development variable has a significant relationship with an investment with respect to the significance level of less than 5 percent and the value of t greater than 1.96 at the 95% significance level, and the first hypothesis is confirmed. In fact, the development of Islamic banking has led to an increase in investment in selected countries. The results of this model also show a positive and significant relationship between GDP and investment.

Also, the results of estimating the research model for the second hypothesis of the research using the fixed effects method and considering the heterogeneity of variance and fixing it using generalized least squares (GLS) are shown in Table 5. As can be seen, based on the results of estimating the research model, according to the significance level of F statistic, it is determined that the model is 99% confirmed with confidence. Also, the Watson camera statistic is in the range of 1.5 to 2.5 with a value of 2.240, which indicates a lack of autocorrelation between errors. Also, the adjusted coefficient of determination of the variables used in the model shows that in total these variables explain 54.5% of the variance of the dependent variable in the research sample.

Regarding the second hypothesis, the inflation rate variable has a significant and negative relationship with an investment with respect to the significance level of less than 5% and the value of t greater than 1.96 at the 95% significance level, and the second hypothesis is confirmed. It can be interpreted that with the increase of the inflation rate, we see a decrease in investment in selected countries (Iran-Turkey and Malaysia). The results of this model show a positive and significant relationship between GDP variables, the degree of trade openness with investment.

5 Discussion and conclusion

One of the most important economic goals of countries is to create the necessary conditions to increase GDP and economic growth. One of the necessary conditions for increasing production and economic growth is investing

Table 5: Test results of the second research model

Dependent variable: INV (investment) 3 countries (Iran - Turkey - Malaysia) during the period from 1992 to 2019 Total observations: 84					
variable	Variable coefficient	Standard deviation	t-statistic	Significance level	result
<i>INF</i>	-3361315	1561141	2.153	0.034	Approve
<i>EXC</i>	229.232	531783	0.431	0.667	Reject
<i>GDP</i>	0.002	0.0006	3.137	0.002	Approve
<i>INT</i>	4288100	2601760	1.648	0.103	Reject
<i>OPEN</i>	212.115	106372	1.994	0.048	Approve
<i>C</i>	7.99e+08	1.65e08	4.839	0.000	Approve
0.583	R2Squared		15.233	Statistics F	
0.545	R2		0.000	Statistical probability F	
2.240	Durbin-Watson		0.028	Total residues	

in economic infrastructure. In general, investment increases production and economic growth by increasing the productivity of production factors, expanding the market, balancing supply and demand, creating side effects, creating better competitive conditions and also increasing the level of welfare [2]. For this reason, in this study, we sought to examine the impact of the development of Islamic banking and inflation on an investment.

As shown in the statistical analysis of the first hypothesis, the variable of Islamic banking development has a significant relationship with investment at the level of 95% and the first hypothesis was confirmed. In fact, the development of Islamic banking has led to an increase in investment in selected countries. Also, based on the results, it was found that there is a positive and significant relationship between GDP and investment. In relation to the second hypothesis, the inflation rate variable at the 95% significance level has a significant and negative relationship with investment and the second hypothesis is confirmed.

Based on this, it can be interpreted that with the increase of the inflation rate, we will see a decrease in investment in selected countries (Iran-Turkey and Malaysia). Based on the results of the second model, a positive and significant relationship between GDP variables, the degree of trade openness with investment was also determined.

Considering the results and the positive and significant impact of the development of Islamic banking on the country's investment, the necessary measures should be taken to improve this industry. One of the methods that banks should take to increase investment and encourage people to deposit in banks is to provide special facilities to depositors. So that customers who deposit to invest in Islamic banks can benefit more profit with the implementation of investment projects. Another way to develop Islamic banking and increase investment is that the central bank and related institutions can have more control over the resources provided by the bank to applicants by enacting new laws and amending existing laws, as well as allocating regulatory bodies to the industry. In order to be able to contribute to the economic growth of the country in this way. With the improvement of the economy and its growth in the country, we can expect domestic and foreign investors to be more willing to invest in that country.

Considering the negative and significant relationship proved in the second hypothesis, it can be concluded that one of the most important factors for increasing and continuing investments is reducing and controlling low inflation. By reducing and then keeping the annual inflation rate constant in each country, it can increase investment and, consequently, improve the country's economy, and this trend will also increase the competitiveness of producers internationally. High inflation rates increase short-term investments and intermediation and reduce the country's employment level. As a result, by reducing the inflation rate and keeping it constant at a low level, the value of projected revenues for long-term investment projects should be considered high, in order to increase employment in the country in addition to increasing investment. In short, high inflation leads to an increase in traders in the economy, reduced investment and many challenges, and to increase investment, reduce and control inflation is an inevitable necessity.

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