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Roles of Islamic Monetary Policy towards Economic Growth

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ABSTRACT: The paper explores the multifaceted roles of Islamic monetary policy in fostering economic growth. Not only is monetary policy crucial for maintaining economic stability and overcoming crises, but it also plays a pivotal role in promoting growth and development. Drawing from Islamic literature and principles, the paper elucidates the foundations of Islamic monetary policy embedded in the Holy Quran and the Hadiths of Prophet Muhammad pbuh. The historical analysis reveals the flexibility and adaptability of Islamic monetary policy during the time of Prophet Muhammad and the Caliphs, emphasizing the universal applicability of monetary principles in Islam. The principles of Islamic monetary policy, rooted in ethical and moral considerations, reject interest-based transactions and align financial practices with Quranic values. The paper delves into the intricate relationship between Islamic monetary policy and investment, highlighting the influence of interest rates on economic growth. The profit-sharing system emerges as a distinctive feature of Islamic monetary policy, offering an alternative to interest-based models. However, the practical implementation in Islamic banking often faces challenges, with murabaha dominating over profit-sharing systems. While Islamic monetary policy holds the promise of ethical and equitable financial practices, the paper acknowledges the need for adaptability and a holistic understanding of the economic ecosystem. Bridging the gap between theoretical ideals and practical implementation remains a challenge for Islamic banks to contribute significantly to economic growth. Ultimately, the study underscores the nuanced dynamics between Islamic monetary policy, interest rates, and profit-sharing rates, emphasizing the interconnectedness of the financial system and regulatory environment in fostering sustainable economic development.

KEYWORDS: Islamic Monetary Policy, Economic Growth

I. INTRODUCTION

Monetary policy stands as a cornerstone of modern economic governance, intricately intertwined with fiscal policy in shaping the trajectory of nations' economic fortunes. Its significance reverberates through the corridors of power, where policymakers grapple with the delicate balance between fostering economic growth and navigating turbulent financial waters. Indeed, the efficacy of monetary policy in sustaining the wheels of the economy cannot be overstated, yet its implementation demands meticulous precision. The consequences of missteps in monetary policy loom large, with the potential to exacerbate economic crises and plunge nations into turmoil. In the delicate dance of economic stewardship, the careful calibration of monetary instruments emerges as a linchpin for stability and prosperity, underscoring the imperative of informed decision-making in charting the course of nations' economic destinies.

In addition, monetary policy serves as a linchpin in the arsenal of tools wielded by governments and central banks to steer economies towards stability and growth. Embedded within its multifaceted framework are a plethora of mechanisms through which it exerts its influence on economic conditions. One such mechanism, underscored by Majid & Hasin (2014), is the pivotal role of monetary policy in shaping bank lending practices. By adjusting interest rates and liquidity provisions, central banks can incentivize or disincentivize lending activities, thereby exerting a profound impact on credit availability and investment dynamics within the economy. Moreover, as espoused by Adesina (2018), the overarching objective of monetary policy extends beyond mere tinkering with interest rates; it encompasses the broader imperatives of promoting economic growth, fostering price stability, and ensuring exchange rate equilibrium. This holistic approach underscores the pivotal role of monetary policy in sculpting the macroeconomic landscape, with far-reaching implications for businesses, consumers, and investors alike.

At its core, monetary policy represents the judicious management of a nation's money supply and purchasing power, a mandate entrusted to the stewardship of central banks. As elucidated by Tahir (2013), central banks wield formidable powers in calibrating liquidity volumes and sculpting purchasing power dynamics, thereby shaping the contours of economic activity. However, the efficacy of monetary policy hinges not merely on the exercise of regulatory authority but on a nuanced understanding of its tools and criteria. Kanour et al. (2021) underscore the importance of comprehending inflation targets, fluctuations in price stability, and shifts in employment dynamics as critical determinants of monetary policy effectiveness. Armed with this knowledge, economic policymakers can navigate the complex terrain of monetary policy with greater precision, harnessing its potential to catalyze growth, stability, and prosperity within their respective economies.

Moreover, monetary policy transcends the confines of conventional economic discourse, finding resonance within the rich tapestry of Islamic literature and jurisprudence. In Islam, a religion revered for its comprehensive guidance on matters of faith and daily life, economic issues occupy a prominent place. The Holy Quran and the Hadith of the Prophet Muhammad (peace be upon him) serve as guiding lights, illuminating principles that govern economic conduct, including monetary policy. Islam recognizes the pivotal role of money in shaping societal welfare and economic justice, underscoring the importance of equitable income distribution and fair exchange mechanisms (Khalidin, 2021). Indeed, monetary policies crafted in accordance with Islamic principles seek not only economic prosperity but also the realization of broader societal goals rooted in compassion, fairness, and social cohesion. As such, the integration of Islamic perspectives into discussions on monetary policy enriches our understanding, offering insights that resonate with the timeless principles of justice and compassion espoused by the Islamic faith.

Islam's teachings on monetary theory and policy, as enshrined in the Holy Quran and the Hadiths of the Prophet Muhammad (peace be upon him), resonate with timeless wisdom and relevance. Central to Islamic monetary principles is the prohibition of usury and exploitation, reflecting a commitment to ethical conduct in economic affairs. Additionally, the Prophet Muhammad's (peace be upon him) recognition of prevailing currencies, such as the Dinar and Dirham, underscores Islam's pragmatic approach to monetary matters. By legitimizing these currencies, the Prophet established a framework for a stable and just monetary system, rooted in the needs and realities of the time. Thus, Islamic teachings provide enduring guidance for navigating the complexities of monetary policy, offering insights that uphold principles of fairness, integrity, and economic well-being for all members of society.

The interplay between monetary policy and economic growth stands as a focal point in contemporary economic discourse. Recognized as a cornerstone of prosperity, economic growth captivates the attention of economists and policymakers alike. This paper seeks to elucidate the intricate roles of monetary policy in fostering and sustaining economic growth, a nexus deemed indispensable for the vitality of economies worldwide. As underscored by Serifoglu (2022), the dynamics of economic growth are central to the pursuits of economists, driving a plethora of research endeavors aimed at unraveling its complexities. From scrutinizing the impact of monetary policy on stock markets, as evidenced by Rahmani et al. (2021), to exploring the intricate relationship between growth and social security expenditures, as examined by Reichel (2022), the symbiotic relationship between monetary policy and economic growth continues to fuel scholarly inquiry, offering insights into the mechanisms underpinning prosperity and progress.

Economic growth serves as the cornerstone of societal prosperity, laying the foundation for a flourishing and harmonious community. Without robust economic growth, the aspirations of a prosperous and peaceful society remain elusive. Vital to job creation and economic well-being, sustained growth fosters opportunities for employment and elevates the economic welfare of individuals. Conversely, sluggish growth breeds economic instability, hindering job creation and impeding progress towards societal prosperity. In essence, economic growth forms the bedrock upon which the edifice of societal welfare is built, underscoring its indispensable role in shaping the fabric of nations and the livelihoods of their citizens.

In Islam, achieving sustainable economic growth is intrinsic to fulfilling the Maqasid Sharia, or Sharia goals. Central to this pursuit is the implementation of fair and appropriate monetary policies. Such policies must align with the conditions necessary for economic growth and improvement, ensuring equitable outcomes for all stakeholders. Islam emphasizes the importance of monetary policies that safeguard the interests of the entire community, prioritizing the common good over the interests of specific groups. By adhering to principles of fairness and justice, monetary policies become powerful instruments in realizing the broader objectives of societal welfare and economic prosperity as envisioned in Islamic teachings.

Juhro and Lyke (2019) present a fundamental view of monetary policy, highlighting its dual objective of achieving macroeconomic and price stability. This perspective underscores the multifaceted role that monetary policies play in shaping the economic landscape. Macro stability encompasses vital indicators such as employment levels, economic growth, and overall stability, while price stability revolves around maintaining a steady inflation rate. Balancing these objectives requires policymakers to navigate a delicate equilibrium, ensuring a robust and sustainable economic environment. This holistic approach to monetary policy reflects the intricate interplay between various economic factors and underscores the importance of comprehensive policy frameworks in fostering long-term prosperity.

Samhan and Al-Khatib (2015) underscore the pivotal contribution of Islamic banks to economic development. Beyond traditional financial functions, Islamic banks serve as catalysts for growth by promoting ethical investment practices. Adhering to Shariah-compliant principles, these institutions foster a financial environment rooted in equity and fairness. By attracting investors committed to ethical finance, Islamic banks stimulate economic activity and contribute to the cultivation of a sustainable and socially responsible economic sector. In essence, the emphasis on ethical finance not only aligns with Islamic principles but also fosters a robust ecosystem conducive to long-term prosperity and societal well-being.

II. History of Monetary Policy in Islam

In Islam, monetary policy has existed in the early days of the birth of Islam, namely during the time of the Prophet Muhammad pbuh either in Mecca or in Medina Period. During the Medina Period, in particular, many provisions related to daily activities such as political, social and economic issues were conveyed by the Prophet. Among them are those that related to monetary concepts and policies. The Prophet Muhammad is a role model for the Muslim community, both his words and attitudes are a guideline for the Muslim community (Kilic & Canaker 2022). He oversaw monetary policy and controlled economic activities of the Arabic people (Khalidin, 2021).

One of the most important hadiths of the Prophet regarding monetary policy is the Hadith which stipulates that the Dinar and Dirham currencies that prevailed at that time were converted into the Islamic currency. It should be noted that the monetary system and medium of exchange existed before Islam, because the Arab country itself was flanked by two major powers at that time, namely Rome and Persia, and both were considered advanced in the field of monetary and exchange.

Economic problems were not so dominant in the early days of Islam, so that the development of monetary theory and mechanisms did not occur much at that time. However, recognition of the legitimacy of the use of classical instruments of exchange and payment methods that had previously been in effect among traditional societies is an important step and momentum for the development of the monetary system in Islamic Economics. The establishment of dinars and dirhams as the official currency in Islam, both in terms of form and dosage according to those already in force in Mecca and Medina, was the only monetary policy during the time of the Prophet Muhammad. However, even though only one policy was taken during his time, the nature and impact of that policy was very broad and universal.

The hadith of the Prophet Muhammad SAW which acknowledged the existence of Dinars and Dirhams as currency even though they did not originate from Islam, is a meaning that the monetary system in Islam is very flexible and in accordance with the times. During the reign of Khulafaur Rasyidin, economic and monetary problems did not occur much, it’s just that there was a currency policy during the Caliph Umar bin Khattab. During the time of Caliph Umar bin Khattab, the Dirham currency was modified with Islamic names. There was no policy in terms of value and size for the Dinar and Dirham currencies during the caliphate, and this happened in the next two caliph periods.

In 76 H, during the Umayyad Caliphate, there was a change in the currency made by Caliph Abdul Malik bin Marwan. However, there have been no significant changes and developments regarding monetary theory and policy in Islam. Changes at that time were in the printing and images of the Dinar and Dirham currencies, which fully reflected Islam. However, both value and weight did not change as before. The size and limits of these currencies, Dinars and Dirhams, eventually become guidelines and benchmarks in various legal provisions in Islam. For example, Abu Hanifah, in his fatwa on fiqh laws, such as zakat, jinayat and others, relates them to dinars and dirhams.

III. Principles of Islamic Monetary Policy

Islam recognizes the monetary system and policy that is practiced in today's modern world, as long as it achieves economic benefits that do not conflict with the principles outlined in Islam itself. For Islam, monetary is something that is very important in the life of economic and financial transactions, as explained. However, even though the objectives are technically the same, Islamic monetary policy has main principles that must be considered, especially for the monetary authority itself.

The principles of Islamic monetary policy are deeply rooted in ethical and moral considerations, guided by the Quran and a commitment to avoid practices such as riba (interest), gharar (uncertainty), maisir (gambling), and non-halal (prohibited) activities. The Quran, while not providing a specific definition of riba, sets the tone for Islamic finance by discouraging the practice. Ahmad and Hassan (2015) note that the absence of a clear definition in the Quran prompts scholars to derive principles based on the broader ethical framework established by Islamic teachings.

Islamic banks, in adherence to these principles, operate on a foundation that rejects interest-based transactions. Egresi (2015) emphasizes that Islamic banks distinguish themselves by steering away from interest and conducting their operations in alignment with a comprehensive set of moral and ethical guidelines. This commitment is not only a financial strategy but a reflection of Islamic values, fostering an ethical financial system.

Fikri (2018) sheds light on the operational aspect of Islamic banks, highlighting their role as intermediaries between depositors and financing customers. In contrast to conventional banks that often rely on interest-based models, Islamic banks navigate a different path by employing various Shariah-compliant financial instruments. The core concept involves collecting funds from depositors and redistributing or lending them to financing customers within the bounds of ethical and interest-free practices.

In response to the Global Financial Crisis, Ilhan (2022) argues that the traditional focus on price stability alone is inadequate for ensuring financial stability. This recognition underscores the need for alternative policy tools and frameworks in monetary policy. Islamic monetary principles, with their emphasis on ethical and interest-free transactions, offer a unique perspective that could serve as an alternative approach to foster financial stability and resilience.

Addressing fiscal deficits is a common challenge for governments, often leading them to resort to printing new money. However, Javid and Arif (2014) caution that this practice can result in inflation, presenting a monetary phenomenon that Islamic monetary

policy seeks to manage. The principles discourage arbitrary creation of money and promote responsible fiscal policies that align with the broader goals of economic stability and fairness.
Ledhem and Mekidiche's (2020) research delves into the performance of Islamic financial institutions and its impact on economic growth. While Islamic finance is often lauded for its ethical underpinnings, the study suggests that the ratio of the performance of Islamic financial institutions alone may not be sufficient to make a positive contribution to economic growth. This insight prompts a deeper examination of the mechanisms and frameworks within Islamic finance to ensure a more holistic and impactful role in economic development.
Omer (2019) emphasizes that conducting business in the Islamic way necessitates transactions free of interest. Unlike conventional banking where interest is a common facet of lending and borrowing, Islamic finance prohibits interest or usury. This fundamental distinction requires lenders in Islamic finance to engage in transactions that are ethical, transparent, and aligned with Islamic principles.
The principles of Islamic monetary policy are deeply rooted in ethical and moral considerations, providing a distinctive framework that rejects interest-based transactions and aligns financial practices with the broader values outlined in the Quran. Islamic banks, as proponents of these principles, serve not only as financial intermediaries but as ethical guardians of economic transactions. As the global financial landscape evolves, the principles of Islamic finance offer an alternative perspective, emphasizing ethical conduct, financial stability, and sustainable economic growth.

IV. Islamic Monetary Policy and Investment
The basic concept of Islamic monetary management, as outlined by Ascarya (2014), revolves around achieving stability in money demand. This foundational principle sets the stage for examining the intricate relationship between Islamic monetary policy and investment. In the broader context, the implementation of different monetary policies is a well-recognized phenomenon, impacting the conditions and rates of investment. The crux lies in the fact that a country's monetary policy plays a pivotal role in shaping its investment landscape, influencing both the model and level of investments. Particularly during economic crises, the stakes are higher, as the wrong policy choice can have fatal consequences, potentially exacerbating the crisis instead of facilitating recovery.
The theoretical underpinning of the relationship between monetary policy and investment is underscored by the importance of capital or money in the investment process. Macroeconomic studies highlight that monetary policy, with its arsenal of interest-based instruments, determines the size of money circulation, thereby influencing investors in their activities. In times of economic sluggishness characterized by lack of production activities and minimal employment, governments often resort to expansionary monetary policies. This entails increasing the money supply by lowering interest rates, aiming to stimulate investment and economic activity.
The challenge in developing an Islamic financial system lies in finding indicators of monetary policy that align with Islamic principles, as noted by Ahmad and Ismail (2018). This underscores the importance of adapting monetary frameworks to adhere to Islamic values, introducing a layer of complexity compared to conventional monetary systems. Hossain et al. (2018) contribute to the discussion by highlighting a long-run equilibrium relationship between economic growth, human resource development, and trade openness. This insight emphasizes the multifaceted nature of economic growth, suggesting that factors beyond monetary policy, such as human capital development and trade dynamics, play integral roles.
Atici's (2018) study delves into the causal relationship between Islamic (participation) banking and economic growth in Turkey, shedding light on how Islamic banking practices may impact a country's economic development. Similarly, Kumar et al. (2019) explore the relationship between insurance consumption and economic growth in India over a specific period. Utilizing indicators such as insurance penetration, insurance density, and per capita GDP, the study provides insights into the interplay between insurance practices and economic growth.
Utama et al. (2017) highlight the dual role of interest rates and money supply in monetary policy, emphasizing their use in achieving inflation targets. This adds another layer to the discussion, showcasing the multifunctional nature of monetary tools. Lastly, Zank (2019) draws attention to historical instances, such as the monetary unification during the reunification of Germany. This serves as a reminder of the pivotal role monetary issues play during critical junctures in a nation's history.
In essence, the statements collectively underscore the nuanced relationship between Islamic monetary policy and investment, emphasizing the need for careful consideration of economic, cultural, and historical contexts when formulating and implementing monetary strategies.
The interplay between Islamic monetary policy and investment is a dynamic and intricate relationship, shaped by economic, cultural, and historical contexts. Ascarya's (2014) foundational principle of achieving stability in money demand sets the stage for understanding the multifaceted nature of this relationship. As governments strive to shape their investment landscape through various monetary policies, the unique challenge in Islamic finance lies in aligning these policies with Islamic principles.
Traditional monetary policies often rely on interest-based instruments to influence the size of money circulation and stimulate investment during economic slowdowns. However, Islamic finance rejects interest-based transactions, necessitating the development of indicators that adhere to Islamic values (Ahmad & Ismail, 2018). This introduces complexity compared to

conventional monetary systems. The long-run equilibrium relationship highlighted by Hossain et al. (2018) emphasizes that economic growth is influenced not only by monetary policy but also by factors such as human resource development and trade openness. Understanding these broader dynamics becomes essential for formulating Islamic monetary policies that contribute to sustainable economic development.

Atici's (2018) study on Islamic banking in Turkey sheds light on the potential impact of Islamic practices on economic growth. The causal relationship explored suggests that Islamic banking, with its adherence to Shariah principles, may have distinct implications for a country's economic development. Similarly, Kumar et al. (2019) delve into the relationship between insurance practices and economic growth in India, showcasing the diverse avenues through which financial systems can influence economic dynamics. Utama et al. (2017) highlight the dual role of interest rates and money supply in achieving inflation targets, adding another layer of complexity to Islamic monetary policy. While adhering to Islamic principles, policymakers must navigate the multifunctional nature of monetary tools to achieve economic stability. Zank's (2019) historical analysis, focusing on the reunification of Germany, serves as a reminder that monetary issues play pivotal roles during critical junctures in a nation's history.

The nuanced relationship between Islamic monetary policy and investment becomes evident in the challenges of adapting these policies to varying economic landscapes. The rejection of interest-based transactions often leads Islamic banks to favor simpler systems like murabaha over profit-sharing models (Rashid & Jabeen, 2016). This discrepancy between theoretical ideals and practical implementation raises questions about the widespread application of profit-sharing systems.

The challenge for Islamic banks lies in bridging the gap between theoretical concepts and practical realities, adapting to external conditions, and maintaining alignment with profit and loss-sharing principles (Fakhri & Darmawan, 2021). The intricate relationship between monetary policy, interest rates, and profit-sharing rates, as emphasized by Khalidin (2022), underscores the interdependence between the financial system and the regulatory environment. n conclusion, the discussion on Islamic monetary policy and investment highlights the need for a comprehensive understanding of economic, cultural, and historical factors. As Islamic finance navigates the complexities of aligning monetary policies with Shariah principles, policymakers must carefully consider the multifaceted nature of economic growth. Bridging the gap between theory and practice remains a challenge, but addressing this challenge is crucial for Islamic banks to contribute significantly to sustainable economic development.

V. Profit Sharing System and Economic Growth

Basically monetary principles in Islam are very flexible and broad. This is in accordance with the main principles of the Islamic ushul fiqh, which states that everything is permissible as long as there is no prohibition. This means that all forms and models of monetary policy are basically permissible in Islam, as long as these are not prohibited. In the other words, all forms of policy in regulating the circulation of money in the economy are acceptable in Islamic Economics, as long as they do not conflict with predetermined legal provisions. Therefore, for instance, monetary policy based on an interest system is forbidden by the majority of Islamic scholars, because it is included in the category of usury, where the usury itself is prohibited in Islam.

The prohibition of interest prompts consideration of alternative models in monetary regulation, such as the profit-sharing system, pivotal in Islamic monetary policy. However, it’s crucial to recognize that profit-sharing isn’t solely a monetary tool within Islamic Economics; various models may underpin Islamic monetary policy. Fundamentally, monetary policy aims to manage money supply, aligning with Islamic economic principles. This encompasses activities regulating and controlling money circulation, harmonizing with Islamic tenets. Thus, Islamic monetary policy integrates diverse instruments to uphold economic stability while adhering to the ethos of interest-free finance, ensuring consistency with Islamic economic principles.

The profit-sharing system, advocated in Islamic economic principles, offers a viable approach to monetary policy (Ahmad & Mustofa, 2022). It emphasizes distributing profits from investments or business endeavors based on agreed-upon ratios among involved parties. While integral to Islamic financial activities, the profit-sharing system isn't the sole model employed; Islamic Economics encompasses various systems and methods. Beyond Islamic contexts, profit-sharing finds application in diverse economic and business domains. For instance, contemporary capital and stock markets adopt profit-sharing through dividends. This highlights the adaptability and relevance of the profit-sharing concept beyond Islamic finance, underscoring its potential as a solution for monetary policy challenges within and beyond Islamic economic frameworks.

Interest rates indeed hold a central position in economic growth, as extensively explored in contemporary economics literature. The impact of interest rates on economic growth manifests through various channels, predominantly regulated by the central bank's monetary policy using diverse instruments. When interest rates decrease, the demand for money typically rises, facilitating investment activities indirectly. Concurrently, reduced interest rates spur public consumption by lowering the cost of borrowing, thus stimulating economic activity. Both avenues, whether through increased investment or consumption, contribute to bolstering economic growth. Consequently, it's evident that interest rates constitute a pivotal variable, exerting a significant influence on the trajectory of economic growth, thereby underscoring their critical role in economic dynamics.

Basically the existence of monetary policy serves as a tool to achieve economic growth only. Thus, good monetary policy is a policy that can increase economic growth, and this can be done through various channels. Indeed, one of the important objectives of monetary policy is to maintain sustainable economic growth. Among the main factors affecting economic growth is the level of investment, both in the short term and in the long term.

The implementation of a profit-sharing system, particularly through contracts like Musyarakah, stands as a fundamental principle in Islamic finance. Musyarakah is a contractual agreement that employs a profit-sharing ratio, ensuring that all parties involved share either the profits or losses generated by the contract (Berger et al., 2019). This profit and loss-sharing (PLS) principle forms the bedrock of relationships within Islamic banks, as highlighted by Hamza (2015). The inherent idea is one of collaboration and shared responsibility, aligning with Islamic financial principles.

Despite the theoretical emphasis on profit-sharing models like mudharabah and musharakah, the reality within Islamic banking often diverges. Rashid and Jabeen (2016) note that, in practice, Islamic banks tend to favor the murabaha system over profit-sharing systems. This trend is particularly pronounced in Indonesia, where the dominance of murabaha is observed, raising questions about the appropriateness of its widespread application (Shofawati, 2014). Murabaha, fundamentally a type of sale, deviates from the profit-sharing ethos, revealing a gap between theoretical ideals and practical implementation (Shah & Niazi, 2019).

For Islamic banks to thrive and contribute significantly to economic growth, the ability to adapt to external conditions becomes paramount. Fakhri and Darmawan (2021) highlight the importance of factors such as liquidity management, efficiency, and the quality of financing. This adaptability ensures that Islamic banks can navigate varying economic landscapes while adhering to their equity-based financing principles, as emphasized by Tabash (2019).

The relationship between monetary policy, particularly interest rates, and profit-sharing rates within Islamic banking adds another layer to the discussion. Khalidin (2022) underscores the strong correlation between these two factors. This connection emphasizes the sensitivity of Islamic banking practices to broader economic policies and conditions, revealing the interdependence between the financial system and the regulatory environment.

The discussion on the profit-sharing system and its implications for economic growth in the context of Islamic banking is multifaceted. While the theoretical underpinnings advocate for collaborative, equity-based models like Musyarakah, the practical landscape often leans towards simpler systems like murabaha. The challenge for Islamic banks lies in bridging this gap, adapting to external conditions, and maintaining alignment with their profit and loss-sharing principles. Moreover, the intricate relationship between monetary policy, interest rates, and profit-sharing rates emphasizes the need for a holistic understanding of the economic ecosystem in which Islamic banking operates.

V. CONCLUSIONS AND RECOMMENDATION

Monetary policy emerges as a critical instrument in economic management, pivotal for achieving desired economic outcomes and overcoming challenges. The careful selection and implementation of monetary policy are imperative, as mistakes can lead to severe consequences, exacerbating economic crises. Islam, as a universal religion, encompasses principles governing monetary theory and policy derived from the Holy Quran and the Hadith of the Prophet Muhammad SAW. The primary objective of Islamic monetary policy is to foster mutual benefit and economic prosperity, aligning with the concept of maqashid sharia. Policies that lead to harm, such as usury or riba, are strictly prohibited in Islamic monetary frameworks. Instead, Islamic monetary policy emphasizes a profit-sharing system and other methods free from elements like usury, gharar, and idhrar. The profit-sharing system, epitomized by contracts like Musyarakah, stands out as a crucial instrument in Islamic monetary policy.

While theoretical ideals promote equity-based models, the practical landscape often witnesses a preference for simpler systems like murabaha. The challenge for Islamic banks lies in bridging this gap, adapting to external conditions, and maintaining alignment with their profit and loss-sharing principles. Furthermore, the relationship between monetary policy, interest rates, and profit-sharing rates underscores the interconnectedness of Islamic banking practices with broader economic policies. This correlation highlights the sensitivity of Islamic financial systems to external conditions, necessitating a holistic understanding of the economic ecosystem. The historical overview of Islamic monetary policy reveals its flexibility and adaptability to different times and circumstances. From the time of the Prophet Muhammad SAW, where the Dinar and Dirham were recognized as currency, to the contemporary era, Islamic monetary principles have evolved while adhering to the core values of Islam.

In practice, the profit-sharing system, though not universally implemented, holds promise for economic growth. The absence of interest rates theoretically facilitates higher levels of investment, a critical factor in driving economic growth. While not widely adopted by Muslim countries, the theoretical underpinnings of Islamic monetary policy suggest positive implications for economic development. In summary, Islamic monetary policy offers a unique and ethically grounded approach to economic management, emphasizing equity, collaboration, and adherence to Shariah principles. The challenge lies in the effective implementation of these principles within the modern economic landscape, ensuring that Islamic financial institutions play a significant role in fostering economic growth, stability, and social responsibility. As the global economic landscape continues to evolve, the principles of Islamic monetary policy provide a distinctive perspective that may contribute to a more ethical and sustainable financial system.

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