

# **ISLAMIC BANKING AND ECONOMIC GROWTH: CASE OF PAKISTAN**

**AFIA MUSHTAQ**



University of Management and  
Technology



Institute of  
Islamic Banking

بِسْمِ اللَّهِ الرَّحْمَنِ الرَّحِيمِ



معهد المصارف الإسلامية  
**Institute of Islamic Banking**

# **ISLAMIC BANKING AND ECONOMIC GROWTH: CASE OF PAKISTAN**

**AFIA MUSHTAQ**

**A thesis submitted in partial fulfilment of the requirements for the  
MS degree in Islamic Banking and Finance**



University of Management and  
Technology



Institute of  
Islamic Banking

**Lahore, Pakistan.**

**1436 AH / 2015 CE**

## TABLE OF CONTENTS

CERTIFICATE OF APPROVAL.....	6
DECLARATION .....	7
STATEMENT OF COPYRIGHT.....	8
DEDICATION.....	9
ACKNOWLEDGEMENT .....	10
ABSTRACT.....	11
LIST OF TABLES.....	12
LIST OF FIGURES .....	13
LIST OF ANNEXURES.....	14
CHAPTER # 1 .....	<b>Error! Bookmark not defined.</b>
1. Introduction.....	<b>Error! Bookmark not defined.</b>
1.1 Islamic Banking and Economic Growth in Pakistan ...	<b>Error! Bookmark not defined.</b>
1.2 Economic Growth.....	<b>Error! Bookmark not defined.</b>
1.3 Objective of the Study .....	<b>Error! Bookmark not defined.</b>
1.4 Research Questions.....	<b>Error! Bookmark not defined.</b>
1.5 Theoretical Framework.....	<b>Error! Bookmark not defined.</b>
1.6 Organization of Thesis.....	<b>Error! Bookmark not defined.</b>
CHAPTER # 2 .....	<b>Error! Bookmark not defined.</b>
2. Literature Review.....	<b>Error! Bookmark not defined.</b>
CHAPTER # 3 .....	<b>Error! Bookmark not defined.</b>
3. Research Methodology .....	<b>Error! Bookmark not defined.</b>
3.1 Research Hypothesis.....	<b>Error! Bookmark not defined.</b>
3.2 Stationarity Tests .....	<b>Error! Bookmark not defined.</b>
CHAPTER # 4 .....	<b>Error! Bookmark not defined.</b>
4. Results and Discussion .....	<b>Error! Bookmark not defined.</b>
4.1 MODEL I.....	<b>Error! Bookmark not defined.</b>
4.2 MODEL II .....	<b>Error! Bookmark not defined.</b>
4.3 MODEL III.....	<b>Error! Bookmark not defined.</b>

CHAPTER # 5 .....	<b>Error! Bookmark not defined.</b>
5.1 Conclusion.....	<b>Error! Bookmark not defined.</b>
5.2 Recommendations .....	<b>Error! Bookmark not defined.</b>
REFERENCES .....	<b>Error! Bookmark not defined.</b>
ANNEXURES .....	<b>Error! Bookmark not defined.</b>
ANNEXURE A - MODEL I ESTIMATIONS .....	<b>Error! Bookmark not defined.</b>
ANNEXURE B - WALD TEST .....	<b>Error! Bookmark not defined.</b>
ANNEXURE C - HETEROSKEDASTICITY TEST.....	<b>Error! Bookmark not defined.</b>
ANNEXURE D - BREUSCH-GODFREY SERIAL CORRELATION LM TEST .....	<b>Error!</b>
	<b>Bookmark not defined.</b>
ANNEXURE E - RAMSEY RESET TEST.....	<b>Error! Bookmark not defined.</b>
ANNEXURE F - MODEL II ESTIMATIONS.....	<b>Error! Bookmark not defined.</b>
ANNEXURE G - MODEL III ESTIMATIONS.....	<b>Error! Bookmark not defined.</b>
ANNEXURE H - SIMILARITY REPORT .....	<b>Error! Bookmark not defined.</b>

# CERTIFICATE OF APPROVAL

## CERTIFICATE OF APPROVAL

The thesis entitled "*Islamic Banking and Economic Growth: Case of Pakistan*" by **Ms. Afia Mushtaq** (ID # 12002130-010) has been examined by the undersigned panel of examiners and has been accepted in partial fulfillment for the degree of **MS Islamic Banking and Finance**.




Supervisor  
Dr. Rukhsana Kaleem  
Dean  
School of Business and Economics,  
University of Management and Technology, Lahore

Date: 24-08-2015



External Examiner  
Dr. Muhammad Ali Jibrán Qamar  
Assistant Professor  
Management Sciences/Center of Islamic Finance,  
COMSATS IIT University, Lahore

Date: 24-08-2015



Chairperson IIB Graduate Committee  
Muhammad Mahmood Shah Khan  
Director  
Institute of Islamic Banking,  
University of Management and Technology, Lahore

Date: 24-08-2015

**Institute of Islamic Banking**  
**University of Management and Technology**

## DECLARATION

I hereby declare that no portion of the work that appears in this study has been used in support of an application for another degree in qualification to this or any other University or institution of higher learning.

This thesis is a presentation of my original research work. Wherever contributions of others are involved, every effort has been made to indicate this clearly, with due reference to the literature and acknowledgement of collaborative research and discussions.

The work was done under the guidance of Dr. Rukhsana Kaleem, Dean, School of Business and Economics at University of Management and Technology, Lahore, Pakistan.

---

**Afia Mushtaq**

Date: \_\_\_\_\_

In my capacity as supervisor of the candidate's thesis, I certify that the above statements are true to the best of my knowledge.

---

**Dr. Rukhsana Kaleem**

Date: \_\_\_\_\_

## STATEMENT OF COPYRIGHT

© All rights reserved. No part of this thesis may be reprinted or reproduced or utilised in any form or by any electronic, mechanical, or other means, now known or hereafter invented, including photocopying and recording, or in any information storage or retrieval system, without permission in writing from the author. [afia.mushtaq@umt.edu.pk](mailto:afia.mushtaq@umt.edu.pk)

Without limiting the rights under copyright reserved above, no part of this document may be reproduced, stored in or introduced into a retrieval system, or transmitted, in any form or by any means (electronic, mechanical, photocopying, recording, or otherwise), without the prior written permission of the copyright owner.

The scanning, uploading, and distribution of this document via the Internet or via any other means without the permission of the author is illegal and punishable by law. Please purchase only authorized electronic editions and do not participate in or encourage electronic piracy of copyrighted materials. Your support of the author's rights is appreciated.

## **DEDICATION**

This thesis is dedicated to my parents, husband, children, for their love, endless support and encouragement throughout the course of this work.

## **ACKNOWLEDGEMENT**

First of all, I would like to thank Allah Almighty Who gave me the courage, health, and energy to accomplish this work in due time and without Whose help this study, which required untiring efforts, would have not been possible.

Motivation, encouragement, guidance, corrections, advice, and overall support are the key elements required from the supervisor(s) to write and complete a thesis of a good standard and quality within deadlines. It is a matter of utmost pleasure for me to extend my gratitude and give due credit to my Advisor Professor Dr Rukhsana Dean of School of Business and Economics), whose support has always been there in need of time and who provided me with all these key elements to complete my thesis within the time frame.

Acknowledgement would be incomplete without extending my gratitude to my family and colleagues especially Mr. Noman Arshad and Ms Ramla Sadiq whose immense help made this study possible. Moreover, they have been supporting me enthusiastically throughout my work to make my thesis ready in due time.

**Afia Mushtaq**  
**August 2015**

## ABSTRACT

Islamic banking in Pakistan has gained recognition, in last ten to eleven years. There are many products which are different from conventional banking and the most significant element is zero interest. Currently, a large no of people have motivation towards Islamic banking compared to conventional banking especially in the view of growth in its assets, investment and deposit. The increasing number of Islamic banking institutes indicates an increasing trend of Islamic banking in Pakistan. People are trusting on this mode of banking due to which the number of Islamic banking institutes is increasing and different conventional banks are opening Islamic banking branches to cater the increasing demands of people of Pakistan. Extensive work has been done in evaluating the connection between the financial sector and development, however research work regarding the Islamic banking framework is still insufficient. The present study is unique as it investigates the short run and the long run relationship between Islamic financial investment, its diverse items and financial development, especially in Pakistan. For the analysis we have utilized the bound testing methodology of integration and error correction models (ECMs), developed within an autoregressive distributed lag (ARDL) structure by Pesaran and Shin (1995), Pesaran et al. (1996) and Narayan (2004). Using quarterly data for the period of 2006-2013 it is found that there is a supply side relation between economic growth and Islamic banking in Pakistan and Islamic banking industry exerts significant impact on economic growth.

## LIST OF TABLES

Table 1.1: Industry Progress and Market Share (Rupees in billions)	03
Table 1.2: Province Wise Branch Network (March 2014)	05
Table 4.1: Unit Root Tests	25
Table 4.2: Correlation Matrix	25
Table 4.3: Variance Inflation Factor	26
Table 4.4: Lag Order Selection Criteria	26
Table 4.5: Long Run (causality) Cointegration Test	27
Table 4.6: Determining Long Run Coefficients	28
Table 4.7: Determining Short Run Coefficient	29
Table 4.8 Determining the Lag Order	31
Table 4.9: Long Run (causality) Cointegration Test	32
Table 4.10: Long Run (casuality) Cointegration Test	34
Table4.11: Ganger Casuality Test	35

## LIST OF FIGURES

Figure 1.1: Total Islamic Banking Assets	04
Figure 1.2: Conventional Banks Vs. Islamic Banks	06
Figure 1.3: GDP and GFCF Trend in Pakistan	07
Figure 1.4: Net Financing and Investment (in Rs. Billions)	07
Figure 1.5: Economic Growth and Islamic Net Financing	08
Figure 1.6: Islamic Banking Products	09
Figure : 1.7 Theoretical Framework of Study	11
Figure 4.1: CUSUM Test for Stability	30
Figure 4.2: CUSUM of Squares Test for Stability	30

## LIST OF ANNEXURES

<u>ANNEXURE A - Model I Estimations</u>	48
ANNEXURE B - Wald Test	50
<u>ANNEXURE C - Heteroskedasticity Test</u>	51
<u>ANNEXURE D - Breusch-Godfrey Serial Correlation LM Test</u>	52
<u>ANNEXURE E - Ramsey Reset Test</u>	53
ANNEXURE F - Model II Estimations	54
<u>ANNEXURE G - Model III Estimations</u>	55
<u>ANNEXURE H - Similarity Report</u>	56