# Islamic Banking and Economic Growth: New Evidence

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**Abstract:**

While extensive work has shown that conventional banking development is generally conducive to economic growth, there are only a limited number of studies that investigate the impact of Islamic banking. Importantly, the literature on conventional banking claims that a reverse causality from economy performance to banking may exists, but existing studies on Islamic banking fail to address this potential endogeneity problem. This paper tackles this problem and explores the relationship between Islamic banking development and economic performance in a sample of 32 developed and developing countries based on data spanning the 2000 to 2016 period. The findings show that, although Islamic banks are considered small relative to the total size of the financial sector, Islamic banking is positively correlated with economic growth even after controlling for financial structure, macroeconomic factors and other variables. The outcome is robust across different econometric specifications like pooling OLS, fixed effects, panel data with over-identified GMM, and dynamic difference GMM. The results are confirmed on two different indicators of Islamic banking and hold for different time periods.

**Keywords:** Islamic banking, Economic Growth, Endogeneity, Dynamic Difference GMM

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