Abstract: The aim of this paper is to highlight the current practices of Islamic Finance IF and Islamic Social Finance ISF in mitigating inflation in Malaysia. This study used a descriptive qualitative method collected from secondary data consisting of documents relate to the subject matter at hand. The type of documents used are published articles, reports, journals, and websites. Islamic Finance IF & Islamic Social Finance ISF offers various financial products that help to eliminate riba/interest from society, circulate the wealth from the have to the have not in an ethical approach, hence, stabilizing prices and mitigating inflation. This paper is a conceptual study which does not aim to empirically examine the issues but provide successful cases to be adopted by Muslim countries in eliminating riba/interest from their societies and hence mitigating inflation. This paper dose not only presents the Islamic approach in mitigating inflation, but it provides current practical cases in achieving so. So, this paper will be of great interest to students/researchers/economist/financial institutions and policy makers. Islamic Finance IF & Islamic Social Finance ISF are based on principles deduced from the Quran and Sunnah and which need to be implemented in Muslim societies not only for mitigating inflation but for achieving social justice for all.

Keywords: Islamic finance, monetary policy, fiscal policy, social finance, zakat, waqf.

1. Introduction

Inflation is one of the prominent issues worldwide that keep affecting both the developed and the developing countries for centuries. It is the general rise in the prices of goods and services during a specific period and which will result in the falling of the purchasing value of money.

Even though the World inflation rate witness decline during the past few years yet, it has doubled within the past two years not only in poor countries but in advanced countries too. For example, the World inflation rate for 2019 was 2.19%, a 0.25% decline from 2.44% on 2018, and for 2020 was 1.92%, a 0.27% decline from 2019. However, in 2021 the World inflation rate was 3.42%, a 1.5% increase from 2020 due to the recent Covid-19 Pandemic and the global lockdowns. (World Economic outlook 2022). Similarly, and due to Ukraine war in 2022 which affected the shortages of energy and wheat supplies, according to the International Monetary Fund, World inflation is expected to reach 8.8% in 2022.

Hence, the failure of the capitalist system in reducing the inflation rate throughout the past century (Stiglitz, 2009) encourages the author to review the Islamic finance and the Islamic social financial approaches in mitigating such inflation and achieving social justices for all.
Historically speaking, Muslim countries led the world for 13th centuries in economics, politics, science, philosophy, culture and prosperity until the end of Ottoman Empire and which was followed by the colonization which took place in almost all Muslim countries. Hence, this led to the deterioration of almost all Muslim countries within the past century. Some scholars proclaimed that such deterioration was due to the colonization, oppression, humiliation and policies which had been imposed to them since colonization and which took place in their countries. Others relate this to the incompetence and the corruption on the part of their governments. Although we cannot deny that whatever stated acted as the catalyst for Muslims’ countries deterioration however, it is believed that a great responsibility has been imbedded within Muslims themselves as they keep following the capitalist system in their countries even after independence.

Therefore, if Muslim countries are very keen to return back to their Islamic civilization there is no other option except to return back to their comprehensive Islamic discipline as mentioned in the following Quran verses:

إِنَّ اللَََّّ لََ يُغَي ِرُ مَا بِقَوْمٍ حَتَّى يُغَي ِرُوا مَا بِأَنْفُسِهِمْ

Verily never will Allah change the condition of a people until they change it themselves

(Sura Al-Ra’d 13:11)

Islam is not just a religion of worship, but a comprehensive discipline that includes all aspects of life. The following Quranic verse shows that Allah (SWT) send a perfect and a complete system that includes all discipline to serve mankind in the best way.

اَلْيَوْمَ اَكْمَلْتُ لَكُمْ دِيْنَكُمْ وَاَتْمَمْتُ عَلَيْكُمْ نِعْمَتِيْ وَرَضِيْتُ لَكُمُ الَِْسْلََمَ دِيْنًا

This day I have Perfected your religion For you, completed My favour upon you, And have chosen for you Islam as your religion. (Surat al-Maidah 5:3)

Moreover, the Prophet (PBUH) in the following hadith highlighted the way to the right path if Muslims would like to live a better life in this world and which will be reflected in their Hereafter.

تركت فيكم ما إن تمسكتم به لن تضلوا أبداً كتاب الله وسنتي

...I have left two things behind me for you (the Ummah). You will never go astray as long as you follow these two things. One of these two things is Allahs Holy Book (the Quran al-Kareem) and the other is the Sunnah of his Most Beloved Prophet (pbuh). (Muwatta Imam Malik)

From the above Quranic verses and hadith, three issues can be realized if Muslim countries really seek to solve their current problems including inflation. First, they have no choice except to return back to the Islamic teaching in their life. Second, they have to follow the comprehensive system that Allah (SWT) provided which includes social, economic and political aspects. Third, for the implantation, they must understand the principles deduced from al-Quran and the Sunnah of the Prophet (PBUH) to serve mankind in the best way.

For following the teaching of Islam two important principles need to be understood in differentiating the Islamic system from the capitalist system, the halal and the harm. In Islam
Muslims are obliged to follow the *halal*/lawful which is permissible and not to follow the *haram/unlawful which is prohibited. The rationale behind these principles is that everything that is good and beneficial for mankind and their society is lawful and permissible and anything that causes harm or menace to mankind and their society is unlawful and prohibited (Chapra, 1995). Achieving so automatically the teaching of Islam is distancing people from any forbidden and from doing any harm that might harm them and their society and opens the door wider by following all the lawful means that will be reflected in just and welfare society.

This might bring in the question on what is the relation between *halal/lawful and haram/unlawful with the current issue of inflation. In Islam *riba/*interest is prohibited in all business transaction. Similarly, it is not permissible to lend with a condition that the repayment will be paid with interest which resemble the inflation. Hence, all business activities in Islam must take place through the alternative financial and social financial products to *riba/*interest (Ayub, 2013).

For example, with reference to lending in Islam, Allah (SWT) provided two alternative financial institutions to *riba/*interest which are *al-bai’/trading and al-qard al-hassan/benevolent loan as mentioned in the following Quranic verses:

وَأَحَلَّ اللَّهُ الْبَيْعَ وَحَرَّمَ الرَّبَا

"...Allah hath permitted trade and forbidden usury...

(Surat al-Baqarah 2: 276)

من ذا الَّذِي يُقْرِضُ اللَّهَ قَرْضًا حَسَنًا فَيُضَاعِفَهُ لَهُ أَضْعَافًا كَثِيرَةً

Who is he That will loan to God A beautiful loan, which God Will double unto his credit and multiply many times? (Surat al-Baqarah 2:245)

Similarly, Allah (SWT) provided two alternative social financial institutions to *riba/*interest, *zakat* and *al-sadaqah*, as mentioned in the following Quranic verses:

وَمَا أَنْتَ مِنْ رَبِّي يُزِيبُ فِي أَمْوَالِ النَّاسِ فَلََ يُزِيبُ عَفْدَ اللَّهَ وَمَا أَنْتَ مِنْ زَكَاةِ فِرْيقُونَ وَجَهَةَ اللَّهِ فَأَوْلِكَ هُمُ المُفْضِلُونَ

“And that which you give in gift (to others), in other that it may increase (your wealth by expecting to get a better one in return) from other people’s property, has no increase with Allah; but that which you give in Zakat seeking Allah’s Countenance, then those they shall have manifold increase.” (Surat al-Rum, 30:39)

يَمْحَقُ اللَّهُ الرَّبَا وَيُرْبِي الصَّدَقَاتِ وَاللَّهُ لََا يُحِبُّ كُلَّ كَفَّارَ أَثِيمٍ

“Allah will deprive usury of all blessing, but will give increase for deeds of charity...”

(Surat al-Baqarah 2: 276)

Moreover, the importance of distributing and redistributing the wealth is much recommended in Islam as they will circulate the wealth in a just and ethical manner. The importance of these two is mentioned in acquiring and spending the wealth as highlighted in the following hadith;
On the authority of Abu Barzah Nadlah bin Ubaid Al-Aslami, may God be pleased with him, he said: The Messenger of God, may God’s prayers and peace be upon him, said: A servant’s feet will not move on the Day of Resurrection until he is asked about his life, how did he spend it? With his knowledge, what did he do with it? And about his body, how did he wear it? And about his wealth how he acquired it? And how he spent it? (Narrated by Ibn Hibban & Tirmizi)

In Islam, acquiring and spending the wealth must be achieve through the distribution and redistribution of wealth. For the distribution of wealth, it must be through Islamic Finance IF and for the redistribution of wealth it must be through Islamic Social Finance ISF. Following the teaching of Islamic in distributing and redistributing the wealth this in turn will mitigate inflation as this will increase the aggregate demand on one hand and increases the aggregate supply on the other consequently, will prevent inflation from happening in the market place as will be explained in the following sections.

2. Mitigating Inflation from Islamic Perspective

2.1 Mitigating Inflation via Islamic Finance

As mentioned above Muslims are answerable during the Day of Resurrection on how they acquire their wealth. Following the teaching of Islamic in business transaction where riba/interest is prohibited, both the owner of the capital and the entrepreneur have to be engaged in halal finance. Hence, this means both the entrepreneur and the owner of the capital must agree on engaging on lawful trade only whereby both the capital and the entrepreneur can share the profit or bare the loss while doing their business (Sadr, 2016). This can be achieved through many financial products such as musharakah, mudarabah, murabahah, ijarah, salam sale, mua’jjal sale, istsisna’ sale, ijarah, and musharakah mutanaqisah in which risk will be spread between the owner(s) of the capital and the entrepreneur(s). Recently all these modes of finance have been practiced in Islamic banks in many Muslim countries and show successful cases (Khan & Mirakhor, 1987).

Therefore, in Islam it is very clear that the process of distribution of wealth may take place through the Islamic financial institution via its various financial products which promote halal earnings through risk sharing in almost all business transaction and which in turn promote economic justice. Financing with the various Islamic financial products will open the door for many people to be engaged in the process of production which in turn will increase production and which in turn reduces prices in the marketplace and hence, will mitigate inflation in Muslim society.

2.2 Mitigating Inflation via Islamic Social Finance

Similarly, once man acquires his wealth, he will be answerable during the Day of Resurrection on how he spends it (Yunus, 2007). Spending in Islam must follow two approaches, spending on the hierarchy of Muslims’ needs and spending on compulsory and
voluntary basis. This is known as the redistribution of wealth which will be achieved through the Islamic Social Finance ISF.

For the hierarchy of Muslim’s need, Islam recognises that man has certain needs to be fulfilled in this world, some of which are more important and others are less important. Muslim scholars classified these needs into three hierarchies of needs which are: daruriyyat/necessities that protect man’s physical existence/al-nafs, such as food, clothing and shelter; protection of din/religion; protection of mind/al-‘aql, protection of progeny/ al-nasl or pedigree, and property/al-mal. Hajjyyat conveniences which includes things that improve on the quality of life and remove bearable hardship and difficulties. And tahsiniyyat/beautification also known as luxury which adds beauty and elegance to life without transgressing the limits of moderation as defined by the Shari‘ah. Nevertheless, before spending on the conveniences and the luxury, man must contribute to his society through re-distribution of wealth which is also the alternative institutions to riba/interest as mentioned above through both the compulsory which is the zakat social financial product and the voluntary spending which includes sadaqat socio financial products.

After satisfying man’s need, part of the acquired wealth must be redistributed through compulsory and voluntary spending and through lending with al-qard al-hassan in order to ensure a just and equitable redistribution of wealth (Ahsan, 2016). Achieving so will circulate the wealth from the rich to the poor in a harmonise manner, thus a just and a more stable economic system will be realized.

2.3 Impact of Tax, Zakat and Sadaqat on Prices

From economic point of view the determination of equilibrium price and quantity will be through the intersection of demand and supply curve. In a competitive market price will function to equalize the quantity demand by consumers, and the quantity supplied by producers, resulting in an economic equilibrium of price and quantity at PE and QE as highlighted in figure (1). Hence, without a tax, the equilibrium price will be at PE and the equilibrium quantity will be at QE.
In case of imposing the tax, the price of the consumers will increase from PE to Pc and the price of the producers will decrease from PE to Pp as shown in figure (2). The consumers' price will be equal to the producers' price plus the cost of the tax. Since the consumers will buy less at the higher consumer price Pc and producers will sell less at a lower producer price Pp, the quantity sold will fall from Qe to Qt. Hence, this will prevent many people from buying such product especially if it is one of the essential goods.

On the contrary, and as mentioned above, after satisfying man’s need, part of the acquired wealth must be redistributed through compulsory and voluntary spending to ensure the circulation of the wealth from the rich to the poor in a harmonise manner, thus a just and a more stable economic system will be realized.

With reference to the compulsory spending being guided by Islamic ethics all eligible Muslims must pay zakat (Abdel Mohsin, 2013). This in turn in increase demand for goods and services and will shift the demand curves from D1 to D2. Similarly, the supply of goods and services will increase to meet the new demand hence, shifting the supply curves from S1 to S2 as shown in figure (3). Therefore, the effect of zakat will create more jobs to meet the demand in the market place hence resulting in stabilizing the prices hence mitigating inflation.
Similarly, with reference to the voluntary spending being guided by Islamic ethics Muslims are encouraged to give sadaqat or to create sadaqah jariyah which is known as waqf. All these in turn will help to decrease the equilibrium price as shown in figure (4). Giving sadaqat this in turn will decrease the cost of factors input hence, will shift the supply side from S1 to S2 and will also decrease the price from Pe to P2 and increase the quantity demanded from Q1 to Q2. In case the cost of factors input decreases more through creating waqf this will shift the supply side from S2 to S3 and hence the price will decrease more from P2 to P3 and quantity demanded will increase from Q2 to Q3 hence, decreasing the prices while benefit all categories of people within the society.

Furthermore, al-qard al-hassan is also one of a redistribution tools in Islam. Since riba/interest is prohibited in Islam, the only loan which is permissible in Islam to do business is al-qard al-hassan which is a loan without riba/interest, i.e. debtors of this kind of loan are only required to repay the amount borrowed. This is the only lending institution which is allowed in Islam in order to assist one’s brother to find a living. Since it is more to help others who are in crucial needs, the lender must not expect any return but seeks multiple rewards from His Creator as mentioned Surat al-Baqarah (2:245).
3. Mitigating Inflation: The Case of Malaysia

Inflation is a persistent concern for economies around the world, and Malaysia is no exception. As a predominantly Muslim country, Malaysia often seeks solutions to economic challenges through Islamic finance and Islamic social finance to mitigate inflation applying the Islamic economic principles and the Islamic monetary and fiscal policies.

3.1 Islamic Economic Principles

Within the last few decades Malaysia managed to integrate the Islamic economic system which is well rooted in the principles derived from the Qur'an and the teachings of the Prophet Muhammad (Peace be upon Him). Some fundamental principles of Islamic economics include fairness, equitable distribution of wealth, avoidance of *riba*/interest, and the prohibition of hoarding and speculation (Siddiqi, 1994). The following are some principles adopted by Malaysia successfully in mitigating Inflation from an Islamic Perspective:

3.1.1 Promoting Ethical Business Practices

In line with Islamic teachings, Malaysia managed to promote ethical business practices that discourage price manipulation and exploitative behaviors. Encouraging transparency, fair competition, and accountability in the marketplace help in preventing unjust price increases and foster a healthier economic environment.

3.1.2 Emphasizing Equitable Redistribution of Wealth

Islamic teachings emphasize the fair distribution of wealth and discourage excessive concentration of wealth in the hands of a few. Recently, Malaysia succeeded in implementing policies that promote income redistribution through zakat and sadaqat to ensure a more equitable society and alleviate the burden of inflation on vulnerable communities.

3.1.3 Curbing Usury and Speculation

Within the last few decades Malaysia managed to enforce regulations that discourage interest-based transactions and speculative activities via encouraging the use of Islamic financial instruments, such as profit-sharing agreements (*Mudarabah*) and trade-based contracts (*Murabahah*), to foster a more stable financial system and mitigate inflation risks.

3.1.4 Investing in Productive Sectors

Since Islamic principles encourages investment in productive sectors that generate real value for society Malaysia succeeded to prioritize investments in many sectors such as agriculture, manufacturing industries and infrastructure development. By focusing on productive investments, the country managed to enhance productivity, reduce dependency on imports, and stabilize prices in the long run.

3.1.5 Strengthening Consumer Protection

Since protecting consumers' rights is an integral aspect of Islamic teachings Malaysia managed to implement a robust consumer protection laws to ensure fair trade practices, quality assurance, and price stability. Empowering consumers with knowledge and resources managed
to contribute to a more informed and resilient society which is capable of making sound economic decisions.

3.2 Islamic Monetary Policy: A Tool Used in Malaysia to Mitigate Inflation

As inflation poses significant challenges to economies worldwide, within the last few decades Malaysia has implemented various measures to tackle this issue from an Islamic perspective. The following highlight how Malaysia employs Islamic monetary policy to mitigate inflation, considering the principles of fairness, stability, and economic well-being rooted in Islamic teachings.

3.2.1 Central Bank's Role in Monetary Policy

The Central Bank of Malaysia known as Bank Negara Malaysia, plays a crucial role in formulating and implementing monetary policy. It operates within the framework of Shariah principles to ensure economic stability and mitigate inflation (ISRA 2016). The central bank's actions are guided by transparency, accountability, and fairness.

3.2.2 Islamic Banking System

Malaysia has developed a robust Islamic banking system that adheres to Shariah principles. Islamic banks operate under a different framework compared to conventional banks (Iqbal, 2013), employing profit-sharing arrangements (Mudarabah), trade-based contracts (Murabahah), and other Shariah-compliant financial instruments. This system helps mitigate inflation by promoting responsible lending practices and discouraging speculative activities that can exacerbate price increases.

3.2.3 Effective Liquidity Management

Islamic monetary policy in Malaysia focuses on efficient liquidity management to maintain price stability. The central bank utilizes various tools, such as the sale and purchase of Islamic securities (Sukuk) and short-term liquidity management instruments (such as Islamic interbank rates), to manage liquidity in the banking system effectively. This approach helps prevent excessive money supply growth, which contributes to inflation.

3.2.4 Implementation of Monetary Policy Instruments

Malaysia employs several monetary policy instruments within an Islamic framework to manage inflationary pressures. These instruments include reserve requirements, open market operations (using Shariah-compliant instruments), and the Islamic Interbank Money Market. By regulating liquidity and interest rates, these tools help control inflation while adhering to Islamic principles.

3.2.5 Promotion of Financial Inclusion

Islamic monetary policy in Malaysia emphasizes the promotion of financial inclusion to ensure equitable access to financial services. This includes providing Shariah-compliant banking products and services to a broader segment of society. By enabling individuals and businesses to participate in the formal financial system, the policy fosters economic development, reduces income disparities, and contributes to price stability.
3.2.6 Collaboration with International Islamic Financial Institutions

Malaysia actively collaborates with international Islamic financial institutions, such as the Islamic Development Bank (IDB) and the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI). This collaboration helps Malaysia stay updated with international best practices in Islamic finance and ensures the implementation of effective monetary policy measures to mitigate inflation.

3.2.7 Establishing Educational Centers for Islamic Finance

Two education centers were established for providing Islamic finance to serve the financial sector namely INCEIF and IBFIM.

In 2005 by Bank Negara Malaysia establish the first International Centre for Education in Islamic Finance INCEIF as a global university to provide a world-class talent for the global Islamic finance industry. This global university offers post-graduate academic programs (Masters in Islamic Finance Practice, Master of Science in Islamic Finance and PhD in Islamic Finance). In addition, the university also offers industry-focused executive education that includes customized executive programs. Moreover, its research unit carries out academic and commercial research which provides trend analysis, economic growth indicators and specific cross-border business strategies.

The second educational center is the Islamic Banking & Finance Institute Malaysia (IBFIM) which was established in 2001, as an industry-owned institute dedicated to producing well-trained, high competence personnel and executives with the required talent in the Islamic finance industry. Its learning modules are customizable to fulfil the specific needs of the clients within Islamic financial markets as well as other sectors engaging in Islamic finance. IBFIM provides classroom training sessions, online learning, advisory engagements and a knowledge management centre, which boasts over 13,500 titles in Arabic, English and Malay.

3.3 Islamic Fiscal Policy: A Tool used in Malaysia to Mitigate Inflation

Similar to adopting Islamic monetary policy, Malaysia has implemented various measures to mitigate inflation by adopting Islamic fiscal policy framework. The following explain how Malaysia employs Islamic fiscal policy to mitigate Inflation.

3.3.1 Progressive Taxation

Malaysia's Islamic fiscal policy includes progressive taxation measures aimed at promoting equitable wealth redistribution. By imposing higher tax rates on higher income brackets, the government managed to generate more revenue to fund essential services while reducing income disparities. This approach helps alleviate the burden of inflation on vulnerable communities and ensures a fairer distribution of the tax burden.

3.3.2 Zakat and Sadaqah

Zakat, one of the five pillars of Islam, involves the obligatory annual payment of a specific portion of wealth to help those in need. Malaysia leverages zakat collections to support social welfare programs, poverty alleviation initiatives, and economic development projects. By implementing effective zakat collection and distribution systems, the government managed
to address inflationary pressures by assisting the less fortunate and promoting socio-economic stability.

3.3.3 Responsible Government Spending

Islamic fiscal policy in Malaysia encourages responsible government spending to mitigate inflation. The government focuses on efficient allocation of resources and avoids excessive borrowing, which can lead to inflationary pressures. By practicing fiscal discipline and prioritizing investments in productive sectors, Malaysia ensures that public funds are utilized for sustainable economic development rather than fueling inflation.

3.3.4 Investment in Productive Sectors:

Malaysia's Islamic fiscal policy promotes investment in productive sectors to combat inflation. By directing funds towards sectors such as agriculture, manufacturing, and infrastructure development, the government stimulates economic growth, reduces reliance on imports, and stabilizes prices. This approach fosters productivity, job creation, and sustainable development, leading to a more stable and balanced economy.

3.3.5 Prudent Debt Management

Islamic fiscal policy in Malaysia emphasizes prudent debt management to mitigate inflationary risks. The government adheres to Shariah-compliant financing methods and avoids excessive borrowing, especially from interest-based sources. By ensuring responsible debt management practices, Malaysia minimizes the risk of inflationary pressures resulting from excessive public debt and maintains economic stability.

3.3.6 Promotion of Ethical Business Practices:

In line with Islamic principles, Malaysia's fiscal policy promotes ethical business practices to counter inflation. The government encourages transparency, accountability, and fair competition in the marketplace, discouraging price manipulation and exploitative behaviors. By fostering a level playing field and ensuring that businesses operate in a just and ethical manner, Malaysia curbs inflationary pressures arising from unfair practices.

4. A Comparison between Malaysia Inflation Rate with other Muslim Countries

As mentioned above, within the last few decades Malaysia integrated Islamic finance and Islamic social finance which help in achieving not only economic growth but stabilise the prices and hence help in mitigating inflation compared to Turkey and Egypt as shown in table 1. For example, the inflation rate of Malaysia in 2017 is 3.87% yet in Turkey it was 11.14% and in Egypt it was 29.51. Recently, the inflation rate of Malaysia is 3.5% yet it Turkey the inflation rate increases to 50.58% and in Egypt it increase to 33.9% in the same year (Macrotrends inflation rate 2023). Hence, this show that integrating Islamic finance and Islamic social finance within the economy will help to stabilize the prices and mitigate inflation compare to other Muslim countries where they lack such integration.
Table 1. Inflation Rate in Malaysia, Turkey and Egypt

<table>
<thead>
<tr>
<th>Year</th>
<th>Malaysia Inflation Rate (%)</th>
<th>Turkey Inflation Rate (%)</th>
<th>Egypt Inflation Rate (%)</th>
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<tr>
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<td>50.58</td>
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<td>2017</td>
<td>3.87</td>
<td>11.14</td>
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5. Conclusion

Current inflation trend is a challenging issue for the global economy. The Islamic Economics and Finance provided alternative solutions for Muslim countries to apply in a manner to not only rely on material tools but mostly on spiritual value for a just socio-economic order based on Quran, Sunnah. The Islamic teachings in distributing and redistributing the wealth help the marketplace to be free of the problems we see today. In general, integrating Islamic finance in business transaction will help in eliminating riba/interest in the marketplace which in turn will help to mitigate inflation and bring more benefit to the society. Furthermore, integrating Islamic social finance will circulate the wealth from the have to the have not in a nice and ethical manner hence stabilize prices and create just and fair societies.

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