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Integrating Shariah-Based Risk Governance for Inflation Mitigation in Islamic Banking: A Thematic Review

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Abstract

Inflation poses significant challenges to Islamic banking, where compliance with *Shariah* principles prohibits conventional interest-based hedging instruments. This study explores how Islamic banking governance can integrate *Shariah*-compliant risk management strategies to address inflationary pressures effectively. Using a conceptual and thematic review methodology, the research synthesizes insights from classical jurisprudence, including *fiqh muʿāmalāt* and *maqāṣid al-sharīʿah*, alongside contemporary governance models. The objective is to develop a normative framework that aligns ethical imperatives with risk resilience in Islamic financial institutions. Key findings highlight that inflation undermines contractual justice and asset stability, violating *Shariah* objectives such as *ʿadl* (justice) and *ḥifẓ al-māl* (preservation of wealth). The study proposes a hybrid governance model featuring inflation-indexed contracts, *fiqh*-validated instruments, and institutional oversight structures rooted in Islamic law. Practical recommendations include embedding inflation sensitivity in operational procedures, enhancing the role of *Shariah* supervisory boards, and promoting collaborative regulation. The study bridges theoretical gaps and offers actionable pathways for managing inflation within Islamic banking without compromising religious integrity.

Keywords

Islamic banking governance; inflation risk; *fiqh muʿāmalāt*; *maqāṣid al-sharīʿah*; *Shariah* risk management

Introduction

The dynamic nature of global financial systems has exposed economies to a myriad of macroeconomic shocks, with inflation emerging as a persistent and complex challenge. In Islamic banking, inflation carries particular implications due to the constraints imposed by *Shariah* principles on monetary tools, such as interest rates and speculative instruments (Chapra, 2000). The conventional approach to inflation hedging, reliant on interest-based instruments, is fundamentally incompatible with Islamic finance, necessitating an alternative framework that upholds *Shariah* integrity while managing financial risks effectively (Iqbal & Mirakhor, 2007). Despite the expansion of Islamic financial assets globally, the sector remains vulnerable to inflation-driven volatility, largely due to insufficient integration of inflation-specific risk governance within its institutional design (El-Gamal, 2006).

From a theoretical standpoint, inflation undermines the principle of fairness (*ʿadl*) in exchange contracts, particularly those involving deferred payment or leasing, as it erodes the purchasing power of money (Siddiqi, 2001). Inflation also challenges the stability of Islamic banks' profit-and-loss sharing (PLS) arrangements, which rely on the real economy rather than nominal indicators (Zaher & Hassan, 2001). Empirical studies have shown that Islamic financial institutions in high-inflation environments struggle to maintain profitability and liquidity, raising concerns over their long-term sustainability (Khan & Bhatti, 2008). Consequently, there is a pressing need to bridge classical Islamic jurisprudence with modern financial risk governance models to effectively address inflation without compromising *Shariah* compliance (Archer & Abdel Karim, 2002).

Previous scholarly work on Islamic risk management has mainly focused on operational and credit risks, often sidelining inflation-specific challenges (Rosly & Zaini, 2008). While research acknowledges the ethical and legal dimensions of *Shariah*-compliant finance, limited attention has been paid to the development of an integrated risk governance structure specifically for inflation mitigation. Furthermore, the scattered literature lacks coherence in linking the jurisprudential principles of *fiqh muʿāmalāt* to modern financial governance frameworks. This disconnect has led to an underdeveloped conceptual foundation that hinders the formulation of robust inflation-responsive governance protocols in Islamic banking (Iqbal & Llewellyn, 2002).

In light of this gap, the present study seeks to address a critical research question: How can Islamic banking governance structures integrate *Shariah*-based risk management to mitigate the effects of inflation? This question guides the thematic exploration of theoretical constructs, historical interpretations, and governance strategies compatible with both classical Islamic law and contemporary economic demands. By addressing this inquiry, the article aims to establish a coherent foundation for developing practical tools that Islamic banks can utilize to manage inflation risks while preserving religious compliance.

The objective of this article is to provide a conceptual and thematic framework that aligns inflation risk management with Islamic banking governance through *Shariah*-based principles. It aims to advance the theoretical discourse by mapping key jurisprudential doctrines onto risk governance models and identifying practical mechanisms adaptable to Islamic financial institutions. The significance of this study lies not only in its academic contribution but also in its policy implications, particularly in enhancing the resilience of Islamic banks against macroeconomic shocks. This research is timely and relevant as inflation continues to impact global economies and demands adaptive, faith-consistent financial governance mechanisms within the Islamic finance sector.

Literature Review

The concept of inflation within Islamic economic thought is intrinsically tied to the preservation of value and fairness in exchange, as emphasized in *fiqh muʿāmalāt*. Scholars have long debated the compatibility of conventional monetary tools with Islamic principles, particularly in addressing inflation. Early literature framed inflation as a deviation from *Shariah*-compliant economic equilibrium, emphasizing the importance of stable money as a medium of exchange and store of value (Chapra, 2000). Modern research has since evolved to examine the effects of inflation on Islamic financial instruments, particularly those involving deferred payments and leasing, such as *ijarah* and *murābaḥah* (Iqbal & Mirakhor, 2007). These studies acknowledge that inflation distorts the real value of contractual obligations, challenging the principle of justice (*ʿadl*) that underpins Islamic financial law.

Theoretical discussions on risk management in Islamic finance often draw from institutional governance literature and *maqāṣid al-sharīʿah* frameworks (Archer & Abdel Karim, 2002). Risk is understood not merely in probabilistic terms but also as an ethical and jurisprudential concern. Scholars like Siddiqi (2001) and El-Gamal (2006) argue for a more nuanced understanding of financial risks, including inflation, that incorporates *Shariah*-compliant hedging mechanisms. However, the literature remains fragmented, lacking a unified theory that links classical jurisprudence with inflation risk governance. Frameworks such as *bayʿ al-salam* and *istiṣnāʿ*, which theoretically account for inflation expectations through pre-agreed prices, have not been sufficiently developed into operational tools within Islamic banks (Rosly & Zaini, 2008).

Existing literature on economic growth and inflation within Islamic finance focuses more on macroeconomic alignment than micro-level governance. Zaher and Hassan (2001) highlight that Islamic financial systems being asset-based, have a natural hedge against inflation due to their emphasis on real transactions. However, Khan and Bhatti (2008) contend that without structured risk governance, Islamic banks remain susceptible to inflationary shocks, particularly when operating in dual financial systems. These gaps underscore the need for a coherent framework that integrates inflation-focused risk management into the governance structures of Islamic banks, supported by both jurisprudential legitimacy and financial efficacy.

Theoretical Framework

The foundation of Islamic financial jurisprudence, *fiqh muʿāmalāt*, emphasizes fairness, transparency, and reciprocity in financial transactions. Within this framework, the principle of *ʿadl* (justice) serves as a cornerstone, particularly relevant when examining the impact of inflation on contractual obligations (Chapra, 2000). Inflation disrupts the equitable exchange of values over time, especially in deferred payment contracts, where the purchasing power of money may deteriorate. Islamic scholars such as Siddiqi (2001) argue that maintaining justice in such cases may necessitate innovative risk governance mechanisms that adhere to *Shariah* constraints. This principle offers a normative basis for addressing inflation within Islamic financial systems, underscoring the need to ensure that contracting parties are not unjustly disadvantaged due to macroeconomic distortions.

Shariah's overarching objectives (*maqāṣid al-sharīʿah*) provide a robust framework for integrating risk management into Islamic finance. Among the five core objectives, *ḥifẓ al-māl* (preservation of wealth) is directly relevant to inflation, as it justifies efforts to shield financial assets from erosion of value (Kamali, 2000). Inflation-induced loss in asset value can be interpreted as a threat to this objective, thereby legitimizing the use of proactive risk mitigation tools. While traditional scholars might resist mechanisms resembling interest-based hedging, the intent behind protecting wealth aligns with the broader ethical goals of Islamic law (Iqbal & Llewellyn, 2002). This conceptual alignment allows for flexibility in developing governance structures that accommodate inflation risk within a legally and morally sound framework.

The governance structures of Islamic banks differ from their conventional counterparts in that they must align with both financial and *Shariah* requirements. Effective governance in Islamic banks incorporates *Shariah* supervisory boards, internal *Shariah* audits, and compliance departments (Archer & Abdel Karim, 2002). However, risk management—particularly inflation-related risk—has not been systematically embedded within these structures. Theoretical contributions by Iqbal and Mirakhor (2007) highlight the importance of aligning risk management with institutional governance for Islamic banks to achieve stability. Governance mechanisms must evolve to not only ensure *Shariah* compliance but also to anticipate and manage inflationary trends through permissible financial tools and structured oversight protocols.

Mainstream risk management theory emphasizes probability-based forecasting, risk diversification, and hedging, often through derivatives and interest-sensitive instruments (Hull, 2006). These are largely inapplicable in Islamic finance, which prohibits speculation (*gharar*) and interest (*riba*). Islamic scholars have thus advocated for a recontextualized theory of risk that considers moral hazard, legal permissibility, and socio-economic justice (Rosly & Zaini, 2008). The integration of classical doctrines such as *bayʿ al-salam*, *istiṣnāʿ*, and *wakālah* within inflation-sensitive contracts allows Islamic banks to manage exposure without breaching legal norms. The theoretical contribution of this approach lies in adapting existing financial governance theories to a faith-based context, thus offering a model for integrating inflation risk management within the institutional framework of Islamic banking.

Previous Research

Chapra (2000); Chapra's study critically examined the role of money in Islam and how inflation distorts its primary functions. Utilizing a theoretical approach, he argued that inflation undermines distributive justice and introduces elements of exploitation into Islamic contracts. His findings laid the groundwork for reconceptualizing monetary stability as a *Shariah* objective. While Chapra focused broadly on monetary theory, his work is crucial in legitimizing inflation governance within Islamic finance through the lens of distributive justice.

El-Gamal (2001); El-Gamal explored the structural limitations of Islamic finance in responding to macroeconomic variables like inflation. Employing a jurisprudential critique, he identified the constraints posed by the literalist application of Islamic legal principles. His findings emphasized the need for reinterpretation (*ijtihād*) to develop inflation-sensitive financial tools. Unlike the present study, El-Gamal did not propose a structured governance model, which this research aims to fill.

Zaher & Hassan (2001); Zaher and Hassan conducted an empirical overview of Islamic banking practices and their macroeconomic effects. They suggested that the asset-backed nature of Islamic finance provides partial insulation against inflation. However, they noted a lack of institutional risk governance models tailored to inflation. Their study supports the current research's premise that Islamic banks must integrate inflation-focused mechanisms within their governance frameworks.

Siddiqi (2001); Siddiqi investigated ethical dimensions of Islamic finance, emphasizing justice and equity. He argued that inflation causes ethical distortions in deferred-payment contracts and advocated for *Shariah*-compliant compensatory mechanisms. His conceptual orientation supports this study's approach to aligning governance with *Shariah* ethics but did not provide operational models, which this research aims to conceptualize.

Iqbal & Llewellyn (2002); This study explored risk and governance in Islamic financial institutions, emphasizing the need for integrated frameworks that incorporate *Shariah* and economic imperatives. Their work introduced the concept of holistic risk governance but did not isolate inflation as a specific risk. This article extends their model by explicitly focusing on inflation within Islamic governance structures.

Khan & Bhatti (2008); Through comparative analysis, Khan and Bhatti assessed Islamic banks' exposure to various risks, including inflation, in dual banking environments.

They concluded that current governance mechanisms inadequately address inflation-specific challenges. Their findings directly reinforce this article's focus on conceptualizing an inflation-responsive governance framework grounded in Islamic legal and ethical norms.

Despite valuable insights from the above studies, none have offered a comprehensive framework for integrating *Shariah*-compliant inflation risk management into Islamic banking governance. While past literature emphasizes ethics, justice, and theoretical compatibility, practical integration into governance structures remains underdeveloped. This study fills that void by thematically reviewing and structuring a conceptual model that bridges jurisprudence with institutional governance, specifically addressing inflation within Islamic financial systems.

Research Methods

This study adopts a conceptual research design grounded in thematic and jurisprudential analysis. As a qualitative inquiry, it does not involve empirical data collection but instead synthesizes theoretical perspectives and textual interpretations from Islamic jurisprudence and financial governance literature. This approach is suitable for exploring the integration of *Shariah*-based principles into risk management structures tailored to address inflation in Islamic banking. By focusing on doctrinal sources, historical legal reasoning, and governance theories, the study constructs a normative framework for inflation risk mitigation within a *Shariah* context (Iqbal & Mirakhor, 2007).

The primary data sources include classical *fiqh* texts, legal opinions (*fatāwā*), and scholarly interpretations concerning contracts, justice, and the preservation of wealth in Islamic law. In addition, authoritative books and journal articles on Islamic economics and banking governance published before 2009 form the secondary corpus. These texts are selected based on their academic credibility, jurisprudential relevance, and alignment with the study's thematic focus on inflation risk and governance (Chapra, 2000; Siddiqi, 2001). The use of both English and Arabic sources ensures comprehensive coverage of the epistemological foundations and modern interpretations of Islamic financial principles.

Document analysis is the central technique employed in this research. Thematic coding and analytical abstraction allow for the classification of principles related to risk, governance, inflation, and financial ethics. Through this technique, relevant elements from various texts are categorized to develop a coherent and interconnected framework. This process facilitates the extraction of key governance concepts that can be operationalized in contemporary Islamic banking (Archer & Abdel Karim, 2002).

The method of analysis involves triangulating themes from jurisprudential literature with governance theories to identify overlaps and divergences. This method ensures that the proposed framework for inflation governance is not only legally sound but also administratively feasible. The study assesses each concept based on its consistency with *Shariah*, theoretical utility, and adaptability to modern banking structures. In doing so, it bridges the epistemological divide between classical jurisprudence and modern institutional needs (Iqbal & Llewellyn, 2002).

The conclusions drawn are synthesized through normative reasoning supported by established *maqāṣid al-sharīʿah* theory. Rather than generalizing from empirical data, the study derives conclusions through analogical reasoning (*qiyās*), interpretation (*ijtihād*), and comparative analysis. The research does not aim to offer definitive legal rulings but proposes a conceptual framework grounded in classical sources and validated through contemporary academic discourse. This method ensures the model's integrity within both the spiritual and technical domains of Islamic banking (Rosly & Zaini, 2008).

Results and Discussion

The evolution of dual banking in Indonesia reflects a broader intellectual and institutional struggle to reconcile Islamic economic principles with the operational logic of a modern financial system. This section engages the theoretical framework and earlier research to establish how the discourse surrounding this duality has developed. The analysis reveals a consistent tension between preserving *sharia* values and adapting to global banking standards. While earlier scholars such as Ariff (1988) and Chapra (2000) envisioned Islamic banking as a transformative force, subsequent literature has highlighted the challenges of actualizing this vision within Indonesia's pluralist regulatory environment. This study contributes by synthesizing diverse perspectives into a coherent narrative that maps the trajectory of discourse while revealing points of friction, convergence, and adaptation.

Institutional dualism theory provides a foundation for understanding how two distinct financial paradigms—Islamic and conventional—can coexist within a shared economic structure. This theoretical lens allows for an appreciation of Indonesia's pragmatic approach, where Islamic banking institutions are granted space to develop without directly challenging the existing financial order (Iqbal & Mirakhor, 2007). Yet, previous research by Kuran (2004) and El-Gamal (2006) has raised critical concerns that this coexistence often results in the Islamic banking sector replicating the same profit-driven mechanisms it seeks to reform. This literature points to a conceptual dilemma: Can Islamic banking remain true to its foundational values while operating under regulatory constraints that prioritize standardization and risk minimization?

Newer contributions to the discourse, though still rooted in earlier frameworks, have begun to explore more integrative models. These approaches propose a hybrid financial architecture where Islamic banks do not merely imitate conventional instruments but instead innovate within a shared ecosystem. Lewis and Algaoud (2001) hinted at this possibility, emphasizing the role of gradualism and institutional learning.

The Indonesian context provides fertile ground for such exploration, given its legal pluralism and relatively young Islamic banking sector. The existing literature, however, has not fully articulated how this hybrid model can be systematized or whether it risks eroding the distinctiveness of Islamic finance. The present study addresses this gap by identifying patterns in the discourse that point toward implicit models of integration.

Furthermore, the role of stakeholders—particularly regulators, religious authorities, and consumers—emerges as a critical variable in shaping the dual banking discourse. While much of the academic focus has been on institutional design, recent literature (e.g., Siddiqi, 2006; Iqbal & Llewellyn, 2002) underscores the importance of stakeholder alignment for legitimacy and functionality. In Indonesia, the alignment appears partial at best. Regulatory bodies support Islamic banking through legal reforms and institutional frameworks, yet consumer education and *sharia* board independence remain areas of concern. This study adds to the discourse by highlighting how stakeholder dynamics are not just peripheral but central to the feasibility of dual banking in Islamic economic thought.

Ultimately, the findings affirm that the Indonesian dual banking model represents both a practical accommodation and a conceptual challenge. It is a model born out of compromise but aiming toward coherence. By critically analyzing the literature, this research illustrates how the discourse has evolved from ideological delineation to institutional negotiation and now to a tentative hybridization. Each stage reflects the broader transformation in Islamic economic thought from doctrinal purity to contextual realism. This progression, while not without its flaws, demonstrates a maturing academic field grappling with the realities of economic governance in a pluralistic society.

Thematic Discussions

Research Question 1: How does inflation impact Islamic financial contracts, and what *Shariah*-based principles can mitigate these effects?

Inflation's Disruption of Contractual Justice

Inflation poses a direct threat to the equilibrium of Islamic financial contracts, particularly those involving deferred payments, such as *murābaḥah* and *ijarah*. These contracts are governed by the principle of fairness (*ʿadl*), which inflation undermines by reducing the real value of money over time (Chapra, 2000). In a contract where one party receives payment years after delivering goods or services, inflation can unfairly benefit one party at the expense of the other, violating the *Shariah* objective of equitable transactions. Siddiqi (2001) emphasized the ethical need to maintain balance in deferred contracts and supported the use of alternative mechanisms that adjust for inflation without invoking *riba*.

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Preservation of Wealth through Maqāṣid al-Sharīʿah

The principle of *ḥifẓ al-māl*—the protection of wealth—is one of the five objectives of *maqāṣid al-sharīʿah* and directly supports the legitimacy of inflation risk mitigation (Kamali, 2000). When inflation erodes the value of money, it threatens the stability and wealth of both individuals and institutions. Therefore, any mechanism that seeks to preserve value—such as linking contracts to a real asset or price index—may be justified if it fulfills this *Shariah* objective (Iqbal & Mirakhor, 2007). This concept allows for inflation-adjusted instruments that do not replicate conventional interest-bearing contracts but instead rely on *Shariah*-approved methods like deferred pricing and cost-plus sales.

Permissible Mechanisms for Inflation Hedging

To mitigate inflation without violating *Shariah*, several classical instruments can be modified. For example, *bayʿ al-salam* allows for the pre-purchase of goods at a fixed price to be delivered in the future, implicitly accounting for inflation expectations (El-Gamal, 2006). Similarly, *istiṣnāʿ* contracts used in construction and manufacturing can be indexed to real costs over time. These contracts naturally incorporate inflation considerations without resorting to interest-based compensation. Rosly and Zaini (2008) recommend structured application of these contracts within governance protocols to stabilize returns and maintain value over time.

Need for Inflation-Sensitive Contract Design

Current Islamic banking contracts often fail to include clauses that adjust for inflation, leaving institutions exposed to long-term value loss. By embedding inflation-sensitive mechanisms into *Shariah*-compliant contracts, banks can ensure stability and fairness. Iqbal and Llewellyn (2002) call for proactive *ijtihād* to update contract templates in light of inflation realities. This proactive stance would allow Islamic financial institutions to evolve while remaining within *Shariah* boundaries.

Integrating Legal and Governance Oversight

Effective implementation of inflation-mitigating measures requires oversight mechanisms grounded in Islamic governance. Internal *Shariah* supervisory boards and external compliance audits must be empowered to evaluate whether inflation-related clauses meet both legal and ethical standards (Archer & Abdel Karim, 2002). This governance model strengthens the institutional legitimacy of Islamic banks and ensures that contractual justice is preserved even in volatile economic conditions.

Research Question 2: How can Islamic banking governance integrate *Shariah*-based risk management principles to manage inflation effectively?

Aligning Risk Governance with Shariah Objectives

To manage inflation effectively, Islamic banking governance must align with the foundational goals of *Shariah*, particularly justice (*ʿadl*) and preservation of wealth (*ḥifẓ al-māl*) (Kamali, 2000). Conventional risk governance models emphasize capital adequacy and compliance but often neglect ethical dimensions central to Islamic finance. By integrating these objectives into board-level policies and internal risk procedures, Islamic financial institutions can enhance legitimacy and resilience (Iqbal & Llewellyn, 2002).

Embedding Maqāṣid-Based Oversight in Institutional Frameworks

A key step in integrating *Shariah*-based risk governance is institutionalizing *maqāṣid*-driven oversight mechanisms. Governance models that incorporate *maqāṣid al-sharīʿah* enable banks to justify inflation-hedging strategies as ethically and legally sound (Chapra, 2000). This involves developing compliance scorecards or metrics that evaluate product offerings against objectives such as economic justice, public benefit (*maṣlaḥah*), and value preservation. Siddiqi (2001) emphasized that such integration helps navigate the tensions between jurisprudential adherence and financial adaptability.

Roles of Shariah Boards and Internal Audits

Effective inflation risk governance in Islamic banking requires empowered *Shariah* supervisory boards. These bodies should actively assess inflation-adjusted financial products and contracts, ensuring compliance and suggesting adaptations where necessary (Archer & Abdel Karim, 2002). In addition, internal *Shariah* audits must monitor contract execution and risk exposures, identifying instances where inflation may distort financial fairness or lead to hidden *riba*.

Structured Tools for Inflation Risk Management

Risk management tools must be developed or adapted to Islamic contexts. These include real-asset-linked sukuk, commodity-indexed leasing agreements, and dynamic pricing models within *murābaḥah* contracts. Unlike conventional interest-based instruments, these tools preserve contract integrity while absorbing inflationary pressures (El-Gamal, 2006). Embedding such tools into governance policies enables Islamic banks to manage inflation without compromising legal or ethical standards.

Governance Protocols and Regulatory Support

Inflation risk management should not be ad hoc but embedded within regulatory frameworks that oversee Islamic banks. Regulatory bodies and central banks in jurisdictions with dual banking systems must provide guidelines for permissible inflation-adjusted instruments (Khan & Bhatti, 2008). This institutional support ensures consistency and reduces operational ambiguity. Risk governance models must thus be collaborative, involving both institutional compliance units and national regulators.

Ethical Risk Culture as Governance Foundation

Finally, governance structures must foster an ethical risk culture that transcends rule compliance. Risk management in Islamic banking should be viewed not merely as a technical necessity but as an ethical duty grounded in *Shariah* values (Rosly & Zaini, 2008). Board training, executive workshops, and stakeholder engagement should reinforce this culture, ensuring that inflation-risk governance upholds both prudence and faithfulness.

Research Question 3: What conceptual models can be developed to operationalize *Shariah*-compliant inflation risk governance in Islamic banks?

Toward a Hybrid Governance Model

A viable model for inflation risk governance in Islamic banks must combine classical jurisprudential insights with modern risk management principles. This hybrid approach involves mapping *fiqh muʿāmalāt* rules onto contemporary governance functions such as compliance, audit, and board oversight (Iqbal & Mirakhor, 2007). The proposed model includes three tiers: jurisprudential validation (via *Shariah* boards), institutional implementation (via risk and compliance departments), and macroeconomic alignment (via regulatory bodies). Each tier contributes to ensuring that inflation risks are identified, assessed, and addressed within a faith-based governance structure.

Jurisprudential Anchoring through Fiqh-Based Tools

Conceptually, the model is anchored in recognized *fiqh* mechanisms such as *bayʿ al-salam*, *istiṣnāʿ*, and *wakālah*. These tools inherently incorporate forward pricing, agency roles, and delivery schedules, which can serve as indirect inflation hedges (El-Gamal, 2006). Their structured inclusion into the operational policies of Islamic banks ensures that value preservation remains *Shariah*-compliant. The model also recommends that contracts be reviewed by *Shariah* committees for potential inflation exposure, and adapted accordingly through risk-sharing clauses or indexed pricing.

Risk Mitigation via Value Preservation Indexing

One innovative feature of the proposed model is the application of a *Shariah*-approved indexation mechanism. Unlike conventional inflation indexing tied to interest rates, the model employs commodity-based or asset-linked indices as references for adjusting deferred-payment contracts (Zaher & Hassan, 2001). This method aligns with the *maqāṣid al-sharīʿah* goal of protecting wealth while avoiding *riba* and *gharar*. Integration of this method into internal bank systems enhances transparency and stability, supporting both governance compliance and customer trust.

Governance Integration Through Standard Operating Procedures

Operationalizing the conceptual model requires embedding risk governance into standard operating procedures (SOPs). These SOPs should outline specific inflation-monitoring responsibilities across departments, establish trigger points for inflation-adjustment clauses, and guide contract reviews. Archer and Abdel Karim (2002) advocate for clear documentation and internal controls to ensure consistency. Governance manuals, staff training, and *Shariah* audits must reflect this model, ensuring that inflation risks are managed proactively and systemically.

Collaborative Frameworks with Regulators

The model also emphasizes collaboration between Islamic banks and regulatory authorities. Regulatory institutions should provide benchmarks and frameworks that validate inflation-adjusted instruments under *Shariah*. Khan and Bhatti (2008) argue that standardized guidelines across jurisdictions enhance cross-border compatibility and reduce compliance ambiguity. This harmonization is essential for Islamic banks operating in global financial environments.

Continuous Feedback and Reform Mechanism

Finally, the model includes a built-in reform mechanism that encourages continuous improvement through feedback loops from audit reports, customer feedback, and market performance analysis. This aligns with the *Shariah* principle of *iṣlāḥ* (reform and improvement), allowing the model to adapt over time without deviating from foundational religious and ethical norms (Siddiqi, 2001). The adaptability of the model ensures it remains relevant in volatile inflationary environments while preserving legal and moral integrity

Core Findings and Pathways Forward

This study has demonstrated that inflation presents a critical challenge to Islamic banking, not only as an economic variable but as a matter of ethical and jurisprudential concern. By integrating *Shariah*-based principles—particularly *fiqh muʿāmalāt*, *maqāṣid al-sharīʿah*, and wealth preservation objectives—into risk governance structures, Islamic banks can respond more effectively to inflationary pressures. Each research question was addressed by connecting classical jurisprudence with contemporary governance needs, culminating in a conceptual model that facilitates inflation-sensitive, ethically grounded financial practices. The novelty of this contribution lies in its holistic view: it treats inflation risk not merely as a financial hazard, but as a test of governance legitimacy and ethical accountability within Islamic institutions.

Theoretical implications of this research extend to the reinterpretation of Islamic finance doctrines through the lens of macroeconomic volatility. By situating inflation within the broader framework of *Shariah* governance, the study opens new pathways for developing adaptive and compliant financial instruments. Practically, this model offers Islamic financial institutions actionable tools for inflation mitigation, including the use of indexed contracts, structured oversight mechanisms, and ethically mandated audit processes. The research also calls for institutional collaboration with regulatory bodies to harmonize standards across jurisdictions. These contributions establish a foundation for future research aimed at empirical validation and policy development within inflation-vulnerable Islamic financial systems.

Conclusion

In synthesizing classical Islamic jurisprudence with modern financial governance, this study offers a robust conceptual framework for integrating *Shariah*-based inflation risk management into the operational and strategic fabric of Islamic banking institutions. It addresses a critical void in the existing scholarly landscape by articulating practical, jurisprudentially sound mechanisms to navigate the destabilizing effects of inflation within Islamic contractual systems and institutional governance structures. The framework is grounded in foundational principles of *fiqh muʿāmalāt*, which emphasize contractual equity, risk-sharing, and the avoidance of *riba*, as well as *maqāṣid al-sharīʿah*, particularly the objectives of preserving wealth (*ḥifẓ al-māl*) and upholding justice (*ʿadl*). These principles are not only ethically imperative but also functionally necessary for maintaining financial resilience in inflation-prone economies. By interpreting these classical doctrines through the lens of contemporary risk governance, the study establishes inflation not merely as a fiscal anomaly but as a fundamental governance challenge that necessitates *Shariah*-aligned, institution-wide responses.

The study's contribution is multidimensional—both theoretical and practical. Theoretically, it advances Islamic finance scholarship by reclassifying inflation as a critical test of the legitimacy, adaptability, and ethical orientation of Islamic banking systems. It invites scholars to reconsider the interpretive space within Islamic jurisprudence for risk adaptation and institutional reform. Practically, it provides a structured roadmap for Islamic financial institutions to incorporate inflation sensitivity

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into their products, operations, and compliance regimes. Tools such as real-value indexing in *murābaḥah* and *ijarah* contracts, the institutionalization of inflation-monitoring units, and enhanced roles for *Shariah* supervisory boards are proposed to translate jurisprudential ideals into operational norms. Moreover, the study underscores the importance of cultivating an ethical risk culture that promotes accountability, transparency, and proactive governance. As a way forward, it recommends that future research empirically test these concepts across jurisdictions and explore regulatory harmonization to ensure that Islamic banking systems remain not only resilient but also authentically aligned with the spiritual and legal ethos of Islam..

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