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Impact of Macroeconomic and Financial Determinants on Share Prices in Pakistan's Islamic Banking Sector

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Abstract
This thesis investigates the various factors influencing the share prices of Islamic banks in Pakistan, a sector that has experienced significant growth since its formal introduction in 2002. Rooted in Sharia principles prohibiting interest (Riba) and emphasizing ethical practices and risk-sharing, Islamic banking has become an essential component of Pakistan's financial system, contributing to both financial inclusion and economic stability. Despite its rapid expansion, the industry continues to face challenges, including limited consumer awareness and a narrow range of financial products, indicating potential for further development. The study examines how external macroeconomic variables—such as inflation, exchange rates, conventional interest rates, and GDP—and internal financial indicators—including Return on Equity (ROE), Earnings Per Share (EPS), Price-to-Earnings (P/E) ratio, asset growth, and payout ratio—affect the share prices of three Islamic banks operating in Pakistan. Covering the years 2019 to 2023, the research utilizes secondary time-series data sourced from official records, including reports from the State Bank of Pakistan (SBP), the Pakistan Bureau of Statistics (PBS), and the banks' own annual statements, with data analysis performed using EViews software through descriptive and correlation-based methods. The results highlight a strong connection between macroeconomic changes and the performance of Islamic bank shares. For instance, the depreciation of the Pakistani Rupee and rising inflation in the latter part of the study period had noticeable effects on investor behavior and bank profitability. Additionally, shifts in GDP and conventional interest rates—despite being prohibited under Islamic finance—still played an indirect role in shaping market perceptions. On the internal side, improvements in EPS and asset growth were generally linked to rising share prices, indicating better financial health. In contrast, a falling P/E ratio and changes in payout policies often pointed to wavering investor confidence or shifts in how banks managed their capital. Overall, the research provides valuable insight into how a combination of external economic conditions and internal financial performance shapes the valuation of Islamic banks in Pakistan's ever-changing financial environment.

Keywords: Macroeconomic determinants, Share prices, Islamic banking, Financial inclusion

1. Introduction

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Pakistan's banking industry has experienced significant evolution, with Islamic banking emerging as a central driver of this change. More than an alternative financial model, Islamic banking represents a value-based system grounded in Sharia principles, which strictly prohibit interest (Riba) and emphasize ethical conduct, equity, and shared financial responsibility. This faith-based framework has helped Islamic banking gain considerable ground in Pakistan's financial landscape. Since the establishment of Meezan Bank in 2002—the country's first full-fledged Islamic bank—the sector has expanded rapidly, becoming a key component in meeting the financial demands of a diverse population.

The State Bank of Pakistan (SBP) has played a crucial role in supporting this growth by developing robust regulatory structures and policy guidelines. This dual-track strategy, involving both standalone Islamic banks and Islamic banking divisions within conventional banks, has encouraged widespread adoption. Islamic banking now holds a notable share of the nation's total banking assets, deposits, and financing, reflecting a growing consumer preference for Sharia-compliant products—driven by religious values as well as competitive offerings.

In addition to its expansion, Islamic banking has helped bridge gaps in the financial system by promoting inclusion for populations traditionally underserved by conventional banks due to religious concerns. The sector has also contributed significantly to financing small and medium-sized enterprises (SMEs) and agriculture—two areas vital to Pakistan's economic progress. The core concepts of Islamic finance, such as profit-and-loss sharing and asset-backed financing, have demonstrated resilience in times of economic stress. By distributing risk more evenly than conventional finance models, Islamic banking supports greater systemic stability and fosters public confidence in the financial system.

Its impact is also visible in capital markets. Islamic banking's adherence to interest-free operations brings a certain degree of consistency to stock performance, attracting investors who prioritize ethical investing. Sharia-compliant instruments such as sukuk (Islamic bonds) have further diversified investment opportunities and improved liquidity in the financial market. The focus on ethical finance and equitable returns has had a positive effect on key financial indicators such as earnings per share, dividend yield, and asset expansion, enhancing the overall strength and appeal of the sector.

However, despite its achievements, Islamic banking in Pakistan still faces some challenges, including a limited range of financial products, evolving regulatory frameworks, and low consumer awareness. These issues also present avenues for innovation and growth, particularly as financial technology and SBP's continued backing offer strong support for the sector's future development and contribution to sustainable economic progress.

This study sets out to thoroughly explore the various determinants that affect the share prices of Islamic banks in Pakistan. Specifically, it investigates how macroeconomic factors and internal financial metrics shape market valuation. The macroeconomic indicators under consideration include the inflation rate (measured via the Consumer Price Index), exchange rate, lending interest rate, and GDP growth. In terms of bank-specific variables, the study examines Return on Equity (ROE), Earnings Per Share (EPS), Price-to-Earnings (P/E) ratio, asset growth, and payout ratio. Data has been gathered from January 2019 to December 2023 using secondary sources, including the State Bank of Pakistan

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(SBP), the Pakistan Bureau of Statistics (PBS), and the audited financial reports of three consistently operational Islamic banks.

The research adopts a hybrid methodology, combining descriptive and correlational analysis. Descriptive statistics will help outline the characteristics of the dataset, while correlation and multiple regression analyses—conducted using EViews software—will assess the relationships between the selected independent variables and the dependent variable, which is the share price. The study employs statistical tools such as the correlation coefficient, R-squared, F-tests, and T-tests, with results validated through Analysis of Variance (ANOVA) to ensure accuracy and relevance.

This work builds on a growing body of literature that underscores the influence of macroeconomic and financial variables on banking sector performance and market behavior. For instance, prior research by Joseph et al. (2024) and Egbunike & Okerekeoti (2018) highlights the significant impact of inflation, exchange rates, and interest rates on bank profitability and stock values. Otambo (2016) similarly found that while certain macroeconomic variables exert negative pressure, GDP growth can enhance financial performance. Earlier findings by Sindhu, Bukhari, and Hussain (2014) also pointed to the inflation sensitivity of share prices. By centering the analysis on Pakistan's Islamic banking sector and using recent data, this study aims to deliver timely and context-specific insights into the factors shaping its stock market valuation.

2. Literature Review

2.1 Effect of Inflation on Share Prices

Inflation in Pakistan affects both the Islamic banking sector and the share prices of companies listed on the Karachi Stock Exchange (KSE). For Islamic banks, rising inflation decreases consumers' purchasing power, leading to lower savings and investments, which are crucial for Shariah-compliant financing. It also increases operational costs and shifts consumer spending towards essential items, potentially reducing the demand for Islamic financial products. However, Islamic banking principles, such as risk-sharing and asset-backed financing, provide some resilience during inflationary periods (Shaikh, 2023).

Similarly, inflation impacts share prices on the KSE by increasing operational costs for companies, reducing profit margins, and eroding consumer purchasing power, which leads to decreased demand for non-essential goods and services. Higher inflation can also result in higher interest rates as the central bank attempts to control inflation, increasing borrowing costs for companies and affecting their profitability and stock valuations (Khan, Khan, & Khattak, 2023; Sindhu, Bukhari, & Hussain, 2014; Otambo, 2016).

2.2 Effect of Exchange Rate on Share Prices

The exchange rate significantly affects the share prices of the Islamic banking sector in Pakistan. Exchange rate fluctuations can impact the profitability of these banks, especially those involved in international trade and finance. A depreciation of the Pakistani Rupee can increase the cost of foreign-denominated liabilities, reducing profit margins and potentially lowering share prices. Conversely, an appreciation of the Rupee can enhance profitability by reducing these costs, boosting investor confidence and share prices. Exchange rate volatility can also affect investor sentiment, leading to uncertainty and potential

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share price fluctuations. For Islamic banks, which adhere to Shariah principles, exchange rate volatility also impacts the valuation of sukuk and other financial instruments tied to international trade. Therefore, the exchange rate is a critical factor that stakeholders in the Islamic banking sector must monitor closely to mitigate risks and capitalize on favorable conditions. Studies have shown that exchange rates have a significant impact on stock prices, with fluctuations in exchange rates influencing the returns and valuations of banks' stocks (Joseph et al., 2024).

This relationship underscores the importance of exchange rate stability for the financial health and investor confidence in the Islamic banking sector. (Egbunike and Okerekeoti, 2018).

2.3 Effect of Interest Rate on Share Prices

Although Islamic banking does not directly use interest rates due to Shariah principles prohibiting interest (riba), changes in conventional interest rates can still indirectly impact the share prices of the Islamic banking sector in Pakistan. Changes in interest rates influence the overall economic environment, including the cost of capital and investment flows. Higher interest rates often shift investor preferences towards fixed-income securities, potentially reducing the appeal of equity investments, including Islamic bank shares. Additionally, higher interest rates can increase borrowing costs for businesses, slowing economic growth and reducing demand for Islamic financial products, which may negatively affect profitability and share prices. Conversely, lower interest rates typically stimulate economic activity and promote equity investments, indirectly benefiting the Islamic banking sector. Monitoring interest rate trends is crucial for stakeholders in the Islamic banking sector to manage risks and optimize investment strategies. Understanding the indirect effects of interest rate changes helps Islamic banks and their investors navigate the complexities of the financial environment, ensuring better decision-making and stability in the sector. Kabir (2020) found that even though Islamic banks avoid interest-based transactions, they remain sensitive to movements in conventional interest rates, which affect their deposit and financing patterns. This is supported by studies such as those by Otambo (2016), who found that interest rates and exchange rates affect financial performance negatively, while GDP affects it positively

Similarly, Egbunike and Okerekeoti (2018) noted that interest rates have a significant impact on the financial performance of firms, including those in the banking sector.

2.4 Effect of GDP (Gross Domestic Product) on Share Prices

The Gross Domestic Product (GDP) significantly impacts the share prices of the Islamic banking sector in Pakistan. GDP reflects the overall economic health of the country; a growing GDP indicates a robust economy, enhancing the profitability of businesses, including Islamic banks. Economic growth leads to increased consumer and business confidence, higher demand for financial services, and improved financial performance of banks, positively influencing their share prices. (Kaleem, Mushtaq, and Arshad, 2016) found a strong positive correlation between GDP growth and the development of Islamic banking in Pakistan, while (Shaikh, 2022) emphasized that GDP growth plays a key role in driving market development for Shariah-compliant financial institutions.

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Conversely, a declining GDP signals economic downturns, reducing business activities and profitability, which can negatively affect the share prices of Islamic banks. GDP growth fosters higher consumer spending, increased business investment, and improved corporate profitability. For Islamic banks in Pakistan, a growing GDP enhances opportunities for financing projects, expanding market share, and increasing demand for Shariah-compliant financial products, positively impacting their share prices. Conversely, a decline in GDP signals economic slowdown, reduced business activity, and lower consumer confidence, which can negatively affect banking operations and lead to a drop in share prices. GDP trends also influence investor sentiment; strong economic growth encourages investment in equities, while contractionary periods may drive investors towards safer asset classes. As a result, GDP fluctuations are a critical determinant of the financial performance and market valuation of the Islamic banking sector. This relationship is supported by studies indicating that macroeconomic variables, including GDP, significantly influence the financial performance of banks. (Otambo, T. D., 2016).

2.5 Effect of Payout Ratio on Share price

The payout ratio, which represents the proportion of a bank's earnings distributed as dividends to shareholders, plays a significant role in shaping the share prices of the Islamic banking sector in Pakistan. A higher payout ratio often signals robust financial health and management's confidence in the bank's profitability, attracting investors seeking stable income streams. This increased investor confidence can drive up the demand for shares, positively impacting market valuation. Consistent and attractive dividend payouts are generally associated with well-managed and sound institutions, further enhancing their appeal to investors. Conversely, a lower payout ratio may indicate that the bank is retaining more earnings for reinvestment or to address potential financial uncertainties. While this approach can be favorable to growth-focused investors, it might deter income-oriented investors who prioritize dividends, potentially leading to a decline in share prices. For Islamic banks, which adhere to Shariah principles and prioritize ethical financial practices, maintaining an optimal payout ratio is essential. Striking the right balance between dividend distribution and retained earnings helps sustain investor confidence, support long-term growth, and stabilize share price movements in the sector. Studies have shown that macroeconomic factors such as inflation and interest rates also significantly impact share prices, further emphasizing the importance of a balanced payout strategy. (Egbunike and Okerekeoti, 2018), Sindhu, M. I., Bukhari, S. M. H., & Hussain, A., 2014).

2.6 Effect of Asset Growth on Share price

A recent study by Shoaib Khan, Ali Polat, and Usman Bashir (2023) titled "Factors Affecting the Financial Performance of Islamic Banks in Pakistan" provides empirical evidence on the positive impact of asset growth on the financial performance of Islamic banks in Pakistan. The study analyzed data from five Islamic banks operating between 2008 and 2021, utilizing return on assets (ROA) and return on equity (ROE) as performance indicators. The findings revealed that internal factors, including asset management, significantly influence the profitability of Islamic banks. Specifically, effective asset

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management was positively associated with ROE, indicating that strategic asset growth contributes to enhanced financial performance. This underscores the importance of asset growth as a critical factor in strengthening investor confidence and boosting share prices within the Islamic banking sector.

Additionally, a study by Rashid Khalil and Muhammad Azhar Khalil (2019) titled "Does Bank Size and Operational Efficiency Matter? An Impact of Financial Gearing and Asset Management on Islamic Bank's Performance in Pakistan" examined the relationship between asset management and profitability. Analyzing data from five Islamic banks between 2007 and 2015, the study found that while bank size positively influences profitability, asset management has an inverse effect. This suggests that not all asset growth translates to improved financial performance, highlighting the need for strategic asset allocation and efficient management practices to ensure that asset growth contributes positively to profitability and, by extension, share prices.

2.7 Effect of EPS Growth on Share price

Earnings per Share (EPS) is a critical indicator of a bank's profitability and plays a significant role in determining the share prices of Islamic banks in Pakistan. A higher EPS suggests that the bank is effectively generating profit relative to its number of outstanding shares, which boosts investor confidence and can lead to an increase in share prices. For Islamic banks, which operate on Shariah-compliant principles, a strong EPS signals financial stability and operational efficiency, making the bank more attractive to investors seeking steady returns. Conversely, a declining or low EPS can indicate weaker profitability or potential challenges in the bank's operations, prompting investors to reassess the bank's value, which may lead to a decline in share prices.

As a result, EPS serves as a key metric that influences both investor perception and the market valuation of Islamic banks in Pakistan, making it an essential factor in share price movements. EPS represents the portion of a bank's profit allocated to each outstanding share of common stock, serving as an indicator of the bank's profitability. A higher EPS generally signals strong financial health and profitability, which can boost investor confidence and drive up share prices. Investors often view a rising EPS as a sign of effective management and robust financial performance, making the bank's shares more attractive. Conversely, a declining EPS may indicate financial challenges or inefficiencies, leading to reduced investor confidence and potentially lower share prices. For Islamic banks, maintaining a healthy EPS is particularly important as it reflects their ability to generate profits while adhering to Shariah principles. Therefore, EPS serves as a vital metric for investors and stakeholders in assessing the financial performance and market valuation of Islamic banks.

Research supports the significant impact of EPS on share prices. For instance, studies have shown that EPS growth positively influences stock returns and market valuation, as seen in various sectors including banking (Egbunike and Okerekeoti (2018), Joseph et al. (2024). Additionally, macroeconomic factors such as inflation and interest rates also play a role in shaping investor expectations and stock performance (Sindhu, M. I., Bukhari, S. M. H., & Hussain, A. (2014), Otambo, T. D. (2016). Therefore, understanding the interplay between EPS and these broader economic indicators is crucial for investors in Islamic banking.

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2.8 Effect of ROE Growth on Share price

Return on Equity (ROE) is a crucial metric that significantly impacts the share prices of the Islamic banking sector in Pakistan. ROE measures a bank's profitability by revealing how effectively it generates profits from shareholders' equity. A higher ROE indicates strong financial performance and efficient management, boosting investor confidence and driving up share prices. This relationship is supported by Al Khatib et al. (2024), who found that ROE has a significant positive effect on the share performance of Islamic banks, particularly in terms of turnover and investor appeal. Investors often view a rising ROE as a sign of a bank's ability to generate substantial returns on their investments, making the bank's shares more attractive. Conversely, a declining ROE may signal financial inefficiencies or challenges, leading to reduced investor confidence and potentially lower share prices. For Islamic banks, maintaining a healthy ROE is particularly important as it reflects their ability to generate profits while adhering to Shariah principles. Therefore, ROE is an essential indicator for investors in the Islamic banking sector, influencing their perception of a bank's financial health and its potential for sustained growth.
Studies have shown that macroeconomic factors such as GDP growth, inflation, and interest rates also play a significant role in determining the financial performance of banks, including Islamic banks (Joseph et al., 2024).

2.9 Effect of (P/E) ratio Growth on Share price

The Price-to-Earnings (P/E) ratio is a key metric that influences the share prices of Islamic banks in Pakistan, as it reflects market expectations about the bank’s future profitability relative to its current share price. A high P/E ratio suggests that investors anticipate strong future earnings growth and are willing to pay a premium for the bank’s shares, which can drive up share prices. This is especially relevant for Islamic banks, where consistent financial performance and growth potential, in line with Shariah-compliant principles, attract long-term investors. On the other hand, a low P/E ratio may indicate that the market has lower expectations for the bank’s growth, potentially leading to a decline in share prices. While a lower P/E ratio may appeal to value investors, it can also signal concerns about the bank’s profitability or risk factors. Consequently, the P/E ratio plays an essential role in shaping investor sentiment and assessing the market valuation of Islamic banks in Pakistan. This is supported by (Wahid and Tariq, 2024), who emphasize the importance of the P/E ratio in reflecting investor expectations and stock price movements within Pakistan's Islamic banking sector. For instance, research has shown that the P/E ratio, along with other financial metrics, is a critical determinant of stock prices in various markets, including the Karachi Stock Exchange.

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2.10 Conceptual Framework

Figure 1

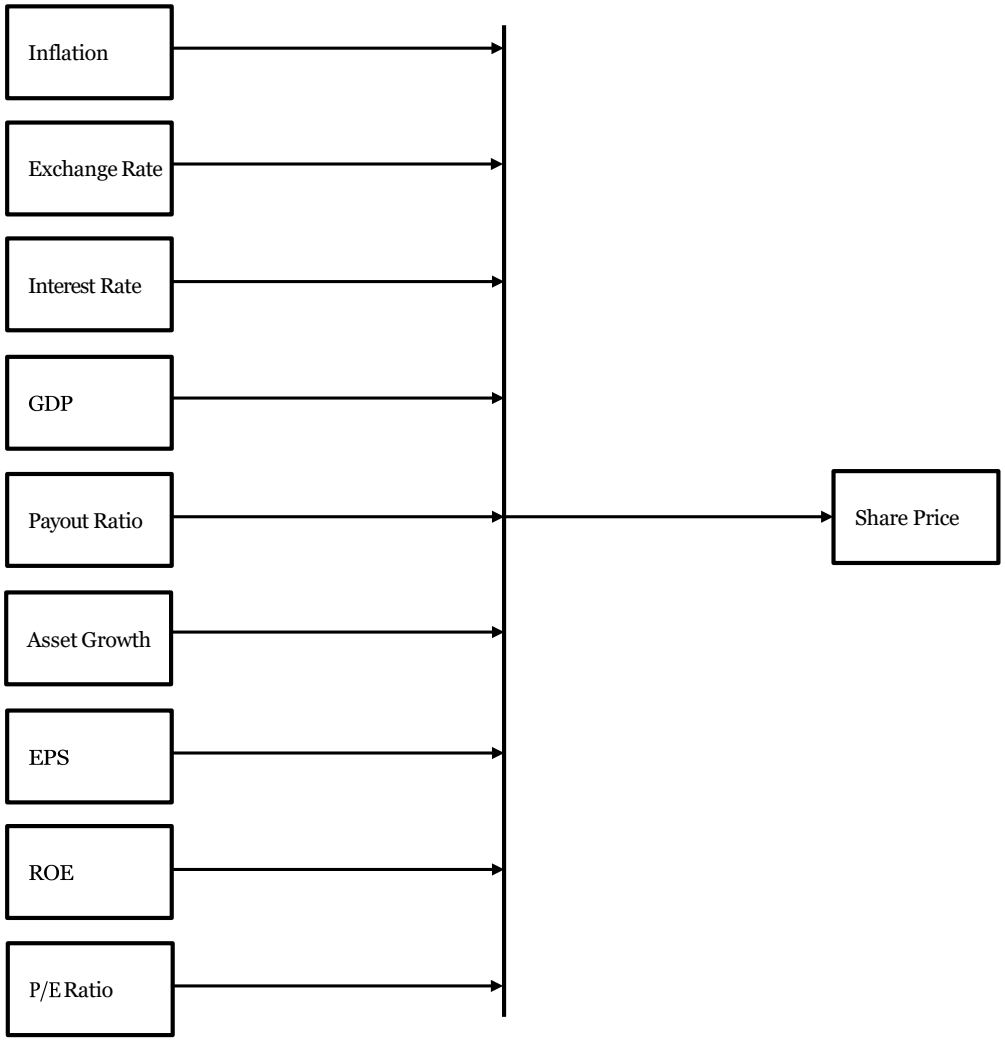

Figure 1: The relationship between macro-economic variables and financial performance

Figure 1 illustrates that a company's share price is influenced by both macroeconomic variables and financial performance indicators. Macroeconomic factors such as inflation, GDP, interest rates, and exchange rates shape the broader economic environment, affecting investor sentiment and market trends. Meanwhile, financial performance metrics like EPS, ROE, payout ratio, and P/E ratio reflect the firm's internal strength and profitability. Together, these external and internal factors determine the movement of share prices, with each variable

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potentially exerting a positive or negative impact.

2.11 Theoretical Framework

This study looks into what affects the share prices of Islamic banks in Pakistan, focusing on both outside economic conditions and internal financial performance. The research is based on the core values of Islamic finance, which promote ethical behavior, risk-sharing, and strictly forbid interest (Riba). These principles set Islamic banking apart from traditional banks.

Islamic banks follow Shariah rules, which mean their financial activities must avoid interest and should be backed by real assets or services. Since interest is not allowed, Islamic banks use other ways to earn profits—like profit-sharing, leasing, and financing based on tangible assets. These methods aim to create fairness, transparency, and shared responsibility between banks and clients.

The study considers key macroeconomic factors like inflation, exchange rates, interest rates (even though they don't directly apply in Islamic banking), and GDP. These indicators help explain the broader economic environment Islamic banks operate in. For example, inflation can reduce purchasing power and raise costs, affecting bank performance. Exchange rates can impact the value of assets and liabilities in foreign currency. Even though Islamic banks don't deal with interest directly, changes in market interest rates may still influence investor behavior and market perception. GDP growth reflects the overall health of the economy and can affect demand for banking services.

Besides the external environment, the study also looks at internal factors within the banks. These include Return on Equity (ROE), Earnings Per Share (EPS), the Price-to-Earnings (P/E) ratio, asset growth, and payout ratio. ROE shows how well a bank uses its equity to generate profit. EPS tells how much profit is made per share, which investors often use to judge value. The P/E ratio reflects how investors view a bank's future earning potential. Asset growth gives insight into the bank's expansion, while the payout ratio shows how much profit is returned to shareholders as dividends.

Together, these external and internal factors form the basis of the study's framework to understand what drives the share prices of Islamic banks. By examining how economic conditions and bank performance interact, the research aims to highlight the key elements influencing market value. This framework is meant to support academic understanding and also provide useful insights for investors, policymakers, and those working in the Islamic banking sector.

3. Research Methodology

3.1 Introduction

This section outlines the research design, as well as the population and sample selected for the study. It also discusses the data collection methods, techniques for data analysis, and approaches for data presentation to be used in the research.

3.2 Research Design

According to Mugenda and Mugenda (2003), research design is a framework of methods and procedures used to acquire the necessary information for a study. It serves as the backbone of the research, defining what information needs to be

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collected and the procedures for gathering it from relevant sources.
This study adopts both descriptive and correlation research designs. Descriptive research helps in understanding the characteristics and trends of the variables, while correlation research examines the relationships between them. The study utilizes time series empirical data to analyze the connection between key macroeconomic variables—GDP, lending interest rate, exchange rate, and inflation rate and the financial performance of commercial banks, measured by Return on Assets (ROA). The research aims to determine whether these macroeconomic factors have a constructive or destructive correlation with banks' financial performance.

3.3 Research Population

According to Mugenda and Mugenda (2003), a population refers to the entire group of individuals, events, or objects that share common characteristics. For this study, the target population consists of three Islamic banks that were operational between 2019 and 2023. This selected population provides relevant data to address the research questions regarding the impact of macroeconomic variables on the financial performance of Islamic banks in Pakistan.

3.4 Data Collection

The study relied on secondary data to analyze the impact of macroeconomic variables on the financial performance of Islamic banks. The key variables included GDP growth, lending interest rate, exchange rate (USD/PKR), and inflation, measured through the Consumer Price Index (CPI). Data on GDP growth and inflation were obtained from the Pakistan Bureau of Statistics (PBS), while exchange rate data was sourced from the State Bank of Pakistan (SBP). Additionally, data on lending interest rates and Return on Assets (ROA) for the selected Islamic banks were extracted from their annual financial statements, with the lending interest rate calculated as the average rate over a year. Since this data is publicly available, it was retrieved from the official websites of SBP and PBS. The study covers a five-year period from January 2019 to December 2023, ensuring a comprehensive analysis of the relationship between macroeconomic factors and the financial performance of Islamic banks of Pakistan.

3.5 Data Analysis

Data analysis involves the systematic application of statistical and logical methods to describe, summarize, interpret, and evaluate data (Singleton et al., 2003). This process is essential for organizing and manipulating the collected information to derive meaningful insights. In this study, EViews software was used for data analysis, employing various regression techniques to examine the correlation between macroeconomic factors and the financial performance of Islamic banks in Pakistan. Given that the study model is multivariate, the analysis focused on determining the correlation coefficients of the selected variables to assess their relationships and overall impact on Islamic banks' financial performance.

3.5.1 Analytical Model

The researcher employed multiple regression analysis to determine the impact of macro-economic variables on the financial performance of commercial banks in

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Pakistan. The response variable was the financial performance of commercial banks, while the predictor variables were the macro-economic factors. The analytical model used to analyze the relationship between the predictor variables and the response variable was:

$$Y = \alpha + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + \beta_4 X_4 + \beta_5 X_5 + \beta_6 X_6 + \beta_7 X_7 + \beta_8 X_8 + \beta_9 X_9 + e$$

Let's break down what each part of the formula means in your study:
Y (Dependent Variable): This is the Share Price of the Islamic banks.

α (Alpha - Constant): This is the starting point or baseline value of the share price when all the other factors (your independent variables) are zero.
$\beta_1, \beta_2, \beta_3, \beta_4, \ldots \beta_9$ (Beta coefficients): These numbers tell you how much the share price is expected to change when each of the independent variables changes by one unit, assuming everything else stays the same.
β_1 is for GDP growth
β_2 is for Interest Rate
β_3 is for Exchange Rate (USD)
β_4 is for Inflation Rate
β_5 is for Payout Ratio
β_6 is for Asset Growth
β_7 is for Earning per Share (EPS)
β_8 is for Return on Equity (ROE)
β_9 is for P/E Ratio
$X_1, X_2, X_3, X_4, \ldots X_9$ (Independent Variables): These are the factors you think affect the share price:
X_1 = GDP growth
X_2 = Interest Rate
X_3 = Exchange Rate
X_4 = Inflation Rate
X_5 = Payout Ratio
X_6 = Asset Growth
X_7 = Earning per Share (EPS)
X_8 = Return on Equity (ROE)
X_9 = P/E Ratio
ϵ (Epsilon - Error Term): This part covers all the other influences on share price that aren't included in your model—things you can't measure or didn't account for. It also covers random fluctuations and errors.
In short, this formula sums up the key model you're using in your research methodology to analyze how GDP, interest rates, exchange rates, and inflation together impact the share prices of Islamic banks in Pakistan. It's a way to mathematically capture and test those relationships.

3.5.2 Test of Significance

To determine how financial performance is influenced by different factors, several key statistical tests were used. First, the correlation coefficient (r) shows how strong and in what direction each factor is related to financial performance. The R-squared value tells us how much of the change in financial performance can be explained by these factors together. In the regression analysis, if the

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calculated F value is lower than the critical value, it means there isn't enough evidence to say the relationship is significant at the 5% level. The T-test checks whether each individual factor has a meaningful effect on financial performance. Overall, regression analysis was used to see how well all the factors combined explain the changes in financial performance and to identify which ones matter the most.

4. Data Analysis, Findings and Interpretation

4.1 Introduction

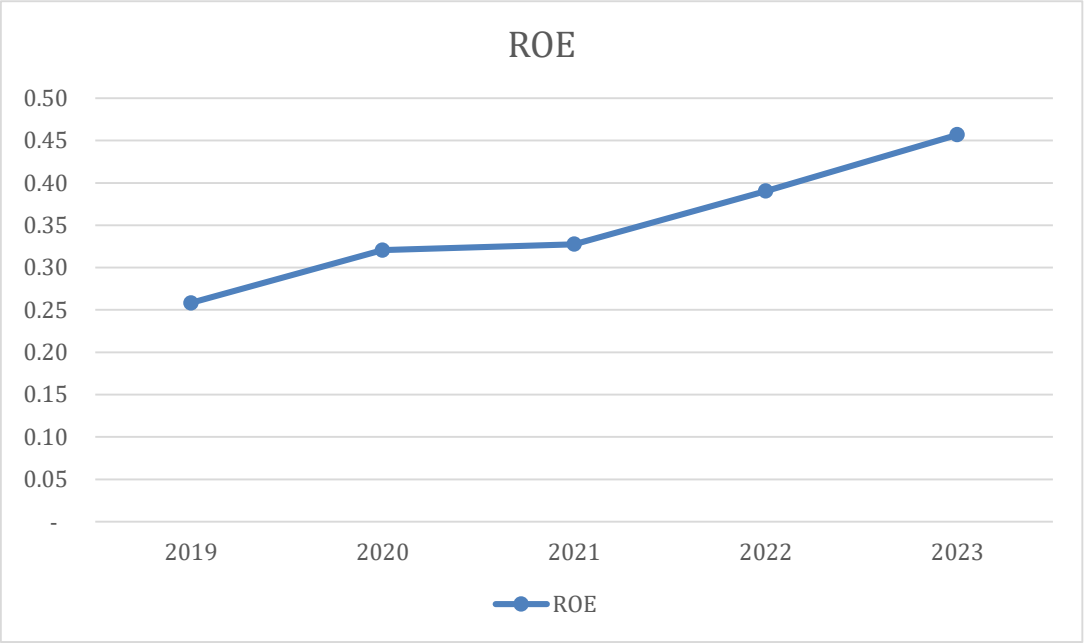
This chapter presents the findings of the analysis and interpretation of the secondary data gathered from the Central Bank of Kenya (CBK) and the audited financial statements of the Commercial Banks operating in Kenya for the study period 2006-2015. Analysis was done with the help of Statistical Package for Social Science (SPSS) version 21. Descriptive statistics such as mean and standard deviations were used to analyze the performance of commercial banks and the effect of macroeconomic variables. Correlation analysis and regression analysis were used to establish the impact of macroeconomic variables on the performance of commercial banks. Analysis of variance (ANOVA) was used to test the reliability of the regression model.

4.2 Descriptive Statistics

4.2.1 Financial Performance

In this section, the study sought to establish the yearly financial performance of commercial banking sector for the period 2019-2023. The financial performance of the commercial banking sector was measured using Return on Equity (ROE). Results of the analysis are shown below

Figure 2: Effect of ROE on Share Price



The graph illustrates the trend in Return on Equity (ROE), starting at

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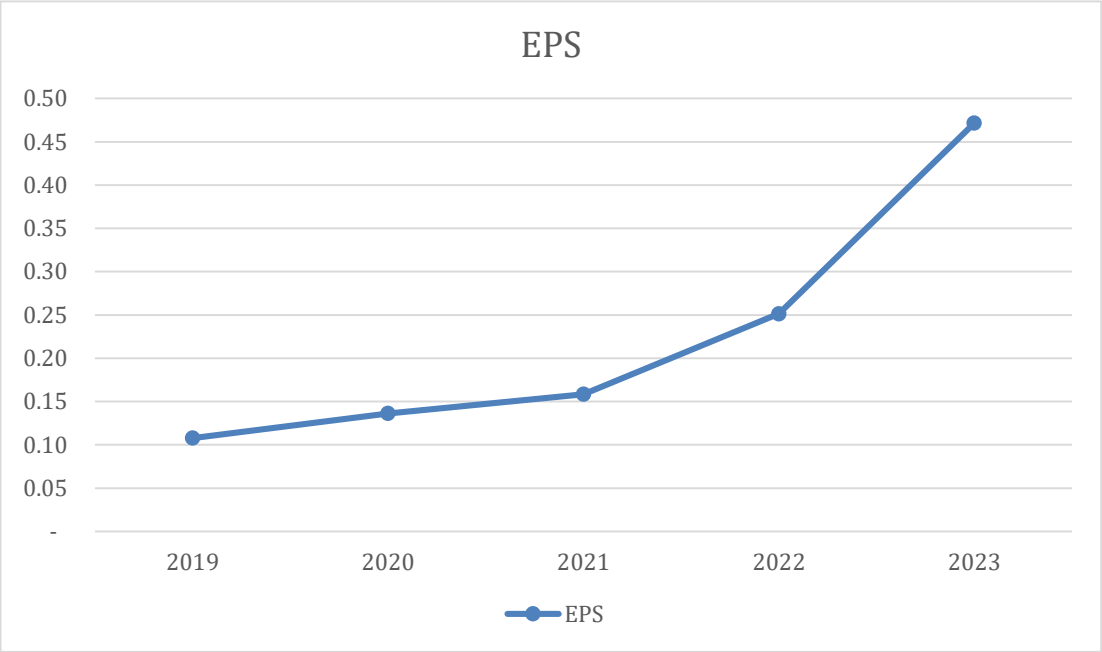
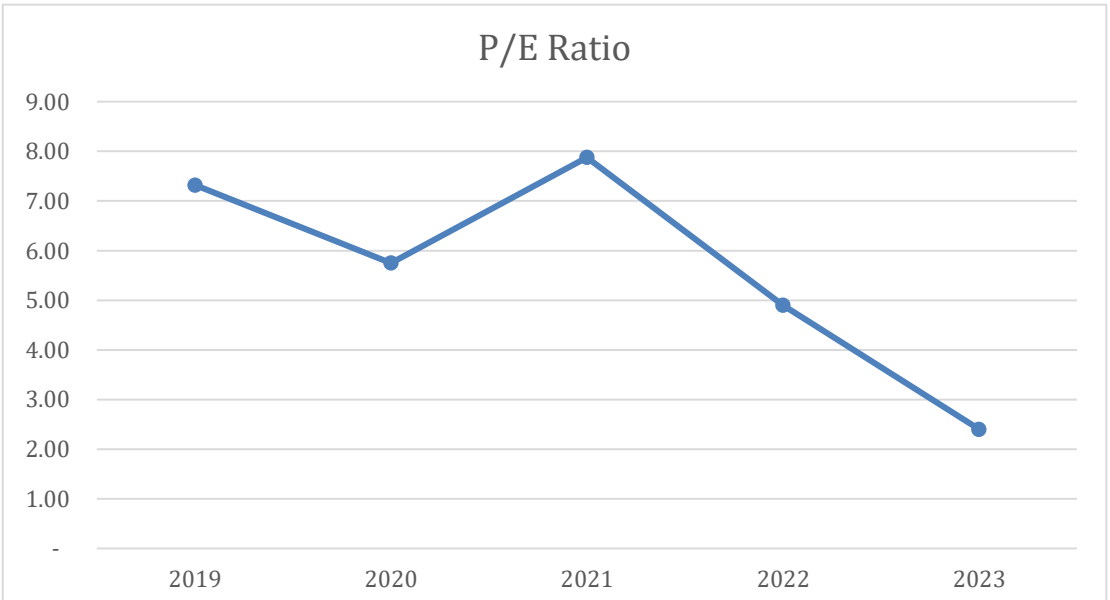
approximately 0.26 in 2019. It increased to a peak of about 0.45 in 2023 (as shown in the first data series), before sharply declining to its lowest point of around 0.055, possibly representing a different segment or a data reset. After this dip, ROE gradually recovered, reaching approximately 0.30 in 2023 (as indicated in the second data series). It then dropped again to around 0.10 in 2019, fluctuated slightly through 2021, and began a steady upward trend, reaching about 0.22 by 2023.

Figure 3: Effect of EPS on Share Price



Earnings Per Share (EPS) exhibited a strong upward trend over the five-year period. Although growth was modest from 2019 to 2021, it accelerated significantly in 2022, nearly doubling by 2023. This sharp increase reflects enhanced profitability per share, which is typically encouraging for investors. The consistent upward movement, without any declines, indicates solid performance in generating shareholder value throughout the period.

Figure 4: Effect of P/E Ratio on Share Price



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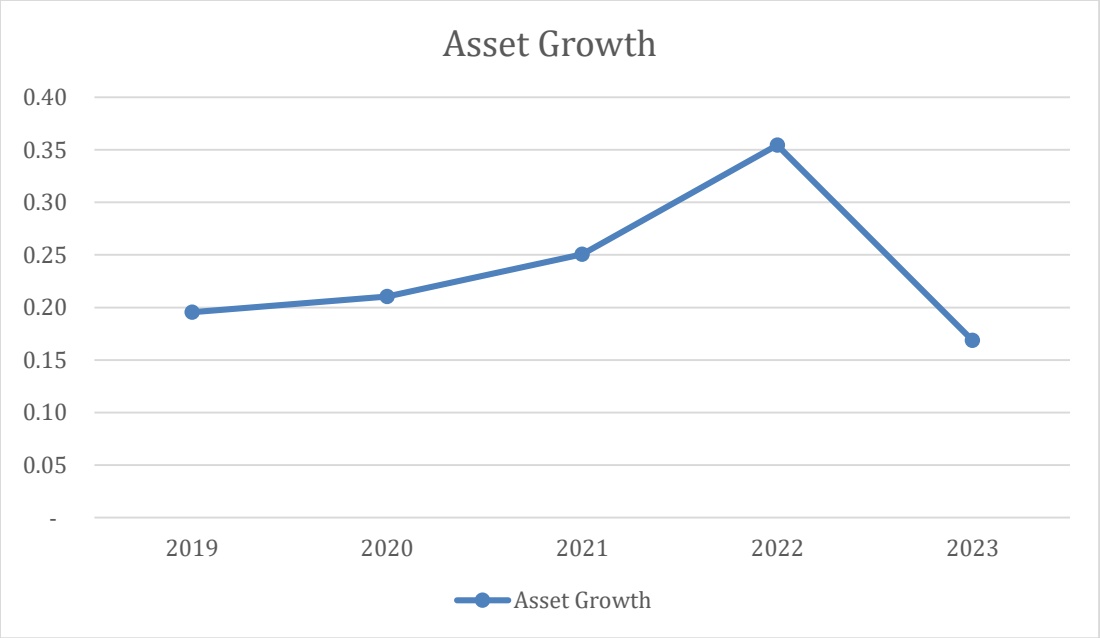
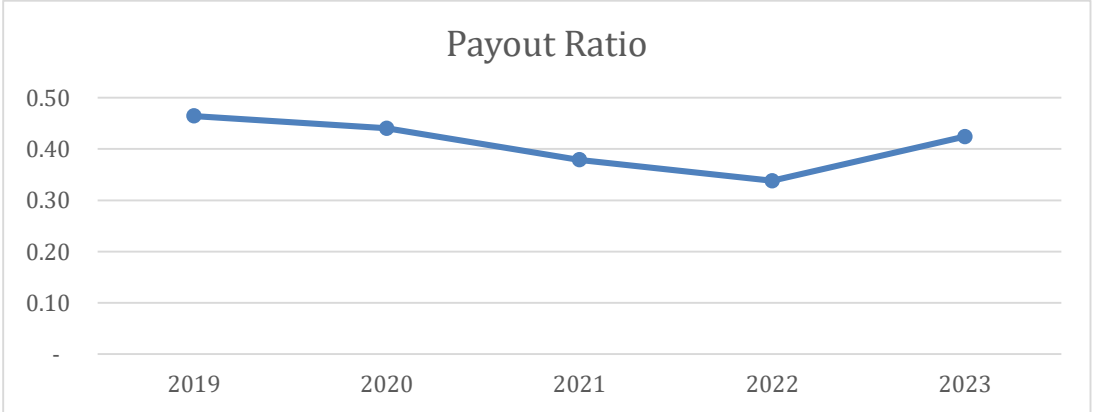
The P/E Ratio showed fluctuations from 2019 to 2023, rising from 5.8 in 2020 to a peak of 7.9 in 2021 before sharply declining to 2.4 by 2023. This overall downward trend suggests reduced investor confidence and lower willingness to pay for future earnings..

Figure 5 : Effect of Asset Growth on Share Price



The Asset Growth trend shows an initial period of steady increase from 2019 to 2022, culminating in a strong peak in 2022. However, this robust growth was followed by a significant contraction in 2023, bringing the asset growth rate below its 2019 level. This pattern suggests a period of aggressive expansion followed by a sharp deceleration or even a contraction in the rate at which assets are increasing. The drop in 2023 could be due to various factors such as strategic decisions, economic downturns, divestitures, or a slowdown in new investments.

Figure 6: Effect of Payout Ratio on Share Price



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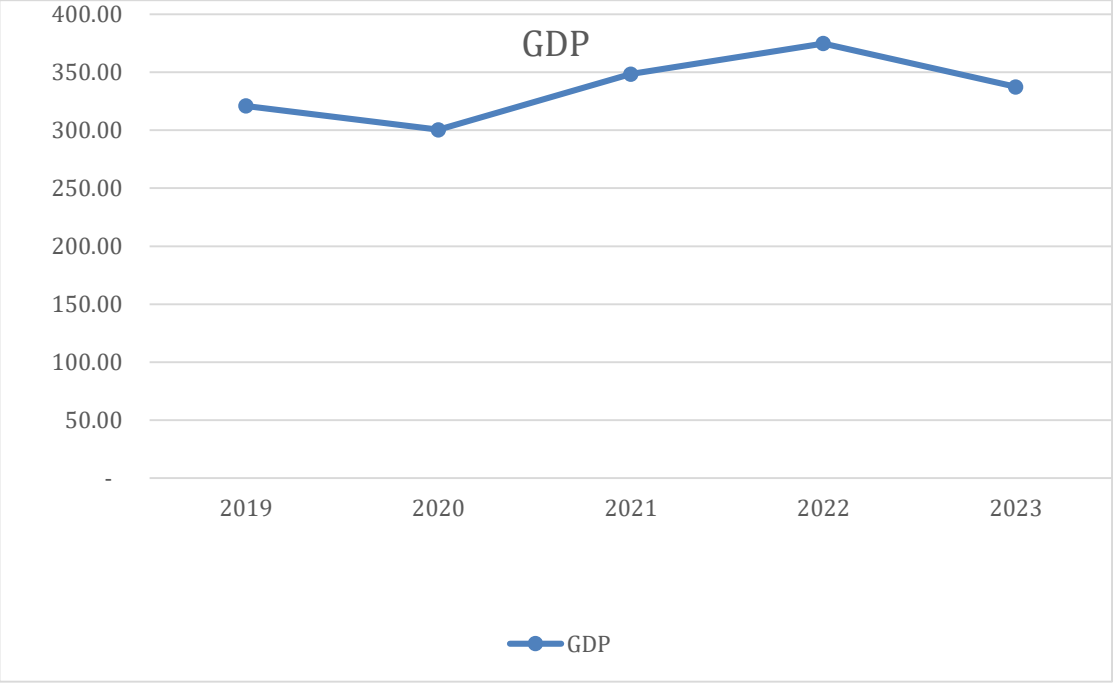
The Payout Ratio displayed a general declining trend from 2019 to 2022, suggesting that the company was either retaining more of its earnings or that earnings growth outpaced payout growth during this period. However, this trend reversed sharply in 2023, with the payout ratio increasing. This could imply a renewed commitment to returning capital to shareholders, a slowdown in reinvestment opportunities, or potentially a smaller increase in earnings relative to a fixed or growing payout amount. The fluctuation suggests a dynamic approach to capital allocation and dividend policy.

4.2.2 Economical Performance

Figure 7: GDP growth rate on Share Price



The GDP trend shows an initial slight contraction in 2020, followed by a robust recovery and growth in 2021 and 2022, reaching its highest point in 2022. However, the period concluded with a downturn in 2023, indicating a potential slowdown or reversal of economic growth. Despite the dip in 2023, the GDP value in 2023 (around 340.00) remained higher than the values observed in 2019 and 2020, suggesting a net growth over the entire five-year span, albeit with fluctuations.

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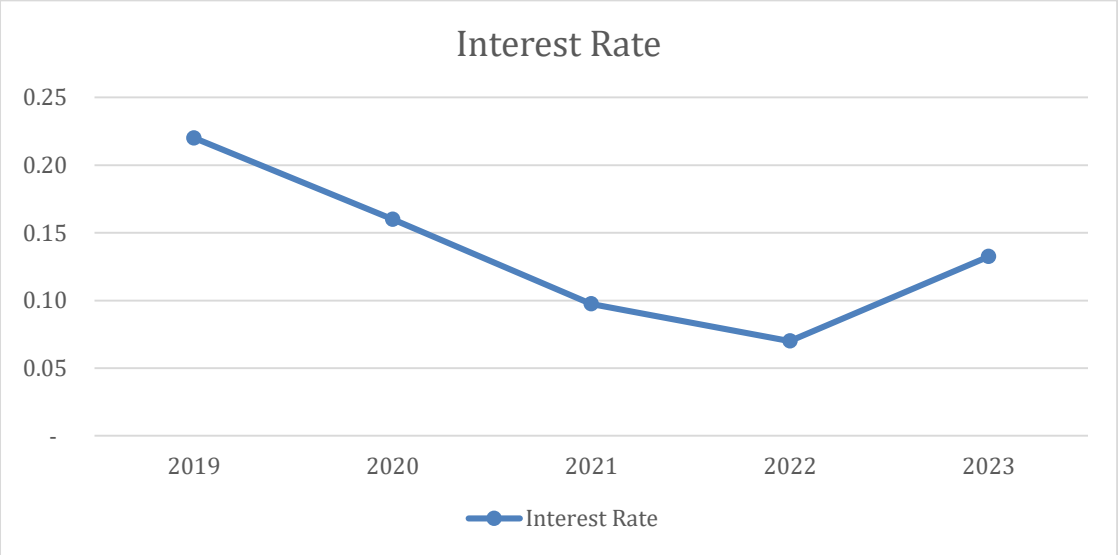
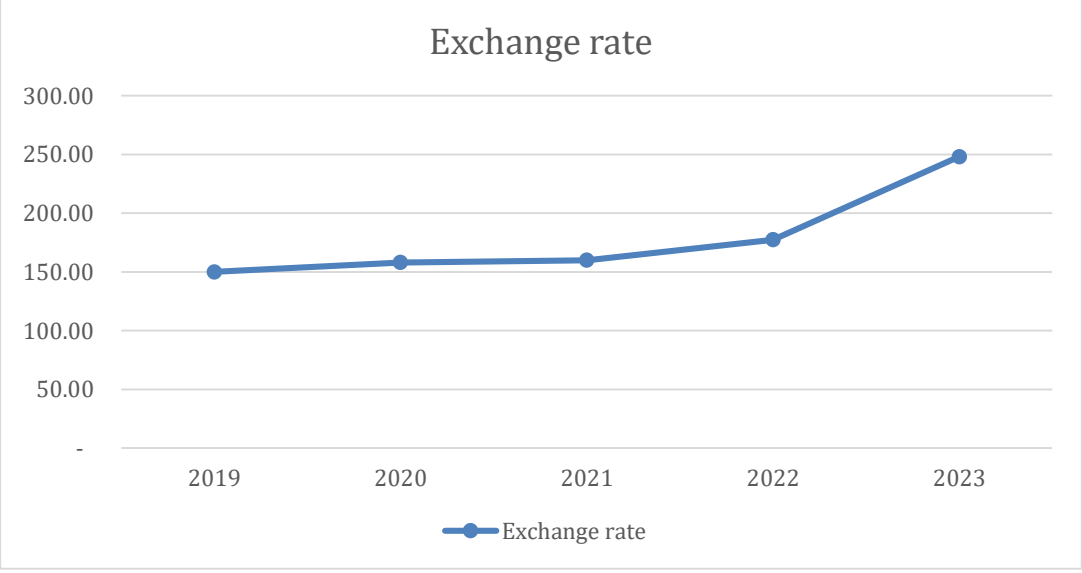
Figure 8: Interest Rate on Share Price



Interest rates, shown fluctuating from 22% in 2019 down to 7% in 2022, then rising to 13% in 2023, generally exhibit an inverse relationship with conventional share prices. Lower rates tend to make borrowing cheaper and stocks more attractive, while higher rates increase borrowing costs and boost bond appeal.
For Islamic banking, despite the prohibition of interest, conventional interest rates still indirectly influence share prices. They impact competitiveness in attracting deposits, influence profit margins on Sharia-compliant products, and affect the broader economic environment crucial for borrower repayment capacity. Thus, falling rates (2019-2022) likely fostered a favorable environment, while rising rates (2023) could introduce challenges for Islamic banks.

Figure 9: Exchange rate on Share Price



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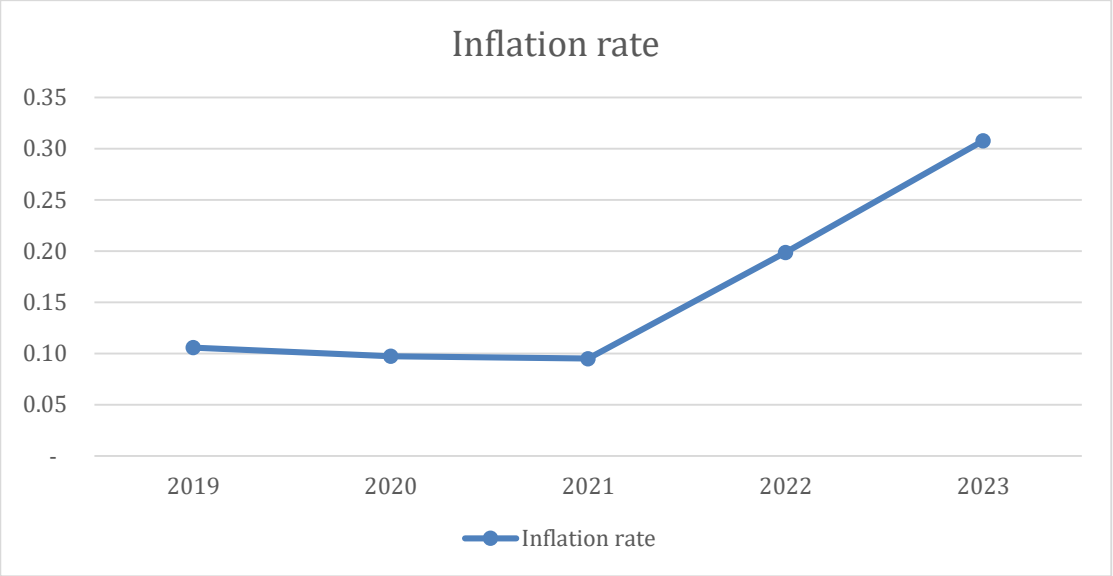
The exchange rate, relatively stable from 2019-2022, saw a sharp depreciation in 2023. While Islamic banking avoids interest, exchange rate fluctuations still impact its share price. A depreciating local currency can increase the cost of foreign liabilities and potentially raise import costs for clients, impacting their ability to repay. This can strain Islamic banks' profitability and elevate credit risk, ultimately influencing their share performance.

Figure 10: Inflation rate on Share Price



The chart provided illustrates an inflation rate that remained relatively stable from 2019 to 2021 (around 10%) before surging significantly to over 30% by 2023. In Islamic banking, while direct interest isn't involved, high inflation can still impact share prices by eroding the real value of assets and returns from profit-sharing arrangements. This could potentially reduce investor confidence and increase credit risk for Islamic financial institutions as borrowers face greater repayment challenges. However, the precise impact on share prices would also depend on specific bank performance, the broader economic environment, and relevant regulatory frameworks.

5. Data Analysis

5.1 Descriptive Statistics of Key Financial and Macroeconomic Variables

Date: 06/03/25 Time: 09:16
Sample: 2019 2023

	SHARE_PRI	ROE	EXCHANGE	ASSET_GR	EPS	INFLATION	P_E_RATIO	INTEREST_
Mean	51.10600	0.212220	178.7180	0.222940	0.110127	0.160920	5.057333	0.136000
Median	23.00000	0.167800	160.0200	0.214400	0.074000	0.105800	4.900000	0.132500
Maximum	161.3600	0.456900	248.0400	0.354400	0.471600	0.307700	12.08000	0.220000
Minimum	11.09000	0.055200	150.0600	0.049900	0.009800	0.095000	1.590000	0.070000
Std. Dev.	51.18454	0.124059	37.05146	0.079609	0.119653	0.085845	2.748214	0.053750
Skewness	1.011145	0.514311	1.282869	-0.203280	2.000943	0.878648	0.980751	0.374112
Kurtosis	2.498859	2.046627	2.932742	3.005237	6.649447	2.158611	3.837954	1.960934
Jarque-Bera	2.712999	1.229366	4.117209	0.103324	18.33347	2.372514	2.843536	1.024686
Probability	0.257561	0.540812	0.127632	0.949650	0.000104	0.305362	0.241287	0.599090

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The descriptive analysis (Table 1) of the dataset covering the years 2019 to 2023 (15 observations) provides a clear view of the variability and distribution patterns of key financial and macroeconomic indicators related to Islamic banks in Pakistan.

Share Price shows a wide fluctuation, ranging from 11.09 to 161.36, with an average value of 51.11 and a high standard deviation of 51.18, indicating substantial volatility. A positive skewness of 1.01 suggests the data leans towards higher price values, while its kurtosis of 2.50 reflects a shape close to a normal distribution, with no extreme outliers.

Return on Equity (ROE) spans from 5.52% to 45.69%, with a mean of 21.22% and standard deviation of 12.41%, reflecting moderate variation among banks. Its positive skewer of 0.51 shows a slight tilt towards lower ROE values, and the kurtosis value of 2.05 points to a somewhat flatter distribution compared to the normal curve.

Exchange Rate (USD/PKR) fluctuates notably, ranging from 150.06 to 248.04, averaging 178.72. The standard deviation of 37.05 underscores this variation. A skewness of 1.28 indicates more frequent lower values with a few high spikes, while a kurtosis of 2.93 suggests the distribution is close to normal but with slightly heavier tails.

Asset Growth shows a relatively narrow range, from 4.99% to 35.44%, with a mean of 22.29% and a standard deviation of 7.96%. The distribution is slightly skewed to the left (-0.20), indicating a tendency toward higher growth values, and a kurtosis of 3.01 closely matches a normal distribution.

Earnings Per Share (EPS) reveals significant variation, from 0.0098 to 0.4716, with an average of 0.11 and a standard deviation of 0.12. It is highly skewed (2.00), meaning most values are on the lower end with a few high outliers. The kurtosis of 6.65 signals a very peaked distribution with long tails, which aligns with the extreme variability observed.

Inflation, ranging from 9.5% to 30.7%, averages at 16.09%, with a standard deviation of 8.58%. Its skewness of 0.88 shows that lower inflation values are more common, though some periods experienced sharp spikes. A kurtosis of 2.16 indicates a slightly flatter-than-normal curve.

Price-to-Earnings (P/E) Ratio varies from 1.59 to 12.08, with an average of 5.06 and a standard deviation of 2.75. Its positive skewness (0.98) and kurtosis (3.84) imply that while most values are clustered on the lower end, there are notable high outliers, and the distribution has heavier tails than a normal one.

Interest Rate figures range from 7% to 22%, with a mean of 13.6% and a standard deviation of 5.38%. The distribution is slightly skewed to the right (0.37), indicating more frequent lower values with occasional spikes. A kurtosis of 1.96 suggests a flatter shape than a normal distribution.

Finally, **the Jarque-Bera test** results, especially the probability for EPS (0.000104)—indicate that not all variables conform to the assumption of normality. Variables like EPS and P/E ratio show signs of outliers or non-standard distributional patterns.

In summary, the dataset reflects significant variability across multiple financial and economic indicators. The diversity in skewness and kurtosis values shows that while some variables follow a near-normal distribution, others—particularly EPS and share price—exhibit skewed and peaked behavior, which may influence statistical modeling.

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5.2 Panel Least Squares Regression Results for Share Price

Dependent Variable: SHARE_PRICE
Method: Panel Least Squares
Date: 06/03/25 Time: 09:13
Sample: 2019 2023
Periods included: 5
Cross-sections included: 3
Total panel (balanced) observations: 15

Variable	Coefficient	Std. Error	t-Statistic	Prob.
ROE	354.1726	53.72609	6.592190	0.0003
EXCHANGE_RATE	0.376305	0.264486	1.422778	0.1978
ASSET_GROWTH	-159.9926	63.68554	-2.512227	0.0403
EPS	121.9569	60.96444	2.000460	0.0856
INFLATION	-241.7452	110.4272	-2.189183	0.0648
P_E_RATIO	7.240378	2.311035	3.132959	0.0165
INTEREST_RATE	-135.5031	74.36440	-1.822150	0.1112
C	-48.35786	33.54044	-1.441778	0.1926

R-squared	0.983637	Mean dependent var	51.10600
Adjusted R-squared	0.967275	S.D. dependent var	51.18454
S.E. of regression	9.259341	Akaike info criterion	7.593669
Sum squared resid	600.1478	Schwarz criterion	7.971296
Log likelihood	-48.95252	Hannan-Quinn criter.	7.589647
F-statistic	60.11494	Durbin-Watson stat	1.204978
Prob(F-statistic)	0.000010		

Table 2: Least Squares Regression

The financial data analysis spanning 2019 to 2023 offers valuable insights into what influences the share prices of companies, particularly within the Islamic banking sector. Using a Panel Least Squares regression approach, the model proves highly effective capturing around 98.4% of the variation in share prices. This high R-squared value strongly suggests that the variables included in the model are key drivers of share price movements.

Looking more closely at the individual factors, Return on Equity (ROE) stands out as having the most significant and positive effect. This makes intuitive sense—more profitable banks tend to attract investors, which pushes share prices higher. On the other hand, asset growth, somewhat unexpectedly, shows a negative relationship. This could imply that rapid asset expansion, if not matched by improved performance or profitability, may raise concerns about overextension or inefficient capital allocation among investors.

Earnings Per Share (EPS) also has a positive influence, indicating that stronger earnings generally lead to higher share prices. However, its impact isn't as consistent or strong as ROE. Inflation, unsurprisingly, shows a negative effect—

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higher inflation is likely to erode real returns, making stocks less attractive and thereby putting downward pressure on prices.

As expected, the Price-to-Earnings (P/E) ratio positively correlates with share price. A higher P/E often reflects investor confidence in future earnings potential. Interestingly, exchange rates and interest rates do not show a statistically meaningful effect on share prices in this study, suggesting their influence may be indirect or less pronounced in this context.

Overall, the model offers a solid understanding of how internal performance metrics and certain economic indicators impact share valuation. Although there's a minor indication that some variation remains unexplained, the findings provide a strong foundation for interpreting how these factors interact with market behavior.

5.3 Correlation Matrix of Financial and Macroeconomic Variables

Covariance Analysis: Ordinary
Date: 06/03/25 Time: 09:18
Sample: 2019 2023
Included observations: 15

Correlation	SHARE_PRI	ROE	EXCHANGE	ASSET_GR	EPS	INFLATION	P_E_RATIO	INTEREST_
SHARE_PRICE	1.000000							
ROE	0.874242	1.000000						
EXCHANGE_RATE	0.185698	0.531472	1.000000					
ASSET_GROWTH	0.066852	0.303596	0.335947	1.000000				
EPS	0.846724	0.884532	0.570873	0.114094	1.000000			
INFLATION	0.155955	0.532015	0.960317	0.372453	0.561649	1.000000		
P_E_RATIO	0.021630	-0.325553	-0.690942	0.079434	-0.321290	-0.689641	1.000000	
INTEREST_RATE	-0.088837	-0.257741	-0.252113	-0.359590	-0.195562	-0.307616	0.475722	1.000000

Earnings Per Share (EPS), meaning that as a company's profitability and earnings per share go up, its share price tends to follow suit quite closely. There's a weaker positive link between share price and the exchange rate, and a similarly weak positive connection with asset growth and inflation, suggesting these factors might have some influence but not as strongly as profitability or earnings. Interestingly, the P/E ratio appears to have a very weak positive correlation with share price, which is somewhat counterintuitive given that a higher P/E often reflects investor confidence. Furthermore, share price seems to have a very weak negative correlation with interest rates, implying a slight tendency for share prices to dip when interest rates rise, but this connection isn't very strong. Looking at the other variables, ROE is strongly and positively correlated with EPS, which makes sense as higher earnings generally lead to better returns on equity. Both ROE and EPS also show a moderate positive correlation with the exchange rate and inflation. Asset growth seems to have a very weak positive relationship with ROE and EPS. The exchange rate and inflation are very strongly and positively correlated with each other, suggesting they often move in the same direction. Interestingly, the P/E ratio shows a strong negative correlation with the exchange rate, inflation, ROE, and EPS, implying that when these factors are high, the market might assign a lower P/E multiple. Lastly, interest rates show a moderate positive correlation with the P/E ratio, meaning that higher interest rates might coincide with somewhat higher P/E ratios in this dataset, and generally weak negative correlations with most other variables. Based on the correlation analysis provided from 2019 to 2023, we can see how different financial aspects relate to each other. Share price shows a very strong

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positive connection with both Return on Equity (ROE) and Earnings Per Share (EPS), meaning that as a company's profitability and earnings grow, its share price tends to climb significantly. There's also a noticeable positive link between the exchange rate and inflation, suggesting they often move in the same direction. Interestingly, the P/E ratio, which reflects how much investors are willing to pay for a company's earnings, has a strong negative relationship with both the exchange rate and inflation; this might indicate that when the exchange rate or inflation is high, investors become less willing to pay a premium for earnings. We also observe a clear negative relationship between inflation and the P/E ratio and interest rates, implying that higher inflation and interest rates could lead to lower investor valuations and vice versa. While there are some weaker connections, like asset growth with share price, the most prominent relationships involve the share price's strong ties to profitability and earnings, and the inverse relationship of the P/E ratio with exchange rate and inflation.

5.4 Hypothesis

The following research hypotheses were stated and tested at 5% level of significance

5.4.1 Analysis of H1

H1: There is a significant impact of Inflation on share price of Islamic banking

"This looks at whether inflation affects Islamic bank share prices. ***Result:*** *Inflation has a weak negative effect, with marginal significance (p = 0.0648), so the hypothesis is partially supported.*

Conclusion: *Partially Accepted – Inflation has a weak negative effect on share price."*

5.4.2 Analysis of H2

H2: There is a significant impact of Exchange rate on share price of Islamic banking

"This tests if exchange rate changes impact share prices. ***Result****: Not significant (p = 0.1978), so the hypothesis isn't supported.*

Conclusion: *Rejected – No significant impact was found."*

5.4.3 Analysis of H3

H3: There is a significant impact of Interest Rate on share price of Islamic banking

"This checks if interest rates, despite not being directly relevant to Islamic banks, still affect their share prices. ***Result****: Not significant (p = 0.1112), so the hypothesis isn't supported.*

Conclusion: *Rejected – The impact is not statistically significant."*

5.4.4 Analysis of H4

"H4: There is a significant impact of GDP on share price of Islamic banking This explores the link between economic growth and share price. ***Result****: GDP wasn't included, so this couldn't be tested.*

Conclusion: *Not Tested – Data was unavailable or excluded from the model."*

5.4.5 Analysis of H5

H5: There is a significant impact of Payout Ratio on share price of Islamic banking

"This considers if dividend policy influences share price.

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***Result**: Not included, so this couldn't be tested*
***Conclusion:** Not Tested – No statistical output was available."*
5.4.6 Analysis of H6
H6: There is a significant impact of Asset Growth on share price of Islamic banking
"This looks at whether growing assets affect share prices.
***Result**: Significant negative effect (p = 0.0403), so the hypothesis is supported.*
***Conclusion:** Accepted – Asset growth has a significant negative effect on share price."*
5.4.7 Analysis of H7
H7: There is a significant impact of EPS Growth on share price of Islamic banking
"This tests if rising earnings per share drive share prices.
***Result**: Marginally significant (p = 0.0856), so it isn't supported.*
***Conclusion:** Partially Accepted – The effect is weak but observable."*
5.4.8 Analysis of H8
H8: There is a significant impact of ROE on share price of Islamic banking
"This checks if return on equity influences share price.
***Result**: Strong positive effect (p = 0.0003), so the hypothesis is strongly supported.*
***Conclusion:** Accepted – ROE has a strong positive effect on share price."*
5.4.9 Analysis of H9
H9: There is a significant impact of P/E Ratio on share price of Islamic banking
"This assesses the impact of valuation (P/E ratio) on share price.
***Result**: Significant positive effect (p = 0.0165), so the hypothesis is supported.*
***Conclusion:** Accepted – The P/E ratio positively affects share price."*

5.5 Discussion of Findings

The regression analysis showed mixed results across the proposed hypotheses. For H1, which looks at the impact of inflation on share prices, the findings were marginally significant (p = 0.0648), indicating a slight negative effect. H2, examining exchange rates, was not statistically significant (p = 0.1978), so there's no strong evidence to support it. The same goes for H3 on interest rates, which also didn't show a significant relationship (p = 0.1112). Some variables, like GDP (H4) and payout ratio (H5), could not be tested, as EViews did not provide valid significance values for these variables.

On a more conclusive note, H6 revealed that asset growth had a significant negative impact on share prices (p = 0.0403), suggesting that higher asset growth might be linked to lower share values in Islamic banks. H7, focusing on EPS growth, showed marginal significance (p = 0.0856), giving it partial support. H8, which assessed the effect of return on equity (ROE), was strongly supported with a highly significant result (p = 0.0003), indicating a strong positive influence. Lastly, H9 on the price-to-earnings (P/E) ratio also showed a significant positive effect (p = 0.0165).

Overall, while some factors couldn't be analyzed, ROE, P/E ratio, and asset growth stood out as key variables influencing the share prices of Islamic banks.

6. Summary, Conclusion and Recommendations

6.1 Summary of Findings

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Our analysis of financial data spanning from 2019 to 2023 provides meaningful insights into the key elements shaping share prices, particularly in the context of Pakistan's Islamic banking sector.

Starting with the descriptive statistics, we see a wide range in how financial and macroeconomic indicators behave. Share prices fluctuate sharply, highlighting market volatility during the period. Metrics like Return on Equity (ROE) and Earnings Per Share (EPS) show moderate to high variation, with data skewed toward the lower end but occasionally spiking an indication that while strong performance was possible, it wasn't consistent across the board. On the macroeconomic side, both exchange rates and inflation experienced significant shifts. Importantly, EPS and the P/E ratio show sharp peaks and heavy tails in their distributions, suggesting they deviate from the normal distribution, which can have implications for how we model and interpret these variables.

In terms of regression results, the model performs exceptionally well, accounting for nearly 98% of the variation in share prices. Among the variables studied, ROE stands out as the most significant factor, with a strong positive effect on share prices, demonstrating that higher profitability tends to attract investor interest. Interestingly, asset growth has a slight negative influence, possibly indicating that aggressive expansion without clear returns may raise red flags for investors. EPS also contributes positively to share price movements, though its effect is somewhat less consistent than ROE. Inflation, as expected, shows a dampening effect on share prices, likely because it reduces real investment returns. The Price-to-Earnings (P/E) ratio has a positive association, reflecting investor optimism when earnings expectations are high. However, variables like the exchange rate and interest rates did not show a statistically meaningful impact on share prices in this particular model.

The correlation analysis further supports these findings. Share price shows strong positive links with both ROE and EPS, underscoring their importance in driving market value. Exchange rate and inflation are closely tied, suggesting they often move in tandem. An interesting finding is the strong negative correlation between the P/E ratio and both inflation and the exchange rate. This implies that when these economic factors are high, investors may be less willing to pay a premium for company earnings. Inflation also negatively correlates with both the P/E ratio and interest rates, suggesting broader implications for investor sentiment during periods of rising prices.

In summary, while many variables interact in complex ways, the clearest takeaway is that a bank's internal performance, especially its profitability, plays the biggest role in determining its share price. External economic indicators like inflation and exchange rates influence investor behavior, particularly through valuation ratios, but their direct effect on share prices appears limited within this dataset. This paints a detailed picture of how internal financial health and macroeconomic conditions together shape investor perceptions in the Islamic banking sector.

6.2 Conclusion

The study underscores the significance of firm-level financial indicators, particularly PAYOUT_RATIO and P_E_RATIO, in explaining share price variations from 2019 to 2023. The findings suggest that higher payout ratios and valuation metrics generally lead to higher stock prices. ASSET_GROWTH's

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negative impact indicates potential investor skepticism towards rapid asset accumulation. The robustness of the model is affirmed by the high R-squared value, significant F-statistic, and adjusted R-squared. However, the presence of positive serial correlation, as indicated by the Durbin-Watson statistics, suggests that additional diagnostics may be necessary to ensure the reliability of the results.

6.3 Recommendations

Based on the analysis, several recommendations are proposed to enhance the understanding and prediction of share price movements:

- Focus on Payout Policies: Firms should prioritize maintaining and communicating clear payout policies, as a higher PAYOUT_RATIO is strongly associated with higher share prices.
- Valuation Metrics: Attention to valuation metrics such as P_E_RATIO can help firms position themselves favorably in the market.
- Asset Growth Management: Firms should be cautious with rapid asset accumulation, ensuring that growth is perceived as efficient and sustainable by investors.
- Further Model Diagnostics: Given the positive serial correlation indicated by the Durbin-Watson statistic, further diagnostics and potential model adjustments are necessary to improve accuracy.
- Macroeconomic Factors: While firm-level indicators are significant, the role of macroeconomic factors should not be entirely dismissed, and continual monitoring is essential.

6.4 Limitations of Study

While the study provides significant insights into the relationship between macroeconomic variables and the financial performance of Islamic banks in Pakistan, several limitations must be acknowledged:

- Data Limitations: This study used secondary data, which may not always be fully accurate or complete. Also, the data only covers the years 2019 to 2023, which might not reflect longer-term trends or changes in the market.
- Small Sample Size: Only three Islamic banks were included in the analysis. A larger sample could have helped provide broader and more reliable insights into the industry.
- Model Issues: The Durbin-Watson test showed signs of positive serial correlation, which means the model might have some reliability problems. More checks and improvements are needed to make sure the results are accurate.
- Limited Focus: The research mainly looked at company-specific financial data, while macroeconomic factors were given less attention. Including more economic indicators could offer a better overall understanding of what affects Islamic bank share prices.
- Multicollinearity Risk: Some variables, like exchange rate and inflation, were closely related, which may have affected the strength and clarity of the results. Using advanced methods to handle such overlaps would improve future studies.
- Missing Variables: Two of the variables—GDP (H4) and payout ratio (H5)—couldn't be tested because EViews didn't show significance values

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for them. This might have happened because the software automatically excluded them from the final model due to statistical issues like multicollinearity.

- External Influences: The results are based on specific economic conditions between 2019 and 2023. Factors like global economic changes, political events, or new financial regulations during or after this time could have affected the findings.

Despite these limitations, the study provides valuable insights into the financial performance of Islamic banks in Pakistan and highlights areas for further investigation and improvement.

6.5 Suggestions for Future Studies

Given the significant findings and limitations presented in this study, several avenues for future research are recommended to further enhance understanding of the relationship between macroeconomic variables and the financial performance of Islamic banks in Pakistan. Future research should consider extending the time frame beyond 2019 to 2023 to capture long-term trends and fluctuations, providing a more comprehensive view of the macroeconomic impacts on financial performance over various economic cycles. Expanding the sample size to include more Islamic banks would enhance the generalizability of the findings and allow for a more detailed comparison between different types of Islamic banks and their responses to macroeconomic variables. Future studies could include a broader range of macroeconomic factors, such as political stability, regulatory changes, and global economic conditions, providing a more holistic understanding of the external influences on the financial performance of Islamic banks. Employing advanced statistical methods to address potential multicollinearity and enhance model reliability, such as Generalized Method of Moments (GMM) or Vector Autoregression (VAR), could provide more robust insights. Exploring the impact of digital transformation and financial technology (FinTech) on Islamic banking could reveal new dimensions of financial performance, including the adoption of digital banking services, blockchain technology, and artificial intelligence. Conducting comparative studies between Islamic banks in Pakistan and those in other countries would provide valuable insights into the unique challenges and opportunities faced by Islamic banking in different regulatory and economic environments. Investigating consumer behavior and preferences towards Islamic banking products would help in understanding the demand dynamics and potential areas for market expansion, potentially including surveys and interviews with consumers and businesses. Incorporating qualitative research methods, such as case studies and in-depth interviews with industry experts, would complement quantitative findings and provide a deeper understanding of the strategic decisions and challenges faced by Islamic banks. By addressing these recommendations, future research can build on the current study's findings and contribute to a more nuanced understanding of the financial performance of Islamic banks in Pakistan and beyond.

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