

Inflation: An Economic Nightmare in Capitalism and the Monetary Policy in Islam as Its Solution

(Translated)

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Inflation has ceased to be merely a numerical phenomenon appearing in central bank bulletins; it has become one of the economic problems most closely linked to people's daily lives. The purchasing power of income declines, savings erode, and the cost of food, housing, energy, and services rises. Those with fixed incomes find themselves facing an economic reality harsher than the one reflected by abstract figures. Consequently, monetary policy has gained a central position in managing the modern economy. The state bank now raises or lowers interest rates, alters credit and liquidity conditions, and intervenes in financial markets, all with the aim of influencing demand, prices, and growth.

The dominant contemporary capitalist view, in its prevalent form, is based on the relative independence of central banks and the targeting of price stability, and in many economies, on a specific inflation target close to 2%. This is clearly evident in the policy of the European Central Bank, which states that price stability is achieved by targeting an inflation rate of 2% in the medium term, and uses interest rates and other tools to achieve this. The dominant economic discourse also acknowledges that inflation may arise from excessive monetary expansion, supply shocks, rising energy costs, or increased demand.

However, Islam does not view the monetary problem as separate from the nature of the economic and political system within which money, property, production, and distribution are organized. It addresses the subject of money, currency exchange, the gold standard, money issuance, and exchange rates within a single system, and it establishes gold and silver as the basis for the Islamic monetary system. It emphasizes that inflation is not merely a cyclical flaw that can be treated by raising or lowering interest rates; rather, inflation is fundamentally linked to the fiat paper monetary system and the detachment of currency from a fixed material value.

The Concept of Inflation and the Status of Monetary Policy

Inflation, in the general economic definition, is a sustained rise in the general price level that leads to a decrease in the purchasing power of a monetary unit. It does not refer merely to the rise in the price of a single commodity, as the price of a good may rise due to a crop failure or a disruption in supplies without that constituting general inflation in the aggregate sense.

Recent economic research points to multiple sources of inflation. The International Monetary Fund distinguishes between inflation resulting from monetary expansion that outpaces economic growth, demand pressures, and supply shocks along with rising production and energy costs. This distinction is important because it shows that inflation cannot always be explained by a single factor. Additionally, the European Central Bank noted in 2026 that rising energy prices caused by war and geopolitical turmoil can spill over into the prices of goods and services, affecting core inflation and price expectations.

This is where monetary policy comes in. When the central bank sees that inflation is persistently high, it can raise interest rates; this makes borrowing more expensive, which weakens certain forms of spending and investment, thereby reducing pressure on demand. The opposite occurs when interest rates are lowered, as financing becomes cheaper, leading to increased borrowing, investment, and consumption, which can support economic activity when inflation is low and demand is weak.

The transmission mechanism can be simplified as follows:

Higher interest rates → higher borrowing costs → decrease in some forms of consumption and investment → decline in aggregate demand → reduced price pressures.

However, this mechanism is not magical. If inflation is primarily caused by a shortage of energy or food or disruptions in supply chains, raising interest rates does not produce oil, open ports, or increase crops. Therefore, central banks are forced to balance between the goal of price stability and the risk of weakening economic activity and employment.

The Capitalist Interpretation of Inflation

There is no single “capitalism” in all its details, but the dominant economic school within contemporary capitalist economies deals with inflation as a problem that can be managed through a mix of monetary, fiscal, and supply-side policies. Central banks consider price stability a primary goal, while using interest rates, liquidity management, and communication with the markets to guide the expectations of households and companies.

The International Monetary Fund (IMF) offers a complex explanation: prolonged periods of high inflation can result from an accommodative monetary policy, when the money supply grows faster than the economy's capacity to produce goods and services; at the same time, supply shocks, such as rising oil prices, can drive up prices, and an increase in demand due to expansionary policies can also create price pressures.

This means that the capitalist remedy is not confined to a single tool. In the case of demand-pull inflation, interest rates are an important tool. In the case of a supply shock, the state may need to address bottlenecks in production, energy, and supply chains, and it may use fiscal or regulatory measures. This was evident in the European Central Bank's statements during 2026, when the bank linked the rise in inflation to the energy shock resulting from the war, while simultaneously using interest rates to anchor medium-term inflation expectations.

However, this treatment faces a fundamental paradox: the monetary tool that curbs inflation may harm economic activity. Raising interest rates reduces demand, but it also increases the cost of financing for households, companies, and governments. If the economy is already suffering from weak production, the treatment for inflation could turn into a treatment for demand at the expense of investment and employment.

Islam's Refutation of the Capitalist Monetary System

The issue of currency holds a fundamental status within the Islamic economic system. Money, the gold standard, the benefits of the gold standard, paper currency, currency issuance, and exchange rates are all fundamentals and matters pertaining to the state's economy. The idea that currency is not merely paper upon which the state places a name and a legal value, but rather must be linked to a monetary basis of gold and silver, is one of the fundamental rulings in monetary policy that constitutes a radical solution to many economic problems.

Thus, Islam made gold and silver the basis for currency, while permitting the use of other means of exchange provided they represent a known quantity of gold or silver—not as a fiat currency separate from a fixed material basis. As for contemporary fiat currencies, their strength depends on the issuing authority and confidence in the monetary system, which is one of the causes of monetary instability.

For example, the deeper cause of the inflation occurring after the Ukrainian war can be attributed to the exposed monetary system, which is not based on intrinsic value or a fixed foundation of goods and services, in addition to global monetary floating and the possibility of expanding money issuance.

From the Islamic perspective, the problem does not begin when the price index rises, but before that: it begins when the issuance of currency becomes a flexible tool in the hands of the state and the banking system, and the money supply can be expanded without a strict

material constraint. At that point, a separation can arise between the quantity of money and the real economy, causing the purchasing power of the currency to decline.

Interest and Credit in the Capitalist Vision and the Islamic Perspective

Modern monetary policy relies heavily on the interest rate. Interest is a tool to control the cost of borrowing, thereby influencing demand and investment. During times of inflation, raising interest rates is one of the most common measures taken. In June 2026, the European Central Bank raised interest rates by 25 basis points, justifying this move by citing inflationary pressures related to energy and war, while affirming its goal of stabilizing inflation at 2% in the medium term.

However, Islam views interest from a different legal and economic perspective; interest (ربا *riba*) is forbidden in Islam, and therefore, Islamic monetary policy cannot be built upon a usurious interest rate. In the Islamic economic conception, monetary dealings must be based on the rulings governing currency exchange, gold, and silver, and usury is prohibited in loans and financial transactions.

Herein lies the fundamental difference: Capitalism uses interest as a tool to manage the economic cycle, whereas the Islamic system abolishes interest at its root and seeks to manage economic activity by regulating property, currency, spending, production, and trade—not through a usurious interest rate.

Monetary Policy: Between Managing Inflation and Managing the Economic System

One of the most significant points of disagreement lies in the very definition of the problem. The capitalist central bank sees its primary task as achieving price stability, and thus it sets a numerical target and adjusts its tools to reach it. In contrast, Islam views the treatment of inflation as not merely targeting a price index, because rising prices may be the result of deeper imbalances in the structure of the economic system.

Herein lies the difference between “managing the phenomenon” and “removing the cause.” A central bank may be able to reduce inflation by raising interest rates, but this does not necessarily mean it has removed the causes of the fragility of the monetary system, debt, speculation, or international imbalances. Conversely, treating a supply shock with monetary policy alone may be of limited effectiveness.

Why Does Islam Not View Inflation as Solely a Monetary Problem?

It is because Islam does not approach the economy from the perspective of it being merely monetary figures, but instead from the “economic policy” that defines the state’s relationship with ownership, production, and distribution. The fundamental economic problem is not the scarcity of goods and services, but the distribution of wealth and enabling people to satisfy their needs.

This changes the perspective on inflation. If prices rise while incomes remain fixed, the harm is not equal among people. A person with substantial financial wealth may be able to absorb the price increases, while the worker and the person with a limited income are harmed to a greater extent. Consequently, distributive justice becomes part of the solution to the economic crisis.

Thus, the Islamic economic system links the three types of property—private property, public property, and property of the state—with economic balance in society. Moreover, Islam makes the fulfillment of people’s basic needs one of the objectives of the state’s economic care.

Therefore, the solution is not limited to restoring the value of the currency; rather, it includes regulating the ownership of public resources, preventing monopoly, applying the rules of Zakat and public spending, and managing wealth in a manner that achieves the fulfillment of basic needs.

Gold and Silver, as a Monetary Solution, Were Mandated by Shariah Law

Gold and silver represent the cornerstone of the Islamic conception; thus, the primary currency is to be gold and silver, and paper money can exist as a substitute for them. The evidence for this is that gold dinars and silver dirhams existed before Islam, coming from the Romans and Persians, and Islam did not begin by inventing them anew. Instead, the Prophet (saw) gave consent (إقرار iqraar) for their use in transactions, and the use of the dinar and dirham continued in the Islamic State until Islamic coinage was minted independently during the era of Khaleefah (Caliph) Abdul Malik bin Marwan. The Prophet (saw) made gold and silver the subject of rulings regarding exchange (ṣarf), interest (riba), and Zakat, considering them to be prices, i.e., monetary standards, and therefore they are not merely two ordinary commodities within the Islamic financial system. It is narrated from 'Ubadah bin As-Samit (ra) that the Prophet (saw) said: «الذهب بالذهب، والفضة بالفضة... مثلاً بمثل، سواء بسواء، يداً بيد» **“Gold for gold, silver for silver... equal for equal, measure for measure, hand to hand.”**

A gold-based monetary system achieves a greater degree of monetary stability and limits the ability of governments and central banks to issue currency without a physical constraint. Furthermore, the stability of the monetary base helps stabilize exchange rates and foreign trade.

And this is not merely a technical proposal to treat inflation, but rather it is part of a comprehensive political legislative system: changing the nature of money means changing the state's relationship with financing, the banks' relationship with credit, international trade's relationship with currencies, and the limits of the state's capacity for monetary expansion.

Islam's perspective does not rely on “the central bank reducing the money supply,” but rather mandates a transition to a fundamentally different monetary system.

Does Gold Prevent Inflation Absolutely?

The gold standard prevents a fundamental type of inflation that results from the uncontrolled issuance of currency. However, the modern economy shows that prices can rise for other reasons, such as wars, disasters, production shortages, changes in transportation and energy costs, taxes, and market imbalances. Therefore, the issue should not be framed in an oversimplified manner that claims “gold prevents all price increases.” A more accurate formulation is that making gold the basis for currency imposes a constraint on monetary issuance and limits the ability of the monetary authority to increase the money supply independently of a physical asset.

This differs from the system of fiat currencies, where monetary authorities can manage liquidity using more flexible methods. This flexibility is simultaneously a source of strength in crisis management and a source of danger if misused.

Capitalism: Between Monetary Flexibility and the Debt Problem

From the perspective of its proponents, one of the strengths of the capitalist monetary system is its ability to respond to crises. When a severe recession occurs, the central bank can lower interest rates, provide liquidity, and purchase assets, and the government can increase public spending. Modern economies have employed these tools during multiple crises.

But the other hidden aspect is the accumulation of debts. Cheap credit can lead to a massive expansion in borrowing, causing asset, real estate, and stock prices to inflate. Then problems emerge when interest rates are raised or when liquidity contracts. The usurious capitalist financial system generates recurring crises, and treating a crisis with the tools of the very same system may postpone the problem rather than uproot it.

However, according to the Shariah rulings of Islam, the prohibition of interest is not a separate, isolated ruling detached from the economic system; instead, it is part of a comprehensive framework that prevents certain forms of financial exploitation and redirects activity toward the real economy.

Direct Comparison Between the Two Narratives

The differences can be summarized in five main areas:

Definition of the Problem: The dominant capitalism views inflation as a general and sustained rise in prices that requires controlling its expectations and its monetary, demand, and supply sources. Islam, however, attributes it, to a greater degree, to the nature of the paper monetary system and to the imbalances of the capitalist economic system.

The Instrument of Treatment: Capitalism relies on interest rates, liquidity management, communication with markets, fiscal policy, and supply-side policies. In contrast, the Islamic perspective prohibits usurious interest and relies on a monetary system based on gold and silver, along with regulations for ownership, spending, and trade.

Money Issuance: In the capitalist system, monetary authorities possess broad scope to manage the supply of money and credit. In the Islamic system, the issuance of currency is restricted by gold and silver, which limits monetary expansion not linked to a physical asset.

The Function of the State: Under Capitalism, the function of the state varies according to the economic school and the specific state, but the central bank focuses primarily on monetary stability, while vast sectors are left to the market. Under the Islamic system, the state is a guardian (راعية raa'iyah); it manages assets of public property and ensures the fulfillment of basic needs, all within the rulings of the Shariah.

The Ultimate Solution: Capitalism typically seeks to reform monetary and fiscal policy within the existing system. However, Islamic Shariah holds that partial reform is insufficient, and that the solution requires a complete change of the ruling system and the implementation of the Islamic economic system.

Inflation and the High Cost of Living from a Political Perspective

Inflation cannot be understood in isolation from international politics. Currency is not merely a means of domestic payment; it is part of the international power structure. Although currency has shifted from the gold standard to paper currencies, its value has become tied to the influence of major powers. The current dominance of the US dollar over the international monetary system is the greatest evidence of this.

In contrast, capitalist economies see that flexible paper currencies allow for absorbing external shocks, facilitating international trade, and managing crises. However, the dominance of a single international currency grants the issuing state significant political and financial advantages and influences global energy prices, trade, and finance.

Hence, the issue of inflation becomes a matter of independence as well: Who has the authority to issue currency? Who sets the interest rate? Who bears the impact of currency devaluation? And who benefits from the global financial system?

Critique of the Capitalist Approach from Within Its Own Reality

It is not correct to say that capitalist monetary policy “does not work” at all; raising interest rates can reduce demand and inflation, and central banks have succeeded in returning inflation toward their targets during various periods. Moreover, targeting inflation provides a clear framework for expectations.

However, the problem arises when the causes of inflation are beyond the scope of monetary policy. If energy prices rise due to war or a supply shortage, raising interest rates does not increase the quantity of energy. If supply chains are disrupted, interest rates do not produce the missing goods. This is why central banks themselves acknowledge the existence of supply shocks and use monetary policy cautiously to avoid turning a temporary shock into persistent inflation. Furthermore, high interest rates have a social cost: higher loan installments, reduced investment, a weak real estate market, and an increased debt service burden.

The Islamic Solution to the Crisis of Inflation

The solution offered by Islam's system is internally coherent, as it constitutes an integrated system: a currency of gold and silver, the prohibition of interest, the organization of ownership of property, the protection of public property, the state's management of assets of public property, and the realization of economic equity. Someone may ask: How can we transition from the current system of paper currencies to a gold-based system? And how can long-term investment be financed without interest? We say: The transition from the compulsory paper monetary system to a system of gold and silver is not merely a matter of replacing existing banknotes with gold coins. Instead, it is achieved by rebuilding the monetary system on the basis of gold and silver, linking the issuance of currency to metallic backing, while addressing the existing currency upon the establishment of the Islamic State through a mechanism that preserves the rights of its holders. The state does not view the required quantity of gold as merely a reserve against all forms of the modern money supply, but instead as the very basis for issuing currency and preventing uncontrolled monetary expansion. On the international level, the return to gold and silver serves as a means to end dependency on dominant currencies, especially the dollar, and to establish more stable exchange rates.

As for investment, the state does not see that the absence of imposing interest on loans leads to stalling development. Instead, it replaces usurious financing with forms of investment, trade, company partnership including *mudharabah* (مصاربة capital and working partner association), and *ijarah* (leasing), whereby the return is linked to real economic activity. And in times of crises, the state does not rely on issuing uncovered money to provide liquidity, but rather on the state's resources, the *Bait ul-Mal* (بيت المال state treasury), gold and silver, and legitimate financing. This prevents turning the treatment of a liquidity crisis into a more severe inflationary crisis.

Contemporary capitalism possesses innovative tools for managing inflation: interest rates, liquidity management, inflation targeting, fiscal policy, and supply-side policies. These tools have proven their ability to influence demand, expectations, and prices, but they do not always have control over supply shocks, energy, wars, and structural imbalances. Furthermore, treating inflation within the capitalist system does not eradicate it at its roots, because the monetary system itself is built on fiat currencies, interest, credit, and monetary expansion. In contrast, the Islamic system offers a comprehensive framework comprising a monetary system based on gold and silver, the abolition of interest, the regulation of public and private ownership, and directing the state toward guaranteeing basic needs and achieving economic balance. It views inflation not merely as a technical issue for the central bank alone, but as a matter of independence, system, and state. In this conception, currency is not merely a medium of exchange, but instead a part of the structure of the state's economic and political power. Therefore, the real cure begins by changing the monetary and economic foundation that produces imbalance and instability, replacing it with a comprehensive Islamic economic system.