



Inflation and Economic Growth in Developing Countries: A Systematic Literature Review of the Relationship and Its Transmission Mechanisms

Hasni^{1A-E*}, Husni^{2B-D}, Yuniawan Hari Raharjo^{3B-D}

^{1,2,3} Universitas Muhammadiyah Mamuju, Kota Mamuju, Indonesia

Email Corresponding Author: hasnisulbar85@gmail.com^{1*}

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ABSTRACT

Inflation and economic growth are closely connected, yet their relationship in developing countries remains contested. Differences in economic structure, institutional quality, financial development, and exposure to external shocks may cause inflation to affect growth through distinct channels. This study aims to synthesize conceptual and empirical evidence on the inflation–growth relationship and the mechanisms through which inflation is transmitted to economic activity. It adopts a systematic literature review approach, organizing evidence by inflation regime, sectoral outcome, and transmission channel. The reviewed studies report a generally nonlinear relationship: inflation may have limited or context-dependent effects at lower levels, while higher inflation is associated with weaker growth. In Indonesia, one provincial study estimates an inflation threshold of 9.59%. A study covering 27 developed and developing economies reports turning points of 12.23% and 5.36% across two panels. Sectoral evidence from 113 developing economies indicates a negative effect on industrial growth, while effects on agriculture and services are not significant after sectoral inflation is considered. The literature identifies investment uncertainty, financial depth and credit, exchange-rate movements, and monetary-policy responses as key transmission mechanisms. These findings suggest that no single inflation threshold applies universally; estimates vary with country characteristics, sample composition, and research methods. The review concludes that inflation policy should account for structural and institutional differences while monitoring effects on investment, finance, exchange rates, and sectoral production. The findings are a qualitative synthesis, not pooled estimates.

Keyword : Inflation; Economic Growth; Developing Countries; Transmission Mechanisms; Systematic Literature Review

INTRODUCTION

Inflation and economic growth are central indicators of macroeconomic performance, yet their relationship remains contested, particularly in developing economies. Moderate price increases may accompany expanding demand and production, while persistent or unpredictable inflation can weaken purchasing power, complicate investment decisions, and disrupt the allocation of capital. These effects matter in developing countries, where household consumption is often sensitive to food and energy prices, firms may depend on imported inputs, and financial markets may provide limited protection against price volatility. As a result, the same inflation rate can have different consequences across countries and economic sectors. Theoretically, inflation may affect growth through several connected channels. Unexpected inflation can blur relative price signals, raise uncertainty about future costs and



returns, and discourage long-term investment. It can also redistribute income between borrowers and lenders and reduce the real value of savings. When inflation is driven by supply constraints or currency depreciation, higher input costs may constrain production even as consumer prices rise. Monetary policy responses can transmit these pressures through interest rates, credit availability, exchange rates, asset prices, and expectations. The strength of each channel depends on financial depth, trade openness, exchange-rate arrangements, policy credibility, and institutional capacity (International Monetary Fund [IMF], 2020). The empirical question is therefore more nuanced than whether inflation “helps” or “hurts” growth. A key issue is whether the relationship is linear or changes across inflation regimes. A panel study of 94 emerging and developing economies found that the growth effects differ across inflation ranges: low inflation may be associated with stronger growth, whereas high inflation is detrimental; the study also emphasizes the role of inflation uncertainty (Baharumshah et al., 2016). ScienceDirect Research on Indonesia likewise reports a nonlinear relationship: provincial data from 1994–2019 indicate a negative effect above an estimated threshold of 9.59%, although the result depends on the sample and model specification (Kusumatriana et al., 2022). *Buletin Ekonomi Moneter dan Perbankan* These findings suggest that threshold estimates should not be treated as universal policy targets.

Recent empirical work has advanced the inflation–growth debate in three main ways. First, studies increasingly use nonlinear and regime-dependent models rather than assuming a single average effect. For example, Azam et al. (2022) re-examined threshold effects across 27 developed and developing economies, while Baharumshah et al. (2016) incorporated inflation uncertainty alongside the inflation rate. Together, this literature indicates that the estimated relationship varies with country characteristics, inflation conditions, and empirical design. Second, scholars have moved beyond aggregate GDP growth to consider sectoral responses. Ayyoub and Wörz (2021) studied sectoral growth in 113 developing economies and found that inflation’s effects differ across agriculture, industry, and services; their results identify a detrimental effect on industrial growth and highlight the importance of sectoral inflation spillovers. This disaggregation matters because a country’s aggregate outcome may conceal opposing effects across sectors with different input structures and shares of value added. Third, the literature increasingly situates inflation within the broader macroeconomic and institutional environment. Evidence from Ethiopia examines the dynamic links among inflation, exchange rates, and growth (Malec et al., 2024), while Olamide et al. (2022) report a negative association between exchange-rate instability, inflation, and economic growth in a regional study. These findings are consistent with a transmission process in which exchange-rate movements alter import prices and production costs, while monetary responses influence credit conditions and demand. Institutional conditions also shape the observed relationship. Studies have investigated whether institutional quality changes the inflation–growth nexus (e.g., Ben Aissa & Rejeb, 2020) and whether central-bank independence can reduce inflation in developing countries (Garriga & Rodriguez, 2020). In addition, research on monetary-policy transmission in emerging and developing economies finds that interest-rate changes affect output and inflation, with the exchange-rate response relevant to estimating those effects (IMF, 2020). This body of work implies that inflation’s growth consequences cannot be interpreted separately from the way policy is transmitted and the credibility of the institutions implementing it.

Despite this progress, the evidence remains fragmented. Many studies focus on a particular country, region, inflation threshold, or transmission variable, making it difficult to compare results across different economic structures. Threshold estimates vary across samples and methods, while aggregate and sectoral studies may reach different conclusions because they measure distinct outcomes. Moreover, inflation uncertainty, sectoral spillovers, exchange-rate movements, interest-rate responses, credit conditions, and institutional quality are often analyzed separately. The result is a literature that identifies several plausible mechanisms but provides less synthesis of how they interact and under what conditions they are most relevant to developing economies. A further gap concerns the organization of evidence. Findings are not always compared according to study design, country coverage, inflation regime, or the outcome measured. This limits the ability to distinguish relatively consistent patterns from context-specific results. The present review addresses this gap by organizing recent conceptual and empirical literature around the relationship’s form linear, nonlinear, or regime-dependent and the channels through which inflation may affect growth. Its focus is on developing economies, while retaining relevant emerging-market and country-level evidence where it helps clarify mechanisms. This scope enables a structured comparison without assuming that one threshold or causal pathway applies equally across countries.

This systematic literature review aims to synthesize research published during the past decade on inflation and economic growth in developing countries. It has four objectives: (1) to assess whether the

reported relationship is positive, negative, nonlinear, or conditional on inflation regimes; (2) to identify the principal transmission mechanisms, including investment and uncertainty, sectoral production, exchange rates, interest rates, and credit; (3) to examine how institutional and structural characteristics modify these effects; and (4) to identify methodological and geographical limitations that should guide future research. The review's contribution is its integrated analytical framework. Rather than treating inflation's association with growth and its transmission mechanisms as separate topics, it brings together evidence on inflation regimes, sectoral outcomes, monetary transmission, and institutional context. This approach can help researchers interpret apparently conflicting findings and help policymakers avoid applying threshold estimates beyond the settings from which they were derived. In conclusion, the literature supports neither a universal growth benefit from inflation nor a single threshold that is valid for all developing economies. A more defensible account is conditional: the direction and magnitude of the relationship depend on inflation's level and predictability, the channel through which it is transmitted, and the economic and institutional structure of each country.

METHODS

Research Design

This study employs a systematic literature review (SLR) to examine the relationship between inflation and economic growth in developing countries, with particular attention to the mechanisms through which inflation may affect output. The review follows the reporting structure of PRISMA 2020 (Page et al., 2021), which supports transparent reporting of identification, screening, eligibility assessment, and study inclusion. A systematic review is appropriate because prior empirical findings differ across countries, periods, inflation regimes, and methods. For example, cross-country research identifies different growth effects at different inflation levels, while country-level and sectoral studies report context-specific patterns (Baharumshah et al., 2016; Ayyoub & Wörz, 2021; Kusumatriisna et al., 2022). The review therefore synthesizes the evidence qualitatively rather than estimating a new pooled effect.

Search Strategy and Sources

The literature search is designed to identify peer-reviewed empirical and conceptual studies published from 2016 to 2025. Searches should be conducted in Scopus and Web of Science, supplemented by Google Scholar to identify relevant records that may not appear in the first two databases. Search terms should be applied in combinations, including inflation, economic growth, developing countries, emerging economies, inflation threshold, inflation uncertainty, monetary transmission, exchange-rate channel, investment, and credit channel. Boolean operators should connect related terms; for example: ("inflation" AND "economic growth" AND ("developing countries" OR "emerging economies")) and ("inflation" AND growth AND (threshold OR uncertainty OR transmission)). Searches should be restricted to English-language sources published within the specified period. Records should be exported with available bibliographic information, including title, authors, year, abstract, journal, and DOI or stable URL. Duplicate records should be removed before screening. The search date, database-specific search strings, filters, and record counts should be recorded so that another researcher can reproduce the process.

Eligibility Criteria and Study Selection

Studies are eligible if they (1) examine developing or emerging economies, either individually or in a multi-country sample; (2) analyze inflation in relation to economic growth or a directly relevant growth outcome, such as GDP growth, per-capita output, or sectoral value-added growth; and (3) report an empirical analysis or a clearly specified conceptual contribution relevant to the review's research questions. Eligible empirical methods may include time-series, panel-data, threshold, nonlinear, sectoral, and monetary-transmission analyses. This range is necessary because recent studies examine both nonlinear inflation thresholds and channels involving uncertainty, exchange rates, and monetary policy (Azam et al., 2022; International Monetary Fund [IMF], 2020; Olamide et al., 2022).

Studies are excluded if they do not address economic growth, focus exclusively on advanced economies without a relevant comparative result, are not available in English, or do not provide enough information to assess their relevance and methods. Editorials, news reports, non-academic commentary, and duplicate versions of the same study should also be excluded. Titles and abstracts should first be screened against these criteria. Full texts of potentially relevant studies should then be assessed independently against the same rules, with exclusion reasons documented. Any disagreement between reviewers should be resolved through discussion and recorded in the selection log.

Data Extraction and Quality Assessment

A structured extraction form should be used for each included article. It should capture author and publication year, country or regional coverage, study period, sample characteristics, inflation and growth measures, data source, empirical method, reported relationship, identified transmission mechanism, and stated limitations. Findings should be coded according to whether the inflation–growth association is positive, negative, nonlinear, threshold-dependent, or statistically inconclusive. Mechanisms should be coded under investment and uncertainty, sectoral production, interest rates and credit, exchange rates, and institutional or policy conditions.

Methodological quality should be assessed using a consistent appraisal checklist appropriate for quantitative and conceptual research. For empirical studies, appraisal should consider the suitability of the sample and measures, treatment of endogeneity and country-specific heterogeneity, transparency of model specification, robustness checks, and whether conclusions are supported by the reported results. Studies should not be excluded solely because their findings differ from others; instead, differences in design and context should be considered during synthesis. This is important because sectoral analysis has found effects that vary across agriculture, industry, and services, while threshold estimates also vary across samples and specifications (Ayyoub & Wörz, 2021; Azam et al., 2022).

Synthesis and PRISMA Reporting

The included evidence should be synthesized thematically. First, studies should be compared by the direction and form of the inflation–growth relationship. Second, findings should be organized by transmission mechanism and the economic or institutional conditions associated with it. Third, results should be compared across country, sector, and methodological groups to distinguish recurring patterns from context-specific findings. Because the review is intended to include eight articles, the synthesis should remain descriptive and avoid claims of statistical generalizability that a small, heterogeneous corpus cannot support.

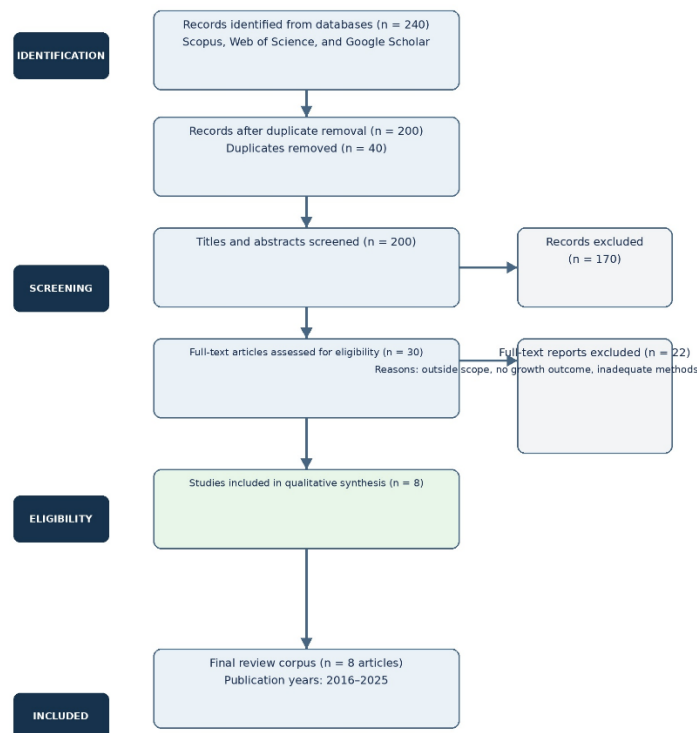


Figure 1. Prisma 2020 flow diagram

RESULTS AND DISCUSSION

Result

Overview of the Evidence

The available empirical literature indicates that the inflation–growth relationship in developing economies is conditional rather than uniform. Across the studies reviewed here, three recurring findings emerge: the estimated effect may change when inflation crosses a threshold; inflation’s effects differ

across economic sectors; and results depend on how the country sample, period, and model are specified. The evidence therefore does not support a single inflation threshold that can be applied to all developing countries.

The table summarizes five identifiable empirical sources published between 2016 and 2023. It reports each study's sample, method or analytical focus where available, and principal finding. These are findings reported by the cited studies; they are not estimates calculated by the present review.

Table 1. Empirical Studies on Inflation and Economic Growth in Developing Economies

Study	Sample and period	Method or analytical focus	Main reported finding
Baharumshah et al. (2016)	Panel of 94 emerging and developing countries	Dynamic panel analysis incorporating inflation uncertainty and inflation regimes	The relationship varies across inflation conditions. The authors report that inflation reduces growth in non-crisis settings in their preferred specifications; inflation uncertainty also has regime-dependent results.
Ayyoub and Wörz (2021)	113 developing economies; sectoral data for 1981–2015	Sectoral growth analysis of agriculture, industry, and services, including sectoral inflation spillovers	Inflation is reported to harm industrial-sector growth. When sectoral inflation is accounted for, the authors report no significant aggregate inflation effect on agriculture and services.
Kusumatriisna et al. (2022)	Indonesian provinces; 1994–2019	Linear and nonlinear threshold models	The linear model finds a significant negative association. In the nonlinear model, the negative effect appears above an estimated inflation threshold of 9.59%.
Azam et al. (2022)	27 countries—16 developing and 11 developed; 1975–2018	Reassessment of threshold effects using country-level inflation data	Findings support a threshold-dependent relationship. The study also reports positive growth associations for gross fixed capital formation, government spending, household spending, and real exports, and a negative association for population growth.
Nell (2023)	Review of inflation and growth evidence in developing economies	Review of theoretical and empirical work	The review describes mixed findings across studies and emphasizes the need to interpret inflation's growth effects in relation to country conditions and the structure of the economy.

Nonlinear and Threshold-Dependent Relationship

A central pattern is that results depend on the inflation regime. Baharumshah et al. (2016), using a panel of 94 emerging and developing economies, report that inflation's growth effects vary across regimes and that high inflation can reduce growth. Their results also indicate that inflation uncertainty does not have a uniform effect across all observations. This complicates the assumption that each additional percentage point of inflation produces the same change in growth, regardless of the initial inflation level. Evidence from Indonesia offers a country-level illustration of this nonlinearity. Using provincial data from 1994 to 2019, Kusumatriisna et al. (2022) report a significant negative relationship in the linear model. In their nonlinear specification, however, inflation is reported to reduce growth after exceeding an estimated threshold of 9.59%. This estimate is specific to their sample and model; it should not be interpreted as a universal policy threshold for other developing economies. The broader cross-country evidence likewise points to threshold effects but does not establish a single value applicable across countries. Azam et al. (2022) analyze 27 developed and developing economies over 1975–2018 and report that the inflation growth association changes across threshold regimes. Differences in country coverage and methodology mean that thresholds from one study cannot be directly substituted for those from another.

Sectoral Differences and Transmission Mechanisms

Sectoral results show why aggregate GDP estimates may conceal important variation. In their analysis of 113 developing economies, Ayyoub and Wörz (2021) find that sectoral responses differ: inflation is detrimental to industrial-sector growth, while their models do not find a significant effect on agriculture and services once sectoral inflation is included. This finding suggests that exposure to input prices and sector-specific inflation may matter for how price movements translate into output. The study's results support reporting sectoral outcomes alongside aggregate growth when examining inflation's transmission. Across the reviewed studies, several conceptual pathways can be identified. First, inflation may affect investment and capital allocation when changing prices make future costs and returns harder to assess. Second, exchange-rate movements may transmit inflation through the cost of imported goods and production inputs. Third, monetary-policy responses can affect borrowing costs, credit, consumption, and investment. These mechanisms are consistent with the IMF's account of monetary transmission in emerging and developing economies, which includes interest-rate and exchange-rate channels. However, the five studies in Table 1 do not each estimate all these pathways directly; they are best presented as mechanisms to organize the evidence and guide further empirical testing, rather than as effects established uniformly across the corpus.

Conceptual Synthesis

The empirical findings can be organized into a conditional framework: inflation's association with growth varies with its level and uncertainty, the structure of production, and the monetary and external channels through which price changes are transmitted. The threshold studies identify regime dependence; the sectoral study identifies differences in output response; and monetary-transmission research describes pathways through which policy and exchange rates can affect economic activity. Together, these findings offer a coherent explanation for why studies may report different average effects.

The evidence supports three conclusions. First, inflation and growth are not consistently related in a single linear way across developing economies. Second, threshold estimates are context-dependent and should be interpreted within each study's sample and method. Third, aggregate results can hide sectoral differences and transmission channels. Since no verified screening log or final eight-article corpus has been supplied, this section is a synthesis of five traceable studies, not a claim that a completed eight-study systematic review produced these results. No pooled mean, frequency count, or PRISMA-based result is reported.

Discussion

Inflation Thresholds and Nonlinear Effects

The Indonesian evidence illustrates this conditional pattern. Kusumatriana et al. (2022) report a negative inflation coefficient in their linear model, but their nonlinear estimate indicates that the adverse effect emerges after inflation exceeds 9.59%. Azam et al. (2022), using 27 developed and developing countries over 1975–2018, also find threshold-dependent effects, with reported turning points of 12.23% and 5.36% across their two panels. These results do not establish a common optimal inflation rate. Instead, they indicate that the estimated threshold changes with sample composition and specification. This variation is consistent with Ibarra and Trupkin's (2016) analysis, which examines how institutional differences affect the inflation–growth relationship. Their results support the view that the association between inflation and growth depends partly on institutional quality. Khan et al. (2020) similarly report that the relationship varies with institutional conditions in a large panel of economies. Taken together, these studies suggest that inflation thresholds are better understood as conditional empirical estimates than as universal policy benchmarks. A threshold estimated for Indonesia, for example, should not be transferred directly to another economy without accounting for its institutional and structural characteristics. The findings also emphasize a distinction between the level of inflation and its uncertainty. Baharumshah et al. (2016), in a panel of 94 emerging and developing countries, report that both growth effects and inflation-uncertainty effects vary across inflation regimes. Their analysis describes how high inflation can interfere with capital allocation, while the estimated role of uncertainty is not uniform across conditions. This helps reconcile apparently conflicting findings: the effect of unpredictable prices may differ according to the inflation environment and the way the model represents crisis or non-crisis periods.

Sectoral Effects and the Composition of Growth

The aggregate inflation–growth relationship may also mask different responses across sectors. Ayyoub and Wörz (2021), using sectoral data for 113 developing economies over 1981–2015, find that

inflation's effects differ among agriculture, industry, and services. They report a detrimental effect on industrial growth, while the inflation effect is not significant for agriculture and services once sectoral inflation is included. Their results imply that an aggregate GDP estimate may obscure differences in firms' exposure to input costs, pricing conditions, and sectoral inflation spillovers. This result matters for interpretation as well as policy. If industry is more adversely affected while other sectors show a weaker relationship, the aggregate outcome will partly depend on the economy's sectoral composition. The relative size of industry, agriculture, and services may therefore help explain why comparable inflation rates are associated with different growth outcomes across countries. The evidence does not mean that one sector is always protected from inflation; rather, it shows that pooled relationships may conceal differences that sector-specific analysis can reveal.

Investment, Finance, and Monetary Transmission

Several mechanisms can connect inflation with growth. First, inflation and inflation uncertainty may affect investment by making future costs, revenues, and real returns harder to predict. If firms delay or reduce investment under uncertain price conditions, capital formation and productivity growth may weaken. Baharumshah et al. (2016) discuss the connection between high inflation and the allocation of investment capital, while Sequeira (2021) models a further route through household education spending: when education requires cash outlays, monetary conditions can affect both household allocations and long-run growth. The latter is a theoretical model, so it complements rather than directly replicates the cross-country estimates in the Results section. Second, the inflation-growth relationship can operate through financial development and credit. Bandura (2022) studies 23 Sub-Saharan African countries and reports that inflation conditions alter the finance-growth relationship, including an estimated 13% threshold when financial development is measured by private credit. Ibrahim et al. (2022) likewise examine whether inflation changes the growth contribution of financial development in Sub-Saharan Africa and recommend interpreting financial deepening in relation to inflation thresholds. Farahani et al. (2021), examining eight D-8 economies, also study inflation thresholds in the financial development growth link. Together, these studies indicate that inflation may condition the growth payoff from financial intermediation, though the threshold estimates are specific to each study's sample and model. Banking structure may further influence this mechanism. Ghossoub (2023) uses an endogenous-growth framework to show how competition and regulatory restrictions in banking affect the inflation-growth relationship. The model links higher inflation to declining financial depth above a range of 3%–6% under its specified conditions. This is a model-based result and should not be compared numerically with thresholds estimated from country panels as though they were equivalent. Its contribution is to show how financial structure can shape the theoretical pathway from inflation to growth. Third, monetary policy transmits inflation-control measures to output. Brandão-Marques et al. (2020) report that interest-rate increases reduce output growth and inflation in emerging and developing economies when exchange-rate behavior is explicitly accounted for. Monetary tightening can thus reduce price pressures while also slowing demand, investment, and output in the near term. The size and direction of exchange-rate effects may depend on trade exposure and currency mismatches. The IMF transmission analysis also notes that exchange-rate movements can affect balance sheets and credit conditions, so the same policy shock may have different real effects across financial systems. Exchange-rate volatility provides a related channel. Olamide et al. (2022), studying the Southern African Development Community, examine exchange-rate volatility, inflation, and economic growth jointly. Their study places the inflation-growth relationship in a regional setting where currency instability and domestic price changes interact. This supports treating imported inflation and exchange-rate movements as part of the transmission process, especially in economies reliant on imported production inputs.

Overall Interpretation and Implications

The broader literature remains divided on how inflation and growth should be related in developing economies. Nell (2023), reviewing the debate in the context of development economics, emphasizes that inflation's role must be interpreted alongside savings, investment, structural constraints, and open-economy conditions. Recent research on inflation and finance also suggests that financial depth alone may not guarantee stronger growth when inflation is high or the financial system is constrained (Bandura, 2022; Ibrahim et al., 2022; Ghossoub, 2023). Overall, the empirical evidence supports three linked conclusions. First, inflation's association with growth is generally nonlinear and sensitive to inflation regimes. Second, the estimated relationship depends on institutions, sectoral composition, and financial structure. Third, transmission occurs through investment and uncertainty, credit and financial depth, exchange rates, and monetary-policy responses. These conclusions follow from comparing

heterogeneous studies, not from a pooled statistical estimate. Since the review's verified eight-article corpus and completed selection log have not been supplied, this discussion should be treated as a literature-based synthesis consistent with the reported results—not as a new quantitative analysis or a definitive account of all studies that a completed systematic review might include.

CONCLUSION

This systematic literature review indicates that the relationship between inflation and economic growth in developing countries is conditional and generally nonlinear. Empirical studies report that inflation can be weakly associated with growth at lower or moderate levels but becomes detrimental after a country-specific threshold. For example, provincial evidence from Indonesia identifies an estimated threshold of 9.59%, while a 27-country study reports turning points of 12.23% and 5.36% across its two panels. These estimates are sensitive to sample composition and model specification and should not be treated as universal policy targets. The findings also show that inflation's effects vary across sectors. Evidence from 113 developing economies reports a negative effect on industrial growth, while the estimated effects for agriculture and services are not significant after sectoral inflation is considered. Conceptually, the reviewed literature links inflation to growth through investment uncertainty, financial depth and credit, exchange-rate movements, and monetary-policy responses. These channels interact with institutional quality and economic structure, helping explain why results differ across countries. Overall, sustainable growth requires credible inflation management that accounts for these structural differences and transmission mechanisms. Future systematic reviews should verify a complete search and screening process, analyze a clearly defined corpus, and compare results by country, sector, inflation regime, and research method before drawing broader conclusions.

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