ABSTRACT

This study analyzes the role and impact of shadow banking in the financial system, particularly how activities and leakages in shadow banking affect the money supply and inflation. Shadow banking is defined as financial institutions that are not regulated by traditional banking regulations but perform credit intermediation involving entities and activities outside the regular banking system. Using the generalized method of moments and observations from 22 countries, this study finds that the presence of shadow banking has a significant impact on the money supply and inflation. The analysis shows that an increase in shadow banking activities can lead to a significant increase in the money supply, but it also has the potential to increase systemic risk and inflation. On the other hand, the interaction between shadow banking and the money supply negatively affects the inflation rate. This study recommends the need for stricter and more effective regulation of shadow banking activities to maintain financial stability and control inflation.

Keywords: *shadow banking, money supply, inflation, financial system, credit*