FATAWA INFLATION AND INDEXATION 2007

Inflation Versus Interest

Subject: Inflation vs interest rate
From: Gillimer through Living Shari`ah – Islam on line
Sent: Wednesday, July 25, 2007 2:54 AM

Question
Asalamualykum Warhmatullahi Wabarakatu.
In a country where inflation is growing very fast compared to the economic growth rate of a nation (depressing the purchasing value of money from time to time), what would be a verdict on interest rate? No doubt, in a country where inflation is growing at an average of 15% the value of money is still depreciating if it is deposited in a bank at an annual interest rate of say 10%. Is it possible to speak of usury in such circumstances? How is the whole issue of interest rate seen in a country where there are no Islam banks? Will you please shed a light on these?

My Answer:
Bismillah al Rahman al Rahim
Alhamdu Lillahi Rab al Alamin, wa al Salatu wa al Salamu ala Sayyidina Muhammad, wa ala Aalihi wa Sahbihi Ajma'in
Dear Br. Nasser
Assalamu Alaykum wa Rahmatu Allahi wa Barakatuh

Interest is an increment in a loan or a debt and it is prohibited. therefore any increment that is in a loan contract is prohibited, whether the contract is providing a loan by a bank to a customer or depositing an amount by a customer for a contractual increment even if the inflation came at the end of they ear to be equal or more to the inflation rate.
Kindly notice that inflation is known only at the end of the period and when a contract is created only an expected rate of inflation may be included in the rate that is charged in the contract. 'Also notice that when there is a high unexpected inflation people tend to "escape" or run away from cash or cash commitments they do not deposit in banks and they do not give loans in cash unless they expect a return that exceeds the rate of inflation. Any contractual increment in a loan is Riba and it is prohibited.
On the other hand, once inflation rate becomes known (although it is very difficult to agree on what is the rate of inflation and there is not a single country in the world that has a 100% accurate calculation of inflation rate and also all countries with no exception announce always different rates of "estimated" inflation because to know it exactly you need info about every single good and service throughout all the period under study and the composition of the basket of purchases of every single household all this are impossible to obtain! therefore all figures are mere approximations), can already existing debts be adjusted accordingly, this is a matter that can be decided by a court and most likely, in many cases they can be adjusted for inflation from A Shari'ah point of view by

an experienced court. This adjustment is not considered interest as it falls under what is known in economics as indexation.
In other words, in your hypothetical question, any charge of an increment in a loan contract is interest even when there is expected inflation whereas an increment decided by a judge in dispute solving about the effect of inflation is not considered interest.
By the way, the Fatwa sessions are for actual cases that happens with a person not for hypothetical issues.

Wa Allahu A'alam
Wa Alhamdu Lillahi Rab al Alamin
Wassalam
Prof. Dr. Monzer Kahf